

# Forrester Consulting

MAKING LEADERS SUCCESSFUL EVERY DAY

April 2008

## **Crafting a Returns Policy that Creates a Competitive Advantage Online**

*A commissioned study conducted by Forrester Consulting on behalf of UPS*

FORRESTER®



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## Table Of Contents

Executive Summary .....	3
Study Background .....	4
Retailers Prefer to Avert Returns Altogether .....	5
Web Shoppers In Contrast Appreciate Generous Returns Policies .....	6
A Framework For An Online Returns Strategy .....	15
Conclusions/Recommendations .....	17
Appendix A: Supplemental Material.....	18
Methodology.....	18
Appendix B: Endnotes.....	19

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## Executive Summary

As the rate of growth in the business-to-consumer eCommerce industry slows, eCommerce managers look to innovative initiatives and marketing messages to drive sales and capture market share. While sales and specials targeted to first-time customers tend to be popular incentives offered by retailers, more eCommerce companies also look to mine their customer databases and segment their messaging to drive incremental volume from core customers. Relatively few retailers, however, take advantage of promotions that are associated with the reverse logistics/returns process, even though the inability to touch or feel items is a core factor that inhibits online sales.

### *The Retailer Perspective*

Few retailers are eager to engage in marketing tactics or programs that affect reverse logistics (e.g. the returns process). While a select few companies (e.g. Netflix, Zappos) have made offers such as free returns a core part of their marketing message, and position such offers as a strategic advantage, most other retailers view overly-generous and overt return policies as a scourge to be avoided at all costs. This is in spite of the fact that the online sales process has inherent limitations such as the inability of consumers to touch/feel products, and the fact that it is impossible to render a product, particularly aesthetic purchases such as apparel, with 100% accuracy via the Internet. In general, retailers view the returns process as a “margin-drain” and believe their efforts are best spent engaging in initiatives to help avert returns altogether. Furthermore, few web retailers believe that a liberal returns policy can drive incremental sales or loyalty in the long-term. On the contrary, a liberal returns policy would cause consumers to engage in the same behavior as always, just at a higher expense to web retailers. Even among those retailers that have employed more liberal returns policies, they often employ those initiatives reluctantly. Such companies often play in competitive landscapes where consumer expectations about returns are often set by a larger, liberal player looking to capture market share at the expense of margin/profitability.

### *The Consumer Perspective*

While core online shoppers do appreciate the convenience of the web, they also recognize that there are risks associated with purchasing products via the Internet. Products occasionally arrive damaged or are incongruous with the images depicted online. In such cases, the process of returning an item to a retailer tends to be viewed as a hassle and in many cases causes buyers to reduce their online spend levels altogether. An inflexible or stringent returns policy can therefore be an obstacle to growth, particularly as those consumers most likely to return items also tend to be the most active online buyers. Furthermore, those same consumers explicitly say that they are more likely to shop in the future with, and recommend, those retailers that have more flexible (e.g. free returns, no-questions-asked returns) returns policies than those that have inflexible returns policies (e.g. forced return authorizations, limitations on what can be returned and when). In fact, among consumers who have purchased items online within the last six months and either returned or intended to return some of those items, we found the following:

- 81% agreed with the statement “If an online retailer makes it easier for me to return a product, I am more likely to buy from that retailer.”
- 81% agreed with the statement “I am more loyal to retailers that have generous return policies (e.g. free return shipping, ability to return any time for any reason).”
- 73% agreed with the statement “I am less likely to buy in the future from an online retailer where the returns process is a hassle.”

This leads us to conclude that online retailers with generous returns policies have a competitive advantage over those retailers who install “gates” in their returns process. We believe these more generous policies, in the long term, have the ability to grow sales, generate loyalty, and drive incremental revenue for retailers with a web presence.

## Study Background

UPS commissioned Forrester Consulting to conduct primary market research by interviewing online retailers to examine the following:

- Current online retailer returns strategies and attitudes towards online returns;
- The business challenges and cost components associated with returns;
- The decision-making process for determining returns policies;
- The effect retailers perceive their returns strategies to have on their customers.

Additionally, Forrester Consulting conducted primary research via an online survey to evaluate the following elements of consumer behavior:

- The demographics of consumers that tend to return online purchases;
- The experiences these customers have with the online returns process;
- Customers’ attitudes toward retailers that offer flexible and inflexible returns policies.

For more information on the methodology for both the qualitative and quantitative primary research, please consult the Methodology section of this paper in Appendix A: Supplemental Material.

## Retailers Prefer to Avert Returns Altogether

Retailers in general fall in between two ends of a spectrum in their attitudes toward returns: At one extreme is the perspective that returns are evil and should be avoided at all costs because they simply drive down margins and are associated with unhappy customer interactions. On the other end of the spectrum is the acknowledgment that returns are a natural byproduct of the online sales process and, given that consumers cannot touch or feel items prior to purchase, that a generous returns policy can in fact be a source of competitive advantage. While a very small group of retailers have adopted the latter perspective, the vast majority lean toward the former point of view. In our interviews with retailers, we found the following:

***Retailers often play “follow the leader” in matters relating to reverse logistics.***

In general, retailers adopt returns policies that are typically similar to their competitive set. That is, if a company's direct competitors do not offer features such as free returns, neither do they. In contrast, if a retailer does play in a landscape where prepaid shipping labels are the norm, then they too will be forced to offer similar programs for customers.

*“There are a lot of catalog companies out there.....and none of them offer free returns, and for good reason—it’s too expensive!”*

*“Many of the shoe retailers [with free returns] are just copying one another to grab market share...but I suspect none of them is yet profitable.”*

***Retailers in lower-margin businesses are the most averse to any generous policies, in either outbound shipping programs or reverse logistics.***

Retailers do recognize that accepting a return for a lightweight, high-margin item that can be sent back to a manufacturer is not all that expensive, while accepting bulky items that are highly seasonal or cannot be offered for resale can often pose an onerous burden on a company's bottom line. Given this reality, those retailers that fear that returns can seriously erode their margins generally enact the greatest obstacles to returns.

*“We’re not a [high-end retailer]...we are about being operationally efficient and maintaining margins. That means having a team of people managing returns and pushing them back to manufacturers. Our returns process has gates like return authorizations—deliberate steps to limit the number of returns.”*

*“If you have higher margins, you can do so much more with your shipping; this applies to vertically integrated manufacturers in particular.”*

***Retailers would rather focus efforts on reducing returns altogether rather than employing more generous returns policies.***

Because retailers are unable to quantify the effect of a generous returns policy and believe it is a cost that is highly correlated to an unsatisfactory customer experience, they generally express an interest in trying to control those elements of the web shopping experience that they can affect: namely, the depiction of products online and the quality-assurance process around ensuring that products are picked, packed, and shipped on-time and accurately.

*“We’d rather open new stores for people to try on products than offer free return shipping.”*

*“We try to have multiple images per items to avoid returns...we go overboard on taking photos. That’s also a big reason we have customer reviews on our site.”*

*“Our business is about Six Sigma and ensuring that our operations are top-notch. That’s the best way for us to avoid returns.”*

***Even retailers that may unofficially employ generous returns policies believe the advantages do not necessarily lie in customer loyalty.***

While consumers say they value companies that enable hassle-free returns, retailers say they do not reap the rewards of such programs from consumers directly. In part, this is because few companies have engaged lifetime value analyses to assess the impact of more generous returns policies on overall sales. Rather, the impact of generous returns is more quantifiable in other areas such as call center contacts.

*“We incorporated [a vendor to manage returns] in order to reduce call center volume.”*

*“We’ve never formally assessed how much more revenue we could drive from free returns. It’s very difficult to do a lifetime value analysis because purchase cycles are so long for many of our products and you have to construct an A-B test. This often means waiting years for results, and with people changing jobs as often as they do, accurate data is just never collected.”*

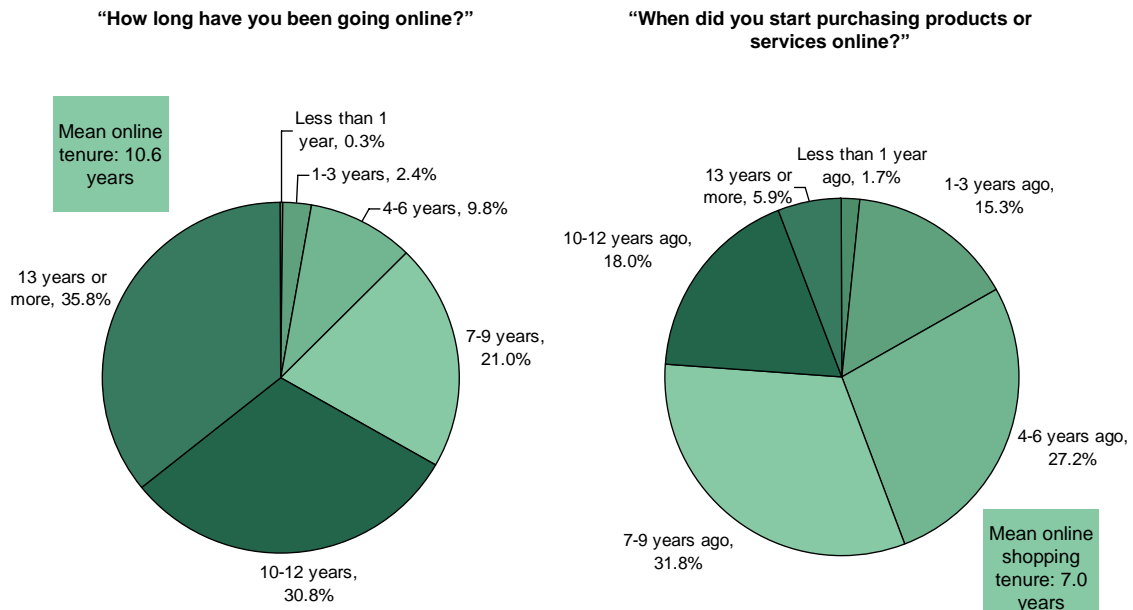
## Web Shoppers In Contrast Appreciate Generous Returns Policies

While web retailers in general do not see the long-term value of how a generous returns policy can affect their business, consumers are very clear about how generous returns policies affect their future web shopping expenditures. The findings from our consumer survey revealed that generous returns policies are most likely to positively affect a web retailers’ best customers and ultimately drive long-term sales and loyalty. Among the specific findings were the following:

***Customers who return items purchased online tend to be tenured, high-spending online shoppers.***

Return rates for the online retail industry converge at around 7%. Given that the vast majority of items purchased online do not end up as returns, and that few customers actively purchase products with the intent to return them, it is not surprising that when returns do happen, it is by frequent buyers who merely due to the volume of transactions they conduct, are statistically more likely to experience some disappointments with their orders. In general, online returners tend to be consumers who have shopped online for 7 years and on average spent over \$1,200 online in the last 6 months (see Figures 1 and 2). This makes them a demographic that retailers would be well-served to treat particularly well.

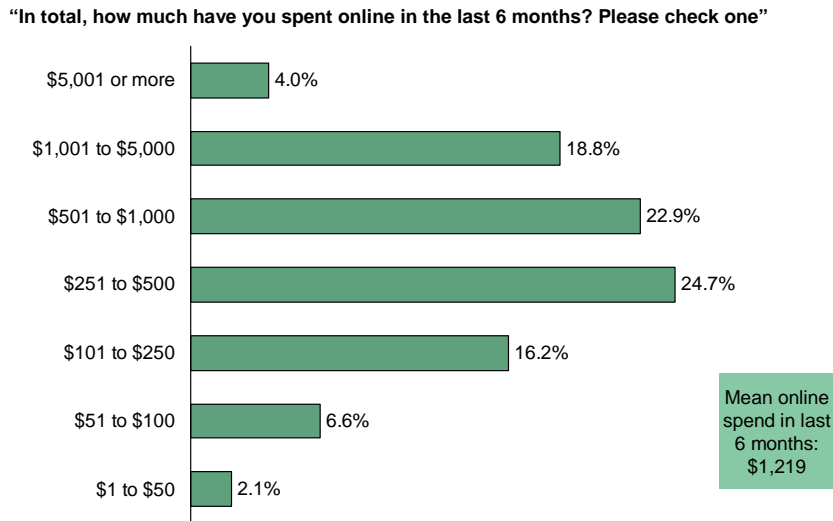
Figure 1: Online and Web Shopping Tenure



Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

Figure 2: Online Returners Spend Significant Sums Online



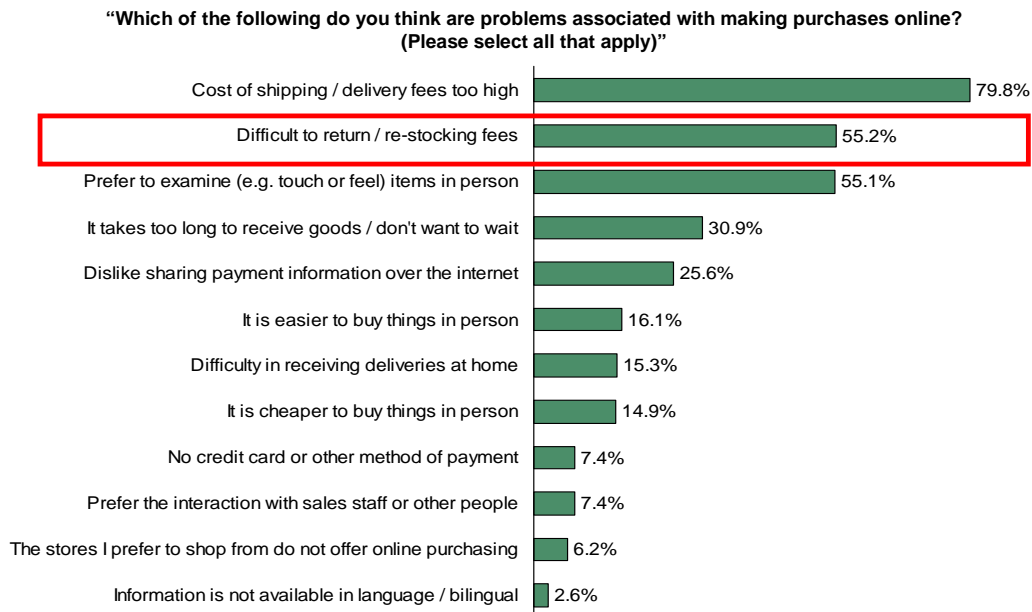
Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

**Returns in general are a hassle, and often due to factors beyond a customer’s control.**

Despite the best efforts of retailers to ensure that products are perfectly depicted or that the correct items have in fact been shipped, the reality is that a significant percent of returns are due to the fact that the wrong items were shipped or that items were not depicted accurately online (see Figures 3 and 4). This contrasts with the retailer perspective that many returns are simply due to a customer’s change of heart and therefore a cost that should be passed on to customers. Furthermore, customers report spending both money and time to deal with returns. When consumers pay for returns, the average cost is more than \$7 and any given return generally consumes approximately 30 minutes of a customer’s time (see Figures 5 and 6).

**Figure 3: Returns Are An Obstacle To Online Shopping In General**



Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

Figure 4: Key Reasons For Returns Are Outside Consumer Control

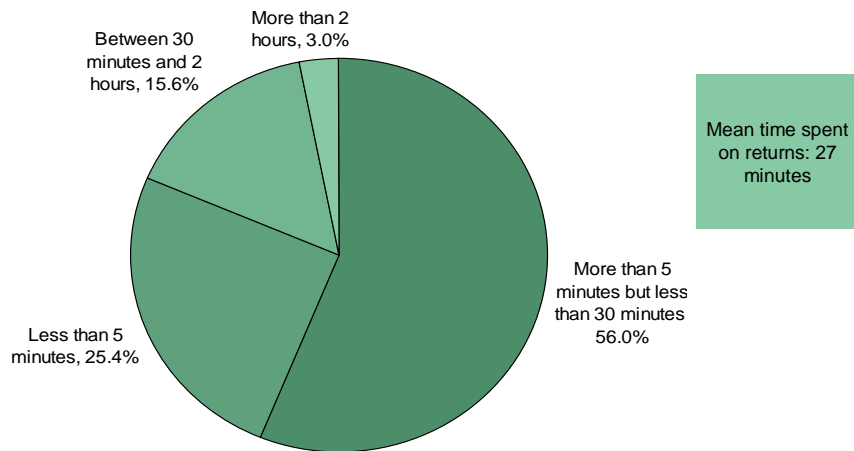


Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

Figure 5: Consumers Spend About A Half-Hour Per Online Return

“How much time did you spend dealing with the complete return process?”

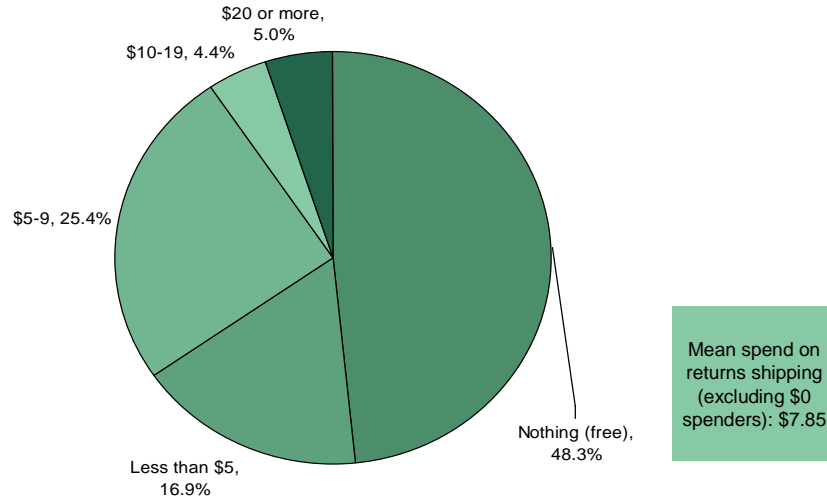


Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

Figure 6: Consumers Who Pay For Returns Spend More than \$7 Per Return

“Thinking of the last item you returned (shipped back) after making an online purchase, approximately how much money did that return cost you (i.e. shipping and packaging)?”



Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

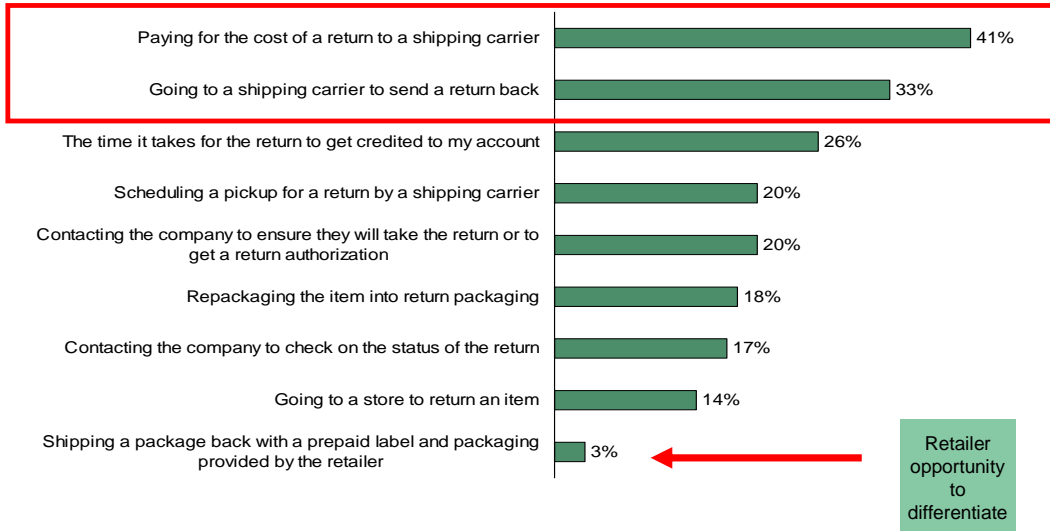
**Cost is the thorniest issue for customers in dealing with returns.**

When asked to rate the specific attributes of returns that were most frustrating to customers, the shipping costs associated with returns were the biggest gripe of customers (see Figure 7). A significant percent of customers were also frustrated by the process of having to go to a shipping carrier to send back their package. In contrast, consumers that returned items with companies that provided prepaid shipping labels and packaging found it a relatively hassle-free and easy experience.

Figure 7: Paying For Return Shipping Is The Top Frustration For Web Returners

“On a scale of 1-5, please rate the following actions often associated with returning items purchased online.”

1 = Extremely difficult/frustrating, 5 = Extremely easy, or N/A if Not applicable  
(Bottom 2 box)



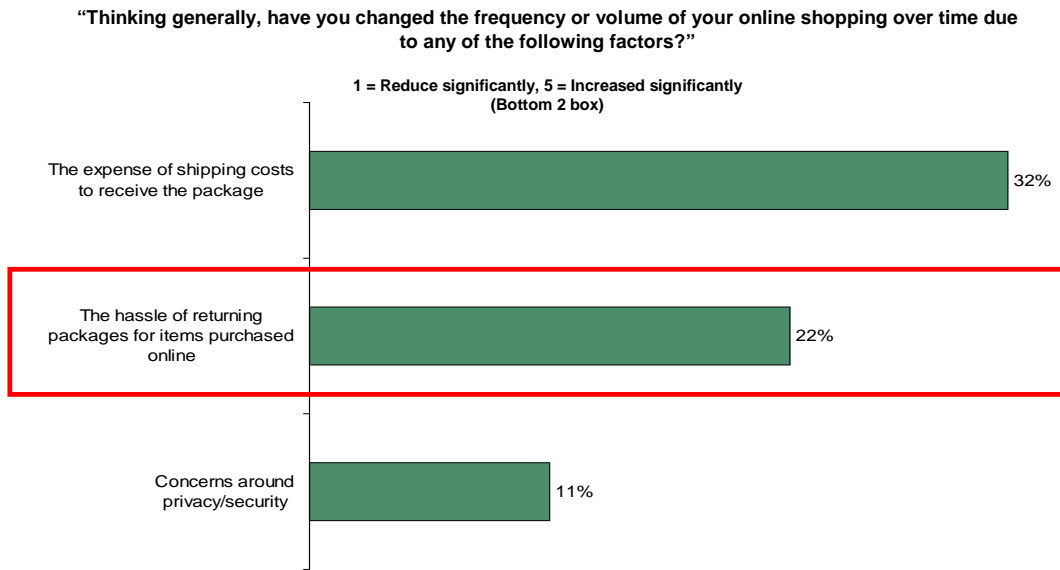
Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

**Poor return experiences can dissuade web shopping altogether.**

In general, the challenges associated with returns have led to decreased online shopping on the part of a significant group of core web shoppers (see Figure 8). Given that this segment is a high-spending group that values convenience, this lends further credence to the notion that retailers ignoring the value of hassle-free returns may be holding back their businesses altogether.

**Figure 8: Approximately One-Fifth Of Consumers Have Reduced Web Buying Because Of The Hassle of Returns**



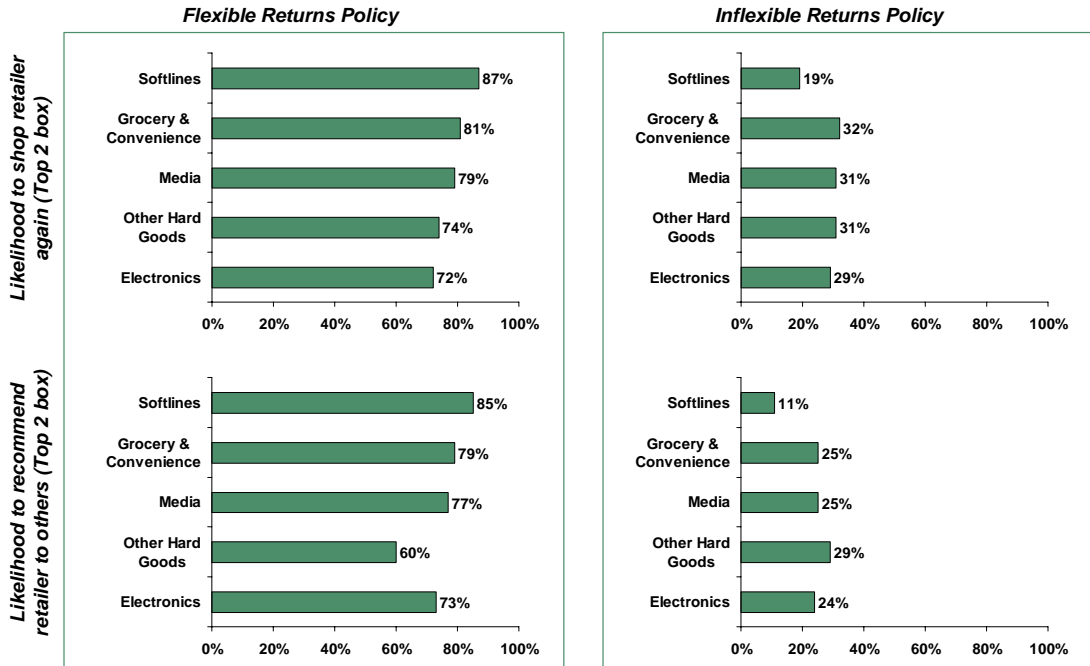
Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

***Consumers ultimately reward retailers with sales and loyalty.***

Across a variety of verticals, consumers say that they are far more likely to shop with and recommend web retailers that offer flexible returns policies rather than inflexible returns policies. While this fact holds true across hard goods, softlines (e.g. apparel), and even digital products, it is particularly notable in softlines (see Figure 9). It is also critical to note that compared to trusted marketing programs such as free shipping, factors such as free returns often play a very significant role for customers in their purchase process (see Figure 10).

Figure 9: Flexible Returns Policies Drive Sales And Loyalty Across The Board



Note: Softlines include apparel, accessories and footwear; Electronics include computers, cameras/camcorders, electronics and appliances; Media includes music, videos/DVDs, books and event tickets; Grocery & convenience include groceries, beauty and health products, housewares, home décor and flowers/cards/gifts; Other Hard Goods include video games, toys, sporting goods, office supplies, tools and garden supplies.

Base: 755 US Online Consumers who have made an online purchase in the past six months  
 Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

Figure 10: The Significance of Flexible Returns Compared To Free Shipping

“How important are each of the following retailer attributes when considering purchasing items on a retailer’s Web site.”

1 = Not very important, 10 = Very important  
(Top 2 box)

	Softlines	Electronics	Media	Grocery & Convenience	Other Hard Goods
Free shipping	78%	69%	79%	70%	76%
<b>Free returns*</b>	<b>77%</b>	<b>75%</b>	<b>71%</b>	<b>68%</b>	<b>74%</b>
<b>Subsidized returns*</b>	<b>72%</b>	<b>69%</b>	<b>66%</b>	<b>69%</b>	<b>66%</b>
<b>Availability of in-store returns*</b>	<b>51%</b>	<b>57%</b>	<b>41%</b>	<b>55%</b>	<b>57%</b>
Availability of in-store pickup	28%	46%	35%	42%	43%

\*Forrester Consulting’s emphasis

Note: Softlines include apparel, accessories and footwear; Electronics include computers, cameras/camcorders, electronics and appliances; Media includes music, videos/DVDs, books and event tickets; Grocery & convenience include groceries, beauty and health products, housewares, home décor and flowers/cards/gifts; Other Hard Goods include video games, toys, sporting goods, office supplies, tools and garden supplies.

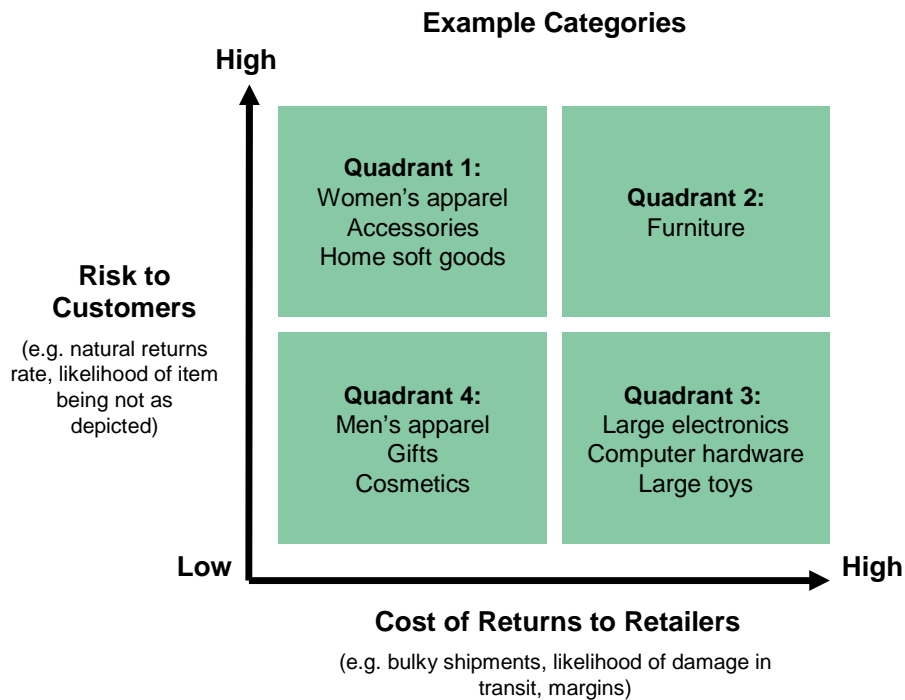
Base: 755 US Online Consumers who have made an online purchase in the past six months

Source: UPS Online Retail Return Study, Forrester Custom Research prepared for UPS, March 2008

## A Framework For An Online Returns Strategy

Given two contrasting challenges—the need to accommodate customers who seek a hassle-free experience when returning products, especially if the return was not their fault, and the need to accommodate retailer’s objectives to preserve margins where possible—we believe most businesses fall in one of four quadrants (see Figure 11).

Figure 11: Quadrants Retailers Should Consider



**Crafting a Returns Policy that Creates a Competitive Advantage Online**

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To elaborate, each quadrant has the following characteristics:

<b>Quadrant</b>	<b>Characteristics</b>	<b>Example Vertical(s)</b>
<b>1</b>	Low cost for retailers to accept returns, but high risk for customers in purchasing that product category	Women’s apparel, home soft goods (e.g. bedding, window treatments)
<b>2</b>	High cost for retailers to accept returns and a high risk for customers purchasing in	Furniture, home hard goods (e.g. flooring)
<b>3</b>	High cost for retailers to accept returns but low risk for customers in purchasing the item	Large electronics (e.g. TVs), computer hardware
<b>4</b>	Low cost for retailers to accept returns and low risk for customers in purchasing the item	Men’s apparel, cosmetics

***Implications***

Retailers should first determine in which quadrant their core products reside. The implications for how retailers should address returns for each of the quadrants varies based on the cost the retailers must incur and overall customer expectations.

Quadrant 1: Products in this quadrant tend to be lighter to ship; therefore, retailers can gain the greatest benefit when they offer consumers money-back guarantees which give consumers comfort with the online shopping process and reduce the risk that customers may receive an item they did not expect or anticipate.

Recommendations: Retailers offering such products will first want to ensure that products are being accurately depicted online, engaging features such as customer reviews, alternate views, detailed and accurate sizing information, and manufacturer specifications where possible. Additionally, such retailers would benefit from also mailing print renderings with alternative photography to customers and encouraging in-store visits (if possible) to both engage customers with a brand as well as to give customers greater perspective on what items actually look like. Prepaid labels or subsidized returns are recommended for retailers in this product segment.

Quadrant 2: Products in this quadrant are difficult online purchases that tend to be logistical challenges for retailers and high risks for customers.

Recommendations: Retailers offering products in these categories should drive in-store purchase/visits above all. For pure play companies, product configurators or extensive call center availability with knowledgeable representatives who can help to guide purchases are particularly critical. Sampling programs to provide color swatches can also help to address some of the risk in these categories. Prepaid labels or free/subsidized returns, due to the onerous cost, are not recommended for web sales in these categories unless items arrive damaged. Restocking fees in fact may be an economically feasible approach to ensure that consumers who purchase items in these categories carefully consider their decisions prior to buying.

Quadrant 3: While bulky purchases generally can pose risks for retailers, products in this quadrant tend to be commodities with which consumers are generally familiar and know what to expect. Issues surrounding returns are therefore less about a customer's change of heart and more about items which are damaged en route, misrepresented online with inadequate product details, or shipped outbound in error by the retailer.

Recommendations: Warranty programs at checkout may help to provide comfort to customers and hedge retailers against unforeseen problems. Additionally, retailers with multichannel presences may benefit from in-store pickup/delivery programs for these products, as well as drop-shipping by manufacturers (the latter enables retailers to simply be the order processor without having to bear any risks associated with fulfillment). Retailers with sophisticated customer databases are also in a position to provide more generous returns policies to the best customers, even though stricter returns policies may be communicated to customers at large.

Quadrant 4: This category of products comprises those that have naturally low return rates, often because they are replenishment purchases where consumers are familiar with brands and particular products. Because return rates are generally very low for these categories - and because there is loyalty and word of mouth leverage to gain - retailers would be best served to provide liberal policies to this segment.

Recommendations: Prepaid returns (i.e. free shipping) are likely to be easiest to manage in this quadrant while at the same time resonating with customers. Given that replenishment is often a driver of sales in this quadrant, retailers may also benefit from marketing product recycling programs as part of their reverse logistics effort while they are also promoting free returns.

## Conclusions/Recommendations

While retailers typically associate a flexible returns policy with "free" returns, it is critical to note that consumers generally associate flexible returns policies with "hassle-free" returns. As a result, retailers are actually empowered to engage in many more tactics other than simply prepaid returns labels which can both serve their margin objectives, as well as provide customers comfort and security during their online shopping experience. To this end, retailers should:

1. Evaluate where on the retailer returns spectrum their various products fall (see Figure 11);
2. Craft policies and programs that are appropriate for each product category and quadrant (e.g. prepaid return labels, warranties, subsidized returns, in-store pickup programs, restocking fees);
3. Message those programs appropriately to customers both in the "help" sections of Web sites and also on product detail pages -- particularly for high-ticket, difficult-to-ship items and "high-risk" purchases (e.g. aesthetic purchases where an item is unlikely to be perfectly rendered online).

## Appendix A: Supplemental Material

### Methodology

In March 2008, UPS commissioned Forrester Consulting to conduct phone-based qualitative interviews with five online retailers in the US from Internet Retailer's Top 500 Guide in the following categories; computer hardware and software reseller/distributor, bags (hand, luggage, etc.), men's/women's clothing and accessories, sporting goods, and shoes. Each retailer respondent was at the director or executive level, and was a key decision-maker for their firm's online returns strategy. Forrester designed the qualitative interview guide with input from UPS but the respondents were not aware of UPS' involvement.<sup>1</sup> UPS was not allowed to audit or participate in the interviews. Each interview was 30 to 45 minutes in duration. Interview participants were told they would receive this document as an incentive for their participation. Direct quotes in this document were taken verbatim and represent the opinions of each interviewee and not Forrester Consulting.

Forrester Consulting also fielded an online, panel-based quantitative survey (n=755) of US consumers who had ordered an item online in the past 6 months, and either returned an online purchase (either by mail or in stores) or intended to return an item. Each respondent was over 18 years of age and went online at least once per month. Respondents were provided points as a part of an incentive program administered by Forrester Consulting's external online survey panel provider. Forrester designed the quantitative online survey instrument with input from UPS but the respondents were not aware of UPS' involvement.<sup>2</sup>

## Appendix B: Endnotes

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<sup>1</sup> Although the interview guide was designed in collaboration with UPS, interview respondents were neither made aware that the interview was sponsored by UPS, nor were any questions asked about UPS or its products or services. In addition, no questions were asked about UPS' competitors nor were questions asked that positioned UPS against any of its competitors.

<sup>2</sup> Although the survey was designed in collaboration with UPS, survey respondents were neither made aware that the survey was sponsored by UPS, nor were any questions asked about UPS or its products or services. In addition, no questions were asked about UPS' competitors nor were questions asked that positioned UPS against any of its competitors.