

# Reducing Returns Fraud While Delivering A Superior Shopping Experience

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# Reducing Returns Fraud While Delivering A Superior Shopping Experience

**Reducing returns, especially fraudulent returns, is one of the few operational areas where improvements impact the top and bottom lines simultaneously. Reduced return fraud improves net sales, gross margins, and cash flow, and results in more accurate inventory and commission payments.**

## EXECUTIVE OVERVIEW

Returns cost retailers billions of dollars. According to a survey by the National Retail Federation, retailers will lose \$9.6 billion from returns fraud in 2006, a third of which would be lost in the holiday season alone. By combining the average rate for fraudulent returns of 9 percent with the return rate by merchandise mix, a US\$1billion apparel specialty retailer could be losing more than US\$17.5 million every year as a direct result of fraudulent returns. Expenses related to legitimate returns such as product repackaging, markdowns, and item disposition cost retailers even more.

Returns can also cost retailers their customers. A July 2006 Harris poll sponsored by Newgistics found that only 13% of shoppers would visit the same online retailer if they needed to go to a mail center to return merchandise. The survey also indicated that 55% of shoppers found inconvenient returns a drawback for shopping from home. Many retailers are unable to meet the expectation of cross-channel returns, especially when the merchandise being returned is not carried by the store. Cross-channel customers are more profitable than single-channel customers, so retailers need to provide a seamless brand experience.

Better management of returns can improve net sales, gross margin, cash flow, inventory, and commission payment accuracy, as well as customer service. With pressure from Wal-Mart to cut prices in order to retain customers, and pressure from Wall Street to grow comparable store sales and profitability, returns management is worth addressing because any improvement positively impacts both the top and bottom lines.

There are many sources and types of fraudulent returns—for example, shoplifters who use fake receipts to steal items to return for cash, and “renters” who return expensive merchandise purchased just for a weekend event. But until recently there have not been many effective ways to reduce fraudulent returns. Relying on after-the-fact point-of-sale exception reporting, manual records, or refund tender ceilings have only made a dent in the problem. More customers shopping multiple stores and multiple channels has exacerbated the problem, making it more difficult to accurately refund a legitimate cross-channel

Estimated loss to a \$1 Billion retailer	
Annual revenue of apparel specialty retailer	\$ 1 B
Average returns rate for apparel specialty retailers	19.4%
Annual average value of returns	\$ 194 M
% fraudulent returns	9%
<b>Annual loss to retailer due to fraudulent returns</b>	<b>\$17.5 M</b>

purchase, and making it easier for thieves who steal merchandise in one store to return it the same day in another.

An effective returns management application should support your overall returns management strategy, without losing customers. An effective strategy should

- Improve customer service by making returning quicker and easier for every customer, including cross-channel shoppers
- Reduce unconscious return abuse through increased return policy and compliance communication
- Decrease abuse by controlling the very worst offenders through manager overrides, denials, or tender restrictions
- Refuse returns to thieves, sending those “customers” to your competition
- Reduce fraud by equipping store and loss prevention personnel with real-time customer, cashier, and store return metrics

## INTRODUCTION

**A real-time, cross-channel solution that addresses both the issues and opportunities at the point-of-return, in addition to including effective tracking and monitoring capabilities, can deliver substantial return on investment.**

Your returns management strategy should be flexible enough to treat each type of customer differently. A real-time, cross-channel solution that addresses the issues and opportunities at the point-of-return through an adaptable decision engine that automates complex policy enforcement to provide a consistent, predictable customer experience can deliver substantial return on investment. In fact, AMR Research analysts Janet Suleski and Scott Langdoc stated in their March 2004 report *POS Software in Specialty and GMA Retail: Extending Beyond the Box*, “Our research reveals that centralized refund management alone provides the hard ROI needed to justify a full point-of-sale software replacement.”

Oracle Retail has worked with several large retailers to design and develop an effective solution that includes functionality to address each of the specified strategies. The balance of this paper outlines in more detail the elements of an effective returns management solution that will enable you to improve customer service while reducing return fraud costs.

Retail is more competitive than ever before. In the past decade, retailers have seen their gross margins consistently decline. A recent report from consulting firm Bain & Company states “Competing with Wal-Mart, the world’s largest retailer, on price alone is futile.” The report’s authors recommend retailers differentiate by becoming the best in their market in terms of quality, product selection, in-store service, and convenient locations. All these strategies can help improve revenue, but increasing comparable store sales isn’t enough. There is also intense pressure to improve profitability. Retailers need to balance the often-conflicting goals of increasing revenue and decreasing costs. Retail return fraud is expected to reach \$9.6 billion for 2006 according to the National Retail Federation’s inaugural Return Fraud Survey.

Even legitimate returns reduce margin. For example, if an outfit comes back after others like it have been marked down, you've lost another 20 to 50 percent of the sale. If the item is not carried by the store, it must be returned to the Web-fulfillment center, incurring more costs.

Reducing returns, especially fraudulent returns, is one of the few operational areas where improvements impact the top and bottom lines simultaneously. Reducing return fraud improves net sales, gross margins, and cash flow, and results in more accurate inventory and commission payments.

## **DEFINING THE PROBLEM**

Reducing fraudulent returns may sound like a silver bullet, but achieving the desired result requires another balancing act. How do you reduce the many types of return fraud without losing customers? If their return is denied, customers may not come back. There is also a ripple effect. A 2004 NRF Foundation study found that store shoppers tell 2.4 people about a bad experience. How do you reduce return fraud without declining customers who have high-dollar returns because they have even higher dollar net purchases? And how do you improve service for your most profitable customers, cross-channel shoppers, to improve the top line?

There are many types and sources of fraudulent returns:

- No-receipt returns of merchandise bought on sale with the expectation of a regular price refund
- Shoplifters who use fake receipts, or employees who steal items to return merchandise for cash
- “Renters” or “wardrobers” who return expensive merchandise purchased just for a weekend event
- Customer tender fraud, associate tender fraud, or associate errors in refunding during the returns process
- Cross-channel returns from organized criminals who commit same-day returns with merchandise stolen from one store or channel and returned to another

Until recently, there have not been many effective ways to reduce fraudulent returns. To date, retailers have only been able to rely on

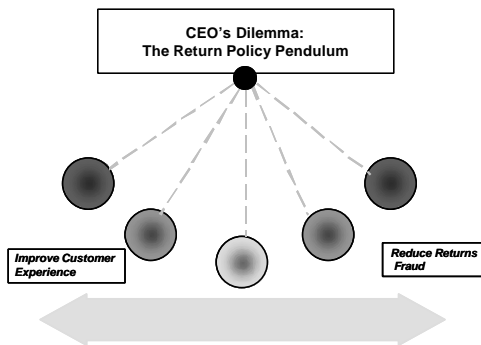
- Day-late corporate analysis of fraudulent returns, from point-of-sale exception reporting
- Manual, in-store transaction records
- Refund ceilings, by original tender and refund tender
- The store manager's alertness

The Center for Retailing Studies estimated returns cost retailers an additional 2 percent of sales for expenses related to returns, such as sales staff time, markdowns, and damaged goods.

That's not a lot of help for what can be a big drain on profits. The KingRogers International study, *Customer Returns in the Retail Industry 2004*, reported that retailers had an average merchandise return rate of 8.5 percent. Specialty and department store formats had the highest rates at 11.6 percent and 12.8 percent, respectively. The same study estimated that 9 percent of all returns are fraudulent. According to a Georgia Tech investigation by merchandise category, apparel had the highest rates at 19.4 percent for merchandise purchased in the store and 35 to 40 percent for merchandise purchased online. Therefore, an apparel specialty retailer with US\$1 billion in annual sales could be losing as much as US\$17.5 million as a direct result of fraudulent returns. The Center for Retailing Studies estimated returns cost retailers an additional 2 percent of sales for expenses related to returns, such as sales staff time, markdowns, and damaged goods. Small improvements can add up. By reducing fraudulent returns and the associated expenses by even 10 percent, an apparel specialty retailer could see US\$1.8 million drop annually, straight to the bottom line.

### Back to the Balancing Act

A Harris Poll sponsored by Newgistics found that 91 percent of consumers interviewed considered return policies and processes important to their decision about where to make a purchase. If the returns process is convenient, 92 percent are very likely or somewhat likely to shop with a retailer again. Backing this up, some retailers got a lot of negative press during the 2004 holiday shopping season when they tried to clamp down on returns. Some customers who got a slip of paper that said "Return Declined" vowed never to shop the store again. Adding to the returns-management challenge, more customers than ever before are shopping multiple stores and channels, and they demand a seamless brand experience. But how do you provide the ease and convenience of a store return for a Web purchase, at the right price, and in the right tender, when the customer lost the receipt and the store doesn't even carry that item?



"...due to an increase in return fraud, retailers are being forced to strike a delicate balance between servicing loyal shoppers and discouraging opportunistic criminals" – Joseph LaRocca, NRF Vice President of Loss Prevention

### DESIGNING THE SOLUTION

Combining a proactive customer communication and service approach with an effective returns management application can help you achieve the goal of reducing return fraud without losing customers, and in fact can help you improve customer service overall. An effective returns management application should support your returns management strategy in the following ways:

- Improve customer service by making returning quicker and easier, reducing check-out time for every customer, including cross-channel shoppers
- Reduce unconscious return abuse by more effectively communicating policy and compliance to your customers
- Reduce abuse by controlling the very worst offenders through manager overrides, denials, or tender restrictions

- Reduce fraud on a larger scale by providing real-time alerts to store and loss-prevention personnel regarding customer, cashier, and return metrics

### **All Customers Are Not Created Equal**

Today's customers have three things in common: they have more information, less time, and less loyalty. These characteristics can make them more demanding. They have better access to information, and are better prepared when they make a purchase. Constantly strapped for time, customers expect a sales associate to be available to quickly and accurately answer detailed how-to and comparison questions. Once they make a purchase decision, they expect checkout to be fast. Because today's product assortments are more homogeneous, and the merchandise they want is always on sale somewhere in their city, customers are more prone to switch to a competitor if they don't receive the level of service they expect.

Customers returning merchandise typically fall into one of six categories. To be effective, a returns management solution needs to address each type of customer:

- Cross-channel returners
- Reluctant returners
- Unaware returners
- High-purchase returners
- Abusive returners
- Outright thieves

#### **Cross-Channel Returners**

Cross-channel customers compare prices, research items, reach a buying decision, and then either buy online or reserve online before going to the store. According to Forrester Research, of cross-channel shoppers who research online and buy offline, 47 percent end up spending more for additional products. A return can be turned into an exchange or upsell. Online sales are rising, and projected to exceed \$200 billion in 2006, up from \$150 billion in 2004, according to a December 2005 Forrester Research study. An August 2004 study by KPMG stated that 82 percent of consumers are now multichannel shoppers. Retail respondents to the Aberdeen Group survey indicated that multichannel customers are more profitable than single-channel customers—60 percent of retailers said they are more profitable, and 40 percent said they are significantly more profitable. Every retailer wants more of these customers. Every cross-channel customer wants a seamless experience across channels.

To better serve and retain these very desirable customers, real-time access to centralized cross-store and cross-channel transactions is needed, including

**Full integration with Point-of-Sale enables the retrieval of the original transaction details, regardless of where the merchandise was purchased, along with customer identification information, resulting in a seamless return process.**

details such as location, item, quantity, price, tender, and customer refund history. This ensures that all your customers get an accurate refund, in like tender, at the original purchase price (if that is your policy), even without a receipt, and even if the store doesn't carry the same merchandise. Full integration with point-of-sale enables the retrieval of customer identification information and the original transaction details, regardless of where the merchandise was purchased, resulting in a seamless return process. Contrast this with having the cashier and customer rewrite or reenter the data, sometimes into a different device. One process means less data entry, and fewer data entry errors. A returns management system that meets these requirements will improve the in-store experience and accelerate checkout for the person returning items, and for all your customers in line behind them. After all, the desire to save time or avoid store crowds is why many of these customers shopped on the Web in the first place.

#### **Reluctant Returners**

Reluctant returners detest the whole return process. There are many reasons for their reluctance. If they have not shopped your store often, or have not returned anything to your store before, they may be afraid they will be turned down or embarrassed in front of others waiting in line. They may expect to be frustrated by the amount of time they will have to spend waiting in line. They may be very privacy-conscious and are anticipating a request for too much personal information in order to get their refund. Or they may have lost their receipt, which could lead to more expectations of problems. Consequently they often put off making the return, or ask a friend or relative to do it for them, further complicating the return process.

For these customers, the key is to make the return process quick and unobtrusive. Real-time access to centralized cross-store and cross-channel transaction details, customer information, and full integration with the point-of-sale means even without a receipt, you should be able to provide a speedy, accurate refund without a lot of paperwork and questions. Once they've had a positive experience returning merchandise, they are more likely to patronize your store going forward, hopefully turning from a reluctant returner into a customer for life.

#### **Unaware Returners**

You may consider unaware returners as abusive, but some customers are not consciously taking advantage—they are simply unaware or forgetful of the time frame stipulated in your policy. Because of their busy schedules, and the rising cost of gasoline, they may keep putting off the return until your store is on their way. By the time they do get there, it may be months past your published policy or time period, and weeks past your unofficial grace period. The Harris Interactive study sponsored by Newgistics found that 54 percent of respondents have held onto unwanted merchandise for a month before returning it, and 24

**The reluctant returner detests the whole return process. The key to pleasing this customer is to make the process quick and unobtrusive.**

**To change the behavior of the unaware returner, dynamic receipt messaging can supplement your in-store return policy postings by alerting customers to your return policy, advising them of their return compliance, and letting them know when you have made an exception for them.**

percent have held onto unwanted items from three months to over a year before trying to return it to the retailer. With that kind of time frame, it is very likely that the merchandise has been marked down since the purchase date, further eroding profits. Sometimes the policy breach is related to the item, not time. Many retailers will not accept the return of personal items such as underwear or special order items like custom framing. Unless the customer was told up-front about the time frame, your policy on marked-down items, or that the item is not returnable, they will expect a full refund. If they are declined, receive only a portion of the purchase price, or are offered a store credit instead of cash, they will be angry.

To change the behavior of unaware customers, dynamic receipt messaging can supplement your in-store return policy postings by alerting customers to your return policy, advising them of their return compliance, and letting them know when you have made an exception for them. If this strategy does not change the customers' behavior and you decide to stop making exceptions, this same information should prevent surprises and confrontations at the point-of-return.

#### **High-Purchase Returners**

Some of your highest returns may be coming from your best customers. If the average return dollar-amount per customer per year is US\$150, and one of your customers is requesting a US\$200 refund, it just might be because this customer buys US\$3,000 per year, whereas the average customer buys only US\$1,500.

To ensure the refund requests of your best customers are not declined, an effective returns management solution enables you to grant customer-service overrides for good customers, even granting unlimited returns. Customers can also be made exempt from exception counting, preventing them from accruing exception history that might otherwise lead to a denial. This can also prevent turning your highly valued customer into a loyal customer of your competition.

Maximize your opportunity when interacting with your best customers during return transactions. For these good customers, use dynamic receipt messaging to give them a discount or coupon on another purchase.

#### **Abusive Returners**

Abusive returners have bought every brand of mascara in your stores and returned every one a month later, requesting a full refund because it dried out. They bought a big screen TV just before the Super Bowl for the past two years, and returned it a few days afterward, claiming it didn't fit in their wall unit. They always have the original receipt, packaging, and price tag, and always bring the item back within the return period stipulated by your policy. It's three days after this year's Super Bowl and here they are back again. What do you do?

With an effective returns management solution in place, the data would be collected on every return, in every store or channel, and handled via an

**Your returns management solution should ensure that the refund requests of your best customers are not declined.**

**Abusive Returners may know your policies better than you do. They always have the original receipt, packaging, and price tag, and always bring the item back within the return period stipulated by your policy.**

authorization engine that checks multiple return policies based on item, customer, associate, and store.

The frequent returns on mascara could be managed with a return policy with rules specifically designed for cosmetics or any other type of merchandise category. That policy might include shorter return periods, returns based on the item's condition (for example, an open box), checking the frequency of returns in a particular category for a particular customer, and receipt messaging to discourage future returns of the same type.

An effective returns management solution should recognize the TV "renter" pattern and allow the retailer to set items or categories and specific purchase and return dates to track. With the return pattern rules included in the return policy, the TV customer could be identified as a "renter" (with a history of this behavior over the years) and their refund capability could be limited to store credit.

#### **Outright Thieves**

Some thieves are so bold as to take an item off your shelf, go directly to the checkout, and without a receipt, demand a cash refund. Or, they may rummage through a trashcan outside, find a receipt, steal the item, and then request a receipted refund. Others employ a two-step process. They buy high-ticket items at your best promotional price of the year and return them, without a receipt, for a regular price refund. Or they purchase two items that look similar, but that are priced very differently, and then switch the boxes to return the cheaper item and obtain a refund for the higher-priced version. Smart and committed to their craft, organized criminals may steal a pallet of merchandise, and armed with fake receipts, orchestrate returns across a region of stores on the same day, expecting to capitalize on the lack of real-time capabilities in legacy point-of-sale systems.

Some thieves are your employees. According to the U.S. Chamber of Commerce, over US\$50 billion is lost annually due to employee theft and employee fraud. One of the fastest growing employee-theft techniques is refund fraud. Employees use all the same techniques as the external thief, but employee thieves are a triple threat because they know your processes and policies, have access to merchandise on the store floor and the back room, and are in charge of the cash register.

Few retailers have the bandwidth to review all transactions every day. An effective returns management solution needs to provide the information that enables retailers to track and monitor both employee and customer behavior so that loss prevention managers and regional managers can focus their efforts on the areas that will yield the maximum savings. The ability to set return rules and track exceptions in order to stop external thieves should cover: same-day purchases and returns, returns to multiple locations on the same day, and invalid or no receipts. When the customer is unable to present a receipt,

**According to the U.S. Chamber of Commerce, over US\$50 billion is lost annually due to employee theft and employee fraud. Unfortunately, one of the fastest growing theft techniques is employee-perpetrated refund fraud.**

retailers need the ability to search for a transaction in a centralized database, using multiple search criteria, to see if any items have already been returned. This prevents a receipt from being used to obtain a refund more than once. For suspicious circumstances where you cannot prove fraud, the flexibility to restrict refunds to a specific tender type, such as a gift card or store credit in the case of a nonreceipted return, or a credit card refund in the case of a credit card purchase, allows you to minimize your losses. When you are sure a customer is a thief, the ability to set up an exception file and deny a return can help reduce the number of repeat offenders and send them to your competitor.

Appropriate tracking and monitoring of cashiers and sales associates is needed to detect internal return fraud and cases where the associate is colluding with customers. Behavior that can be tracked, such as the number of tender overrides, nonreceipted returns, and manager overrides should be available for review by loss prevention or store operations managers. To catch a thief sooner rather than later, an effective returns management system should allow you to set up policy rules differently by store or location hierarchy. Because some of your stores may be more prone to return fraud, you can require a manager override for cashiers with a high exception count when they are transacting a nonreceipted return, or a return from specific merchandise categories. Return policies should also be applied to employee transactions, holding them accountable to the same policies as customers.

## **CONCLUSION**

Good customer service means no surprises. Neither federal nor state law obligates stores to take back merchandise after it's purchased. However, in some states, such as California, sellers must conspicuously post their return policy if it does not meet certain expectations. Policy expectations include multiple stipulations: the types of merchandise covered by the policy, the maximum number of days allowed for an exchange, whether proof of purchase and original packaging is required, and the type of tender that will be refunded if the return is accepted. When defining your policy, in addition to aligning with your brand and meeting state regulations, consider your merchandise mix, product lifecycle, and any manufacturer policies. Adopt flexible policies that can account for particular merchandise categories, individual stores or regions, receipt messaging, and tender configuration.

A rules-based returns management solution effectively addresses the CEO's dilemma of the return policy pendulum by enabling the retailer to achieve the right balance between improving the customer's shopping experience and enforcing policies that minimize returns fraud. With access to all of the required information at the point and time of the return, your associates can make better return decisions. The result is increased profitability through reduced return fraud and a better cross-channel returns experience for your good customers.

The pay-off for an effective returns management solution can be great, because the system helps you reduce fraud without losing your customers. In fact, it

**The ideal returns management solution offers real-time, cross-channel capabilities that help reduce fraud, retain your good customers and give you a substantial return on your investment.**

allows you to be more competitive by improving customer service and providing a superior shopping experience. The ideal returns management solution helps track and monitor employee and customer behavior. It offers real-time, cross-channel capabilities to address the issues and the opportunities at the point-of-return—which gives you a substantial return on your investment.



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