

## U.S. Industrial and Logistics

# Swimming upstream: navigating the world of reverse logistics



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- According to the Council of Supply Chain Management Professionals, reverse logistics is the process of removing unsold or damaged goods from store shelves or receiving them from customers and subsequently disposing of or repairing and reselling them.
- In 2015, \$290 billion of sales were returned in the U.S. and Canada – 8% of total retail sales. E-commerce returns rates are much higher, however—up to 30% in some cases.
- Returns place enormous stress and additional costs on retail stores and distribution networks that are not optimized for the reverse flow of inventory. Returns that are subsequently sold at discount or disposed of are estimated to cost retailers 4.4% of their total revenue each year.
- The solution to the reverse logistics problem lies in improving and expanding supply chain networks—which represents tremendous opportunity for industrial real estate as users add warehouses and distribution centers to support the reverse flow of inventory.
- Owners and operators of Third Party Logistics (3PL) facilities are poised to benefit as retailers look to outsource their reverse logistics to cut costs maximize efficiency.

We've all been there: you place an order online and the product you receive looks nothing like the picture. Or a holiday gift from a relative comes in the wrong size. In both cases, the product in your hand is about to enter the complicated and expensive world of reverse logistics.

SUPPLY CHAIN LOGISTICS

Products almost always move through the supply chain in one direction—from the point of production to the final point of sale. A portion of purchases, however, is sent back upstream for one reason or another—into a supply chain network that, often times, is not designed to handle the reverse flow of goods. According to The Retail Equation, Inc., the return rate averages 8% of total sales in the U.S. and Canada. In 2015, that amounted to \$290 billion, 66% more than the 2010 total. E-commerce represents an increasingly large portion of retail sales experiences an even higher return rate, ranging from 15%<sup>1</sup> to as much as 30%<sup>2</sup> during the busy holiday season. The culture surrounding e-commerce places additional scrutiny and pressure on companies’ strategies for handling returns. Lacking the opportunity to see, touch, or try on an item, e-commerce shoppers have become accustomed to buying multiple items at once, with the intention of returning some of them. The 2015 holiday shopping season was e-commerce retailers’ best season ever, with approximately \$70 billion in sales. An estimated \$20 billion of those sales were returned, however.

Figure 1: 2015 U.S. Holiday E-commerce Sales and Return



Source: eSource, Schorr, January 2016.

Consumers expect a seamless and inexpensive (and free, if possible) return experience. A perceived difficulty with the return process is the number one reason that exclusively in-store shoppers give for their reluctance to buy online.<sup>3</sup> Meanwhile, for e-commerce shoppers, a favorable return policy is crucial—81% of shoppers are less likely to make additional purchases on websites that charge for returns, and customers that paid for a return decreased their purchases from that retailer by 75%-100% within a two year period.<sup>4</sup> It’s clear that a competitive return policy is a business imperative for any retailer competing in the e-commerce sphere. This service comes at a significant cost, however.

<sup>1</sup> New York Times, “In a Season of Returning, a Start-up Tries to Find a Home for the Rejects,” December 28, 2015.

<sup>2</sup> E-commerce Returns Best Practices, Shorr Packaging, October 2015.

<sup>3</sup> Endicia Consumer Survey, June 2014.

<sup>4</sup> ShopRunner/Harris Interactive, April 2013.

THE COSTS OF REVERSE LOGISTICS

Although online retailers are coming to terms with the high volume of returns that come from online shoppers, reducing the cost associated with those returns remains a top priority. Return items that can't be resold or must be discounted cost the average retailer 4.4% in lost revenue, according to research firm IHL Group. Returns are costly in two ways. First are the shipping and handling costs. The process of reversing an online order has many steps and includes the cost of the delivery as well as the many touches (each with a labor cost) that move of the item back into inventory. While these costs can vary widely based on a number of factors—the size of the retailer, the size of the item, the shipping origin and destination, etc.—there is no doubt that the expense will eat into profit margins. The second type of cost is more difficult to quantify but is every bit as meaningful—the erosion of the item's value over the time required to return it. The longer an item stays out of circulation and is unable to be sold, the less value it has. The real key to an effective reverse logistics process that recaptures the most value is the ability to quickly evaluate items and move them to the best location for their resale. In this, time is of the essence.

The options for such excess inventory range from restocking and reselling, which can recapture the most value, to destroying the items and taking a complete loss. (An estimated 2 million tons of unwanted and often undamaged goods—enough to fill 200,000 garbage trucks—is thrown away each year.)<sup>5</sup> In the middle sits a variety of options that range from selling from the discount rack to selling in bulk to liquidation services. The goal is to resell items for their full value, but this can be extremely difficult. An efficient and nimble inventory and supply chain system is the key to positioning inventory in the spot and time where and when it can be most valuable. In offering in-store returns, a brick-and-mortar retailer has a decided advantage over pure e-commerce retailers; they are able to handle the return at a lower cost (no shipping charge to absorb or pass to the customer) and to quickly restock an item in a spot that is visible to customer traffic. This advantage is limited, though, to inventory with a longer shelf life. Sports jerseys, for example, do not change often and enjoy consistent demand, while “fast fashion” retailers are under pressure to turn their constantly updated inventory quickly. For the latter, an e-commerce retailer has the advantage of offering an item for sale to a much wider audience (the entire internet vs. the traffic to one store), which increases the chance that the product will be resold quickly and in season.

Figure 2: The Reverse Logistics Process



Source: CBRE Research, February 2016.

<sup>5</sup> New York Times, “In a Season of Giving, a Start Up Tries to Find a Home for the Rejects,” December 28, 2015.

**REAL ESTATE OPPORTUNITIES**

With e-commerce sales and returns on the rise (growing at 15% annually), and many of the current distribution systems not optimized for reverse flow, the need to develop a solid reverse logistics strategy is paramount. For the industrial real estate market in the U.S., this is a growth opportunity. Both of the most likely solutions for a reverse logistics problem involve warehouse and distribution centers, which will ultimately drive user demand. The first—where a company decides to handle returns itself—will require the company to expand its logistics footprint. Whether through the expansion of current space or by adding space in a parallel reverse supply chain network, a completely self-managed reverse process will require additional real estate.

The second option available to companies—and one that is becoming increasingly common—is outsourcing some or all of the process to a third party logistics (3PL) firm. In these cases, the 3PL handles the collection, handling, and distribution of the goods, while inventory management decisions are left to the company. This has become a preferred choice for many retailers with less robust supply chain networks; it allows them to benefit from best-in-class logistics systems and locations that most 3PL firms employ. Ultimately, the efficiency gained by outsourcing lowers costs and unlocks excess inventory value. 3PLs have become a major driver of industrial real estate demand. For example, in Chicago, the largest industrial market in the country, 3PL users accounted for approximately 20 million sq. ft. of leasing activity in 2014 and 2015—26% of the total leasing demand. Nationwide, it's estimated that 3PLs occupy approximately 700 million sq. ft. and have been growing at 3%-5% annually.<sup>6</sup>

Consumers' growing product return habits pose a serious business challenge to retailers of all types. Likewise, the desire to make the returns experience seamless for the consumer has created immense complexity on the backend. Solutions vary according to a company's service promise, margin leverage and existing infrastructure, but supply chain and industrial real estate are a part of all of them.

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<sup>6</sup> CBRE Global Supply Chain Services, 2015.

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