Effective Returns Management:
Enhancing Retailer – Supplier Relationships

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Abstract

Managing the return flow of product is increasingly recognized as a strategically important activity that is cross-functional within and across firms. We employ the theoretical grounding of a customer value and service-dominant logic perspective to examine such business relationship activity. In order to explore the phenomenon of returns management across a multi-disciplinary, managerial spectrum, a qualitative research methodology was chosen to generate depth of understanding given the current limited understanding of the research topic. Our results suggest that functional integration can lead to better corporate resource utilization as well as create higher levels of both firm and customer value. We also found the external business environment to be important in how a firm creates such value.

Keywords: returns management, value creation, service-dominant logic, functional integration.

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Introduction

Product returns are often considered a necessary cost-of-doing business (Blackburn, Guide Jr., Souza and van Wassenhove, 2004); firms often focus on minimizing the operational cost of returns, missing opportunities to recapture value for themselves and their customers. Firms also often miss the opportunity to manage customer relationships and build customer loyalty (Mollenkopf, Rabinovich, Laseter and Boyer, 2007). In the current economic climate, when resources are severely constrained, achieving those objectives by "doing more with less" becomes an even more monumental task than usual. Yet, effective returns management can increase supply chain efficiency and provide value to suppliers, and their customers.

In this paper, we highlight returns issues between a global appliance manufacturer (Action Appliance) and its retail customers. We make no distinction between consumer-originated returns (e.g., defective product and/or buyer's remorse) or store-originated returns (unsold product being returned from the retailer). Both types of returns move from the retailer to the appliance manufacturer. Managing costs *as well as* customer relationships highlights the strategic role that functional areas such as marketing and logistics/operations perform in returns management. Thus, we seek to understand how a manufacturer can manage returns so as to enhance value to the retail customer while also enhancing value to the firm. We also seek to understand the external factors that affect the business relationship within the context of returns management.

Our research contributes to the business-to-business literature in three respects: 1) we explore creation of customer value within the previously limited research context of returns management; 2) we provide insight into the impact of the external environment on a firm's ability to manage the returns process and create customer value; and 3) we explore such management across a comparative, three region global context.

Value Creation Through Returns Management

The importance of customer value has emerged in recent years (Flint, Woodruff and Gardial, 2002; Sawhney and Piper, 2002; Ulaga, 2003). In the shift to a customer value orientation, sellers have often employed a 'value-added' concept, which focuses on what the seller (producer) has contributed to a product offering, suggesting that sellers create value for customers. Such an approach underemphasizes the customer's world and the customer's role in creating value (Woodruff and Flint, 2006). The emerging concept of service-dominant logic (SDL) (Vargo and Lusch, 2004, 2008) provides a different approach to value, suggesting that firms focus on the exchange of operand and operant resources for value creation of both parties in the exchange. SDL argues that value is not embedded in the product; rather value is defined by and co-created with the customer (Vargo and Lusch, 2004). Thus, suppliers make value propositions, since value-in-use is essentially determined by the customer. SDL emphasis on co-creation of value also acknowledges that value can accrue to both the supplying firm and the customer.

Returns management is an important supply chain management process spanning functional and firm boundaries across the supply chain (Rogers, Lambert, Croxton and Garcia-Dastugue, 2002). Within an organization, return authorization, product recovery, reverse logistics, gatekeeping, avoidance, disposition and processing, and crediting activities are managed. While focused on reverse flows rather than forward flows, the returns management objective is to generate value for the firm and its customers. Customer value may be generated within a returns management context by linking marketing and logistics/operations functions to the customer through internal policies and practices, information sharing, and interaction. Six value-driver categories, and their value-creating activities, have been identified from the literature, as shown in Table 1 (Flint and Mentzer, 2000; Mollenkopf, Russo and Frankel, 2007; Rogers *et al.*, 2002; Ulaga, 2003).

Table 1: Returns Management Customer Value Drivers

1. Returns management policy in place
- Returns avoidance
- Gatekeeping
- Disposition
- Pull out-dated product from retail shelves
- Asset recovery

2. Returns processing
- **Accounts receivable**
  - Returns authorization
  - Reconciliation in accounts receivable
  - Problem solving
  - Timely crediting of customer
  - Systems integration (internal)
- **Operations**
  - Incoming order handling
  - Accurate receipt, inspection & put away
  - Transportation – delivery window and communication
  - Returns network design, routing, frequency

3. Product Quality
- Product performance, reliability, consistency
- Supplier certification
- Improve existing products
- Compliance

4. Service Support
- Information is shared
- Outsourced/3pl to improve efficiency, reduce cost
- Process clarity
- Problem solving

5. Personal interaction
- Communication
- Problem solving
- Mutual goals
- Attitude

6. Supplier know how
- Knowledge of supply market
- Knowledge of customer market, customer business, customer's customer
- Products, services, ideas
- Cost can also be non-monetary (not just price)
- Pricing program options
- What is the cost of a return?
- Performance measurement, reporting, application

Value drivers adapted from:
Flint and Mentzer (2000)
Rogers, Lambert, Croxton and Garcia-Dastugue (2002)
Ulaga (2003)
Mollenkopf, Russo and Frankel (2007)

Methodology and Company Overview

In order to explore the phenomenon of returns management from a managerial perspective, an in-depth case study approach of a single firm across three geographic locations was undertaken (Ellram, 1996; Yin, 2003) for theory building purposes (Flynn, Sakakibara, Schroeder, Bates and Flynn, 1990; March, Sproull and Tamuz, 1991). Consistent with approaches advocated by Eisenhardt (1991), our study of three subsidiaries of a single firm (Italian for Western Europe, American for the United States, and Australian for Australia and New Zealand) uses an embedded design (Dubois and Gadde, 2002; Yin, 2003).

We utilized multiple sources of evidence for evaluation, including in-depth interviews, site visits to each subsidiary, printed materials provided by the firm and obtained from secondary sources. Interviews lasting 60-180 minutes were held individually with each of fourteen participating managers. The in-depth interviews were open ended and discovery oriented, starting with a grand tour technique (McCracken, 1988). An interview guide that broadly identified topics of interest was used for follow-up discussion. All interviews were conducted in English, digitally recorded and transcribed verbatim. We employed two sets of trustworthiness criteria appropriate for qualitative methodology (available from the authors). Tests of construct validity, internal validity, external validity, and reliability were used to assess the quality of the research design (Flint *et al.*, 2002; Yin, 2003). From interpretive research we applied criteria related to credibility, transferability, dependability, confirmability and integrity (Hirschman, 1986).

Action Appliance manufactures and distributes commercial and consumer appliances across a wide spectrum of product categories: heating; air conditioning and air treatment; food preparation and cooking; and cleaning and ironing products. Because global competition is very intense, Action Appliance has traditionally adopted regionalized marketing strategies.

Results

Analysis of the data revealed three themes that reflect the challenges and opportunities of creating value through returns management processes. The *first theme* relates to the role of internal functional integration (between marketing and logistics/operations) within Action Appliance. In Europe, cross-functional integration is becoming an increasingly important aspect of how the company is managed. Common targets are being developed through better analysis of return codes, enabling the marketing/sales teams and the logistics/operations teams to jointly develop resolution or return avoidance solutions. In contrast, the Australian subsidiary has not yet begun to strategically develop cross-functional processes. It has implemented a process for physically handling return goods and issuing credits, but given its historical focus on market development, logistics and operations activities are secondary to the sales mission. One manager acknowledged that if they had a better understanding of the costs of returns, they might start thinking differently about how they manage their customer base and their returns management. The U.S. subsidiary, on the other hand, has a strong understanding of the cost of returns, and the benefits of returns avoidance and gatekeeping. Sales and returns decisions are based on net-margins because the sales team is much more knowledgeable regarding the cost implications of the terms negotiated with customers. Negotiation topics now include pricing and quantity terms, with delivery and replenishment options tailored to different price points; returns options are tailored into the terms of sale. Improved internal functional integration seems to focus primarily on enhancing value to the firm, but also seems to enable enhanced customer value creation, as evidenced in the next two themes.

The *second theme* relates to the role of value drivers (as depicted in Table 1) and cross-functional integration. In Europe, the management team recognizes that Action Appliance could better use its information of inventory positioning, sales trends, and returns policies to help retailers make better decisions about how much stock is needed, or where inventory can be repositioned within the retailer's own network. This "supplier know-how," when integrated with customers could reduce the volume of returns that Action Appliance would need to handle as well as help its customers achieve their own objectives more efficiently. To accomplish such service support co-creation of value, Action Appliance acknowledges that the operations/logistics group must improve its cost and inventory flow management and communication so customers will benefit more fully from its inherent knowledge.

In the U.S., the returns management policy in place has led the company to focus on returns avoidance, reducing costs for Action Appliance while benefitting the retailer. As one manager explained, “instead of giving them more, give them right…. For example, end-of-season returns can be eliminated when you ‘give them right’ and manage inventory together with the retailer.” The U.S. subsidiary also emphasizes gatekeeping because it provides a more complete cost picture for products that may enter the returns channel, enabling better allowance terms and return authorizations for consumer product returns to retailers. Thus, retailers can manage their margins and gain credit for products received from consumers, but Action Appliance avoids unnecessary transportation and returns processing cost.

Consistent with the marketing-driven nature of their organization, the Australian subsidiary focused on customer value through product design quality, product innovation and in-stock availability. Recognition of returns processing value-added has only recently arisen with regard to how the New Zealand market is supported with a call centre, which interfaces with customers. Among its tasks, the call centre issues return authorizations and also tracks the credit flow for customers. This approach allows sales people to focus on selling, while creating a more efficient logistics function that delivers a higher level of service to customers. This approach is currently being rolled out in Australia.

The third theme relates to the role of the external environment in creating value. Regulatory impact was evident in the European organization. Recently enacted EU directives create additional strategic and operational compliance costs for the firm. However, compliance can also be a driver for product quality, which translates into an advantage with respect to retailer loyalty, store shelf placement, and end consumer loyalty.

The nature of the market itself impacts the extent of cross-functional integration and related value co-creation. Retail power seems to be at the root of each subsidiary’s ability (or desire) to enhance customer value. European retailers, exercising their growing channel power, are using return privileges to enhance their competitiveness (i.e., attractiveness with consumers). Some of the stronger retailers have recognized the cost of handling returns, and now make an invoice deduction for every return they send back to Action Appliance. Action Appliance has been able to work with these retailers to determine appropriate terms and levels for return deductions, thus preserving some monetary value for the firm while ensuring value for the retailers. However, the European subsidiary’s response has been fairly reactionary. The Europeans are also struggling to cope with the recent growth of several cross-national retailers. When retailers operated within national boundaries there was little need for a corporate-wide return policy. The power shift occurring in the European market is awakening a need within Action Appliance to become more internally cross-functionally integrated and linked with its customers to manage in the rapidly, changing marketplace.

The Australian subsidiary is constrained by the geographic nature of the Australian continent, coupled with a very powerful retail base, which permits little leverage. A failed industry initiative several years ago convinced Australian managers that they cannot address returns issues on their own. Thus, they see very little reason to manage returns as an element of customer value.

The U.S. subsidiary also has a weak position relative to a powerful retail base; the propensity of consumers to return products creates an additional challenge. While the company recognizes it must comply with this high-return market’s cultural norms, strong retailer power is driving managers to approach their customers with a variety of value propositions regarding sales terms and returns options that will benefit both Action Appliance and its customers.

Implications, Limitations and Future Research

We see preliminary evidence suggesting that cross-functional integration can improve the returns process and ultimately help create value for customers and the supplying firms. This is particularly true when returns management policy is in place and related support processing exists. Moreover, recognition of contributions regarding product quality, information sharing and supplier know-how are valuable when costs are identified, communicated and shared across functional areas. The "sell right, not more" approach found in the U.S. subsidiary can serve as a guiding mantra for integrating multiple functional groups and providing value co-creation.

We also found evidence suggesting the importance of the external business environment, although it varies by location. The challenge for managers is to continually adapt to the changing business environment, in ways that value can be offered, evaluated and captured for both the firm and its customers. From a theoretical perspective, our research lends credence to a cross-functional conceptualization that drives value creation, extending it to include the returns management process. Returns are often thought of solely in operational cost terms, but rarely thought of as a means to enhance customer value and/or as a means to increase the supplying firm's competitiveness in its market environment. Additionally, our focus on value creation re-emphasizes the importance of logistics/operations *and* marketing playing a joint role in creating more satisfied customers over the long term (Flint and Mentzer, 2000; Flint et al., 2002).

From a managerial perspective, we offer several suggestions. First, managers are encouraged to develop a better understanding of the total costs of returns. Second, cross-functional teams should be developed to interact with customers. Third, the importance placed on product and service quality is not just about value for consumers, but should also be considered for managing relationships with intermediary customers such as retailers. Fourth, managers are encouraged to measure performance in a cross-functional manner and develop feedback mechanisms for improvement related to the value drivers within the firm. Lastly, while standardization of returns processes may indeed be impossible to achieve across multiple operating environments due to different market constraints, organizational infrastructures and legal frameworks, what can be standardized is the strategic cross-functional integration of activities that support customers with respect to returns management. In other words, the details of the process may be less important than the underlying philosophy of the process.

Several limitations to the research should be noted. By its nature, an in-depth case study cannot claim to be representative of a broader population. The relationship between cross-functional integration and customer value needs to be explored in more depth. Quantitative research methods which could better address the nature and strength of direct (and potentially mediating) effects would seem to be helpful now that this qualitative approach has provided preliminary evidence of such relationships.

The role of the external business environment is an important element in understanding how and why Action Appliance's three subsidiaries manage returns. Extending the scope and nature of the external business environment to capture additional permutations of how the local operating environment impacts managers' decisions and strategy development would be beneficial. Future research should consider more than one firm, as well as additional geographic locations to gain a broader understanding of returns management processes and how they are influenced by other external factors.

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