Spinnaker Point of View: Developing a Returns Management Financial Strategy

To develop a robust Returns Management Financial strategy it is imperative to understand your desired financial outcomes.

What are the financial objectives for your returned product?

Financial objectives are always top of mind for company executives. Who can blame them? After all, financial gain and loss drive intercompany behavior. When it comes to returns, there is often an overlooked value and opportunity to fiscally managing returns. A challenge in just about every organization is determining: do you want to maximize margin or revenue? The decision to maximize margin can lead to increased inventories while you work to sell product for maximum recovery value. When the inventory grows, focus shifts to the assets in inventory, and one must strategically reduce pricing to relieve inventories. Managing inventory is both art and science. Spinnaker recommends a balanced approach between margin recovery and revenue. The caveat is there are times when there may be a short term need for revenue. It comes down to the needs of the business and company direction.

Answer these to determine your financial strategy:

- Is Returns Management supported with funding and resources?
- Is the company driving revenue or margin?
- What is the value of the unit being returned?
- Financially speaking, who will own the asset of the returned unit?
- Who will pay freight for the return?
- Which department will absorb the margin loss on the original sale?
- What is the market sales price before rework begins?
- Are there controls in place to ensure more rework components are not installed than the expected recovery value (revenue/margin)?
- Do you have a hierarchy of expected disposition values?
- Who gets the revenue from the refurbished unit sales?
- How is inventory valued?

**How do you value your returned product?**

Some companies use the standard cost of the unit as the value of the return. Others assign arbitrary dollar values across all returns.

There is not one right answer; how you value returned product depends on the company’s financial and marketing strategies.

**Major cost to be considered:**

- Freight
- Retail Handling Fee
- Warehouse Handling Fee
- Diagnostic Testing
- Refurbishment/Repair Labor & Components
- Packaging
- Accessories
- Shipping

As an illustrative example, the disposition chart shows how your disposition strategy determines your revenue, cost, and margin recovery for a consumer electronic company. Spinnaker recommends that companies make their disposition decision at the earliest possible time. The closer the disposition is to the customer returning the product, the better. In this way you will minimize your investment into the returned product.
For companies who manage core returns, there is not an industry standardization to value the core returns, usually an internal financial formula is used. Some companies conduct a secondary market analysis to determine core value. Others may use scrap value (until value add remanufacturing). Telecom and heavy duty industrial are high on the list for core returns.

Cost considerations for Heavy Industrial markets:

The Devil is in the Details: Product Type Matters

Often times Heavy Industrial remanufactured products are resold to the dealers who originally purchased the product new. The long lifecycle of Heavy Industrial product, supported by remanufacturing, allows dealers to offset cost and provide customers with a quality product made to new build specifications.

There are different strategies in managing inventories across industries. For example, consumer electronics and telecom have a relatively short lifecycle of 12-18 months versus Heavy Industrial core, which has a lifecycle of 20-30 years. In core management, you may be incentivized to keep some core for decades whereas with consumer electronics and telecom, there is a weekly depreciation in value of refurbished product. Another variable to consider is how you calculate inventory value and inventory turns. This calculation can vary by inventory mix and applied values.

In the previous few sections we have been discussing the actual product. There is, however, another aspect to inventories and this has to do with your reverse supply chain. Product needed for remanufacturing must be managed with the same rigor as your new product inventory. As mentioned earlier, the challenge of industries with shorter life cycles is that companies can blow through their refurbishment supply resulting in several inventory turns per year as opposed to a core inventory that may have less than 10 inventory turns per year. Companies must decide where to limit their lifecycle to maximize repair component inventory. In all industries, the goal is to consume the maximum number of refurbished and tested components and minimize new part usage.

If you are managing core inventory it is interesting how things change. When you start getting refurbished sales orders, you will want to use as much core material as possible and minimize
new part usage. While you always want to maximize core usage, when a new product is launched, there is always a lag period before it’s possible to build the core bank. In the meantime, the teams have to use a disproportional mix of new components until that new/core balance is hit. Eventually the core takes over as the primary refurbishment component - this takes between 15 and 24 months. Once the equilibrium swings in favor of core product, this significantly reduces the overall refurbishment cost and begins to maximize recoveries.

**Conclusion**

A sound financial strategy must address the holistic value of the return and include all facets, including: value of returned product, transportation, refurbishment cost, labor, margin loss, holding cost, inventory management, resell margin or revenue, and shipping. You must provide the tools to accurately determine the net recovery of your remanufactured product. Remember that product lifecycle’s matter – a sound strategy for one product category does not necessarily translate to another product category. How you manage your returns management financial strategy is key to your overall success.

*If you have questions about establishing a financial strategy, Spinnaker can help. Please contact us and set up a returns management assessment.*

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**About the Author**

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**About Spinnaker:**

Spinnaker is a supply chain services company that helps clients grow, manage risk, reduce costs, and improve customer service by developing world-class supply chain capabilities. Our services help clients develop the right supply chain strategy for their business challenges and implement the process and technology solutions to improve Demand/Supply Planning, Procurement and Sourcing, Logistics and Warehousing, and Reverse Logistics business performance. Spinnaker offers a unique service delivery model that combines the strength of deeply experienced management and technology consultants with a seasoned team of business process outsourcing (BPO) and 3rd-party logistics (3PL) professionals. Founded in 2002, Spinnaker has offices in Boston, Columbus, Denver, Houston, Memphis, Pittsburgh, London, and Singapore.

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