Secrets of Return Allowances

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Experts from Philips, Best Buy and Genco share insights on how to utilize Return Allowances to Reduce Reverse Logistics Cost.

Despite good intentions, return allowances, if not done correctly, may not be a good solution to reduce Reverse Logistics costs. Return Allowances started out as a quick and easy way for a manufacturer to give an allowance to the retailer to manage its returned items, thereby reducing the reverse logistics costs of processing, logistics and transportation for both parties. The intention of a Return Allowances was to provide a quick and easy way to negotiate a win for everyone.

However, if not thought through carefully, return allowances can have negative results for both the manufacturer and the retailer. “Very often they are not saving anyone money”, explained Tony Sciarrotta, Director of Returns Management at Philips. To help you better understand return allowances, Sciarrotta, John Slothower, Manager of Innovation and Services at Best Buy and Curtis Greve, President of Retail Services at Genco Supply Chain Solutions have shared some of their knowledge, insights and secrets to achieving better return allowances.

Return Allowance Secrets for Manufacturers

Often a manufacturer will negotiate a flat rate return allowance. This value is quick and easy to negotiate and enables a fixed and predictable amount. For example, every invoice has a flat rate deducted (e.g. 2%). In return, the manufacturer no longer has any obligation to transport, handle, receive or process any returned or damaged goods from the retailer.

However, “manufacturers often regret a return allowance because the costs do not really go away” explains Sciarrotta. From the manufacturer’s perspective, a return allowance can create a number of not so desirable results:

- Incorrect Rate Estimate – if the manufacturer estimates too high, significant margin may be lost to the retailer who may not have any incentive to share the savings. Similarly, if the estimate is too low the retailer will not want to incur the extra cost and may wish to re-negotiate to cover any shortage. While this rate may not fluctuate significantly for some goods, it can be an especially risky area for electronics manufacturers where return rates on higher value items can fluctuate significantly depending on the complexity of the item and the life cycle of the product.

- Loss of Control – the retailer now performs all the returns processing. The manufacturer may have little or no knowledge, visibility or control of the returned items. Are the goods disposed to the proper channels? Is proper environmental disposition taking place?

- Data Capture – the manufacturer may no longer have good data to analyze and improve returns, to understand No Trouble Found rates or to measure recovery rates on returned goods resale.

- No Offset of Recovery Value – the returned goods that remain at the retailer are often resold, sometimes for a significant value and essentially with a real cost of zero. However, the recapture funds from the asset recovery or liquidation may not be applied to reduce the return allowance or shared with the manufacturer.

- Double Warranty Costs – when negotiating an allowance, the manufacturer may often expect that there will be no further costs related to warranty or service on the returned items. In essence, the allowance can be viewed as the equivalent to a warranty cost. However, an end user may eventually purchase the returned goods directly from the retailer or indirectly from a channel the retailer uses to sell or liquidate its returned items.   When this occurs and the end user has a problem with the item, the “warranty costs you thought you had eliminated as a result of the allowance, re-appear from a secondary market seeking warranty service” says Sciarrotta. This, results in a double warranty cost for that item since the manufacturer “paid” the warranty cost once via the allowance and a second time through the warranty and support services.

Return allowances are not for everybody. Several manufacturers interviewed would rather have their returned items shipped back because there is significant recapture value available from the refurbished units. Additionally, they may want or need to have the items returned for hazardous material reasons, environmental reasons, to harvest replacement parts or to avoid channel conflicts.

Return Allowance Secrets for Retailers

The return allowance is meant to offset the costs of purchasing and handling items that get returned or damaged. As mentioned earlier in the article, the retailer may have an opportunity to profit by re-selling the “free” returned goods.   In some cases, the returned goods can be sold with only a few margin points deducted off retail for an open box unit in good condition. Manufacturers may want to include a recapture amount in the allowance negotiation, since recaptured value offsets the costs of purchasing and handling the returned items.

Additionally however, retail costs can increase as well as a result of return allowances:

- Returns Processing Department and Facility – the retailer now needs to expand the staff and facilities to accommodate and attempt to recover value from the returned goods.

- Profit Center conflict – the asset recovery groups sometimes become a profit center.   With a profit objective, the original intention of the returns group may be distorted since they now may seek to recapture returns handling costs and make a profit, rather than just recapture against the returns allowance.

- Expensive to collect data – if the retailer does indeed incur the cost to collect data on the returned goods, resources must be spent for staff, facilities and equipment to perform the processing.

How a Return Allowance Program Can Succeed

Many return allowance programs have now progressed far beyond the original simple flat rate system. A good return allowance program can be made successful by removing the secrets or bias and instead creating an opportunity for a win-win. “Return allowance programs are the wave of the future” explains Curtis Greve from Genco. “They need to be set up properly to satisfy the needs of both the manufacturer and the retailer by including good processes, data collection and visibility”.

“In many cases a combined returns team working together on a regularly adjusted returns allowance program can more effectively maximize profit for both the retailer and the manufacturer” explained John Slothower of Best Buy. In addition, Greve also recommends a regular study of return data provided by an unbiased third party to provide assurance of methods and results for both parties.

Return Allowance with a Profit Twist

John Slothower and his team at Best Buy have been busy creating an even more compelling solution for some of their manufacturers: a combined return processing and reselling service partnership.

The opportunity to reduce transportation, handling, touches and time increases the opportunity for success of any returns program. In addition, outlined Slothower, “Best Buy can offer a very attractive option to recapture high values for the resale of returned goods by utilizing our existing retail skills with ramped up secondary market capabilities”. With many manufactures now outsourcing manufacturing, logistics and support, the opportunity to combine the processing and recovery of returned items while further reducing costs and increase cost recovery on the resale of returned goods seems to be a very attractive value proposition.

Elements of a Successful Return Allowance Program

In summary, a successful return allowance program will include many of the following elements:

- A combined return team made up of people from both the manufacturer and the retailer
- Team includes returns people, service, merchandising, finance and operations to make intelligent decisions
- Agreed processing and data collection
- Visibility tools and shared access to data
- Frequent monitoring and review
- Ability to renegotiate3-4 times per year or when new products launched
- Unbiased study/audit of the data collected from the return goods
- Both teams need to work together to try to understand and reduce returns
- Closely analyze each product line regularly to understand:

- the current nature of the returns

- disposition alternatives make the most economic sense

- Continually seek better methods to:

- increase speed and automation;

- reduce handling, logistics and transportation costs;

- increase value recapture

- reduce environmental impact

Reverse Logistics industry leaders like Genco, Best Buy and Philips are looking closely at returns allowances and breaking new ground. It may be time to take a closer look at your return allowances and use some of the secrets of return allowances to increase your profits.