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Reverse logistics: Conceptualising strategies and procurement best practices

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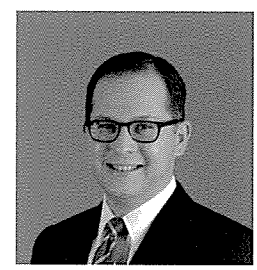
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Abstract

Global e-commerce in the consumer retail sector could not exist without the development, and more importantly acceptance, of sophisticated logistics strategies. The traditional forward supply chain with its inbound and outbound logistics is understood as significant to competitiveness and enterprise value. Reverse logistics, on the other hand, is that largely invisible yet widely used functionality that is increasingly having a very real impact in this economic environment. In fact, reverse logistics is in many ways inseparable from the growth of global e-commerce in the consumer retail sector. The functional elements of reverse logistics are similar to those of its traditional forward logistics counterpart and yet many striking differences exist. The reverse supply chain has a character both in business operations and in consumer buying habits that is as complex and challenging as it is essential to market performance. The strategic development of reverse logistics systems and their procurement from third-party service providers are systematically examined in this paper.

Keywords

reverse logistics, e-commerce, customer satisfaction, procurement and contracting, value add services, supply chain strategy

INTRODUCTION

The future of e-commerce rests in many ways on the emerging sophistication of the reverse logistics supply chain. The continued adoption of customer-friendly return options in the consumer retail

space is only expected to continue, as is the weight that the return service carries in terms of customer sentiment, which will continue to drive reverse logistics as an emerging strategic imperative for many enterprises.[1] Imagine a world where what happens after a customer opens a carton is equally as important as what happens before the click to complete the sale. Today we stand very close to that reality and, in fact, it is fair to say that for some discrete segments it is already here. This is a new way of thinking about corporate strategy, its value to consumers, and the operational means to achieve those objectives — this is the world of reverse logistics.

CONTRASTS OF FORWARD AND REVERSE LOGISTICS FLOW

The monumental rise of global e-commerce is changing the face of consumer retail supply chains. A great deal has been written on the challenge of building distribution networks capable of satisfying the most demanding customer expectations. Far less attention has been lent to the other half of the e-commerce value proposition that virtually eliminates the risk associated with consumer buying decisions. The complexities of reverse logistics strategy, procurement and management in the era of e-commerce are both fascinating and ripe for learnings. Those advancements are equally suited to forward logistics applications and contemporary strategic growth.

The basic functional elements of a reverse logistics strategy are shared with the outbound logistics supply chain and, for that matter, inbound logistics. A network of owned and outsourced resources receive, store, route, move, track, handle and deliver product. Effective management naturally involves close interaction between corporate sales and operations planning, traffic and procurement professionals. Third-party providers are procured to deliver transportation, logistics and warehousing services under contract at heavily negotiated rates, service levels and performance metrics. Each such provider operates under a litany of both international and parochial laws, regulations and rules, designed to ensure the safety of the public and to protect the interests of users of those services. Environmental responsibility, liability for loss or damage, protection of rates and even specific insurance or financial responsibility requirements are often established by mode or jurisdiction.

The strategic and operational challenges of reverse and forward logistics models can be staggeringly different, however. Hallmarks of forward logistics operations such as speed of throughput and minimisation of transit-related loss or damage receive less focus in reverse logistics. The objective of a reverse logistics strategy is, rather, to maximise convenience to the consumer and accomplish efficient disposition of the returned product while minimising total cost.

Viewed this way, the reverse logistics element of a complex supply chain is both a value add from the perspective of driving sales but also a labour-intensive loss mitigation measure designed to manage the salvage and monetisation of product. Although the great complexity of reverse logistics in the consumer retail space is challenging, it is nonetheless paramount to the continued expansion of e-commerce. Truly, certain enterprises such as Stich Fix, Inc.[2] in the US have grown to billions of dollars in revenue based largely on their aggressive deployment

of reverse logistics strategies such that the very business models themselves could not otherwise exist.[3]

UNDERSTANDING VARIANCE IN REVERSE LOGISTICS

Conceptually the most significant distinction between reverse and forward logistics is whether the operational variables are great or small, known or unknown, at the commencement of the movement or instead at its termination. In forward logistics, products begin in inventory with known quantity and condition, at a known distribution or fulfilment centre, and are dispatched often locally to variable consignees at variable times. Conversely, many of the significant challenges presented by reverse logistics are driven by the high variance in product and its circumstance as it enters the reverse supply chain.

Consider that any customer may at any time choose to make a consumer retail return subject to retailer policies. That returned product is of any possible quantity and condition, in a potentially wide array of packaging, and may or may not be suitable for resale. The product is received at residence or local store front and then consolidated with others at a company-owned or third-party facility. It must be examined and then refurbished, repackaged, reracked or retagged as necessary. It is only then routed to its immediate disposition, whether returned to the retail market, placed on a secondary market, donated to charity or disposed.[4] A product's reverse logistics journey ends in a position of relatively low variance, which is exactly the opposite of the same product's forward logistics path.

The complexity inherent in reverse logistics is due to the high variance related to both its products and its required operations. Operations conducted within reverse logistics facilities are by their nature highly intensive and, for lack of a better word, intimate with respect to enterprise risk. Those professionals tasked with engineering the reverse supply chain face a wide array of high-impact considerations. The outbound supply chain may involve pick and pack, kitting, light assembly or related services. On the other hand, reverse logistics can take on a character of production, quality control and decision making that has an equal if not greater impact. An enterprise's customer reputation and competitive advantage are potentially at risk from poor performance.

CHALLENGES OF EFFECTIVE REVERSE LOGISTICS

Customer convenience is critical, but it is also only the beginning of the conversation. A reverse logistics strategy must consider nuanced variables such as: return packaging, carrier pick-up at residence, hazardous materials safety in transit (particularly lithium ion compliance), food safety in transit, customs and export controls challenges for cross-border movements, fraud prevention, standard operating procedures and reporting for processed products, workflows for determinations of product disposition, optimal warehouse node locations, labour and material handling equipment requirements, the transportation cost to the new point of sale, the credibility of product destruction, and, last but certainly not least, the maintenance of brand identity. Issues such as these stand in addition to the ever-present need to remain vigilant on product safety and lawfulness, particularly when potentially adulterated or counterfeit items may be reintroduced to inventory.

Some of the greatest challenges beyond mere operational performance arise from the maintenance of compliance, confidentiality and intellectual property rights. Examples of the potentially high-profile, high-exposure challenges in the reverse supply chain are as voluminous as they are concerning. Returned product may include personally identifiable information from initial purchasers which must be managed in compliance with global data protection and privacy laws. All product must be checked for conformance with shelving standards just as if it had come directly from production. This can include close examination of electronic infrastructure and functionality or chemical testing for contaminants. Even the destruction of product carries risk. For those enterprises with valuable intellectual property, product intended for disposal will have resale value in the domestic market or a grey market. Product bearing owned or licensed trademark, copyright, patent and other proprietary rights must be carefully managed to ensure obliteration of the intellectual property, destruction of the product, or sale through channels that do not dilute or otherwise cause diminution of the portfolio. Theft from internal actors, well beyond typical shrinkage, is even a consideration for those high-value products.

These factors elevate the need for strong standard operating procedures but also information technology systems, data protections and security systems including closed-caption television, live security guards, fencing and gating, alarm systems, visitor policies with escorting and the like. Some in competitive segments of the consumer retail sector may give consideration to certain of these elements during the management of forward logistics, but it is less common. The significance of these intensive activities can be paramount in reverse logistics due to the nature of required services. The mere consideration of these elements highlights the criticality of reverse logistics operations and their conceptual proximity to production. Reverse logistics services are far developed beyond the old world of mere cartage.

BUY VERSUS BUILD DECISIONS

In this e-commerce environment, the design and deployment of reverse logistics strategies can be integral to enterprise value propositions, market presence and financial performance. The unique combination of both production and logistics challenges in the reverse logistics space, and the rigours inherent in those activities, can influence balance between buying value add reverse logistics services on the market or internally building out that functionality. These decisions often turn on factors such as speed to market, scalability, agility, whether the existing infrastructure is capable, whether credible outsourcing solutions are available, and the long-term commitment (or lack thereof) to the reverse logistics strategy.

Depending upon enterprise goals and objectives, it may be the case that present investments and infrastructure are indeed sufficient. For example, the existing fulfilment and disruption network, whether owned or under contract, may be adequate to handle the ad hoc pick-up and return of packages from residence. Doing so may well come at a higher cost per unit than in the forward logistics, but it is nonetheless achievable. Likewise, the existing retail or production facilities may be adequate to accommodate the receipt and processing of items before

returning those to inventory or some alternate disposition. This may require additional headcount, floorspace, material costs and processes, but it is conceivable depending upon complexity and appetite for resource allocation.

Although building-out existing operations may be attractive, many third-party service providers have emerged with sophisticated solutions addressing the challenge of reverse logistics operations. It may be overly generous to call these turn-key solutions since each company's reverse logistics needs, goals and objectives, will vary significantly. Nonetheless, the third-party logistics and value add warehousing providers have developed expertise with the entire end-to-end reverse supply chain, its inventory management function, its performance to specifications and its expense forecasting and cost containment, and as a result quality, bespoke, solutions are available. The traditional benefits of outsourcing including speed to market, absence of learning curve, scalability, agility and the potential to unwind the operation, are also realisable in reverse logistics operations. While cost savings is not necessarily a characteristic to expect in any form of outsourcing, many of these providers are open to negotiating cost plus and other dynamic costing models so that the expense of a launch is more closely aligned with a new build. More importantly, these providers offer experience in reverse logistics itself and often have relatable learnings from the same or adjacent industries.

For many enterprises, the question of whether to buy or build depends in large part on core competencies. The recognised need to design and implement strong reverse logistics solutions may be driven by market pressures or the appreciable underperformance of the current model. Where this is the case, the prospect of investing time and capital into developing internal expertise, technology systems, processes and infrastructure to produce a state-of-the-art operation can be as undesirable as it is daunting. Even where design and implementation are part of an aggressive forward-looking plan, rather than a reaction to external forces, the commitment to own new headcount and fixed costs may be less than attractive relative to a terminable contract with a proven provider. And of course, staged solutions with scalable incremental growth often win the day in their internal persuasiveness relative to significant corporate and professional commitments. In short, the decision to outsource reverse logistics functions in this environment can credibly (and often) result in outsourcing plans, despite the sensitive and production-oriented nature of those operations.

REVERSE LOGISTICS PROCUREMENT BEST PRACTICES

Companies of all sizes outsource at least a portion of their logistics needs. It is always healthy to recognise that every enterprise could, if it so desired, choose to insource nearly all aspects of its logistics operation. This, of course, does not happen. The buy versus build decision is encountered every single day and most often resolved in favour of procurement. The core competencies developed by third parties in addition to their efficiencies of scale and buying power drive tangible benefits to the users of their services. Logistics procurement must likewise perform to desired functionality and cost metrics while serving broader enterprise goals and objectives.

Effective logistics teams implement, directly or indirectly, six key elements

of logistics outsourcing in today's environment: vision, planning, consultation, preparation, negotiation and administration. This framework serves as a helpful tool for analysing the thoroughness of reverse logistics procurement strategies and the relative likelihood of successful implementation. Each of the six keys and its application in reverse logistics and broader corporate strategies are developed below.

Key 1: Vision — what future state are we trying to achieve?

Business leaders are fast recognising the emerging value of strong reverse logistics offerings as part of global supply chain management strategies. It is now more important than ever to align those reverse logistics capabilities with overall corporate goals and objectives. For example, it may be that customer feedback has communicated frustration about existing return policies, or that the lack of ease with returns has curtailed buying decisions. It may also be the case that inventory accuracy or product quality has suffered due to legacy reverse logistics practices. New corporate strategies may focus on proactive solutions to facilitate customer returns so that the exercise is a value add for the customer experience rather than an afterthought. In either event, the efficacy of reverse logistics and related operations have a direct impact on market presence and bottom line enterprise performance. Refining the reverse logistics vision will show the path forward for execution consistent with broader strategies. This is particularly valuable in today's economic environment where procurement needs and approaches may look different than in past years.

Key 2: Planning — what are our procurement needs to support that future state?

All serious reverse logistics discussions are founded on a clear understanding of current and desired operational metrics. Legacy statistics are essential to planning the precise needs of the reverse supply chain just as is the case when procuring warehousing, fulfilment, distribution and last-mile services for forward logistics. Historic rates of return at the item level, the points and regions of those returns and the mix of services required to determine and effectuate the disposition of those returns will be invaluable. Credible service providers tasked with building the reverse logistics solution will use inputs such as those to model operational needs and the associated cost. Capital requirements such as warehouse space and material handling equipment, as well as material and labour costs, are all derived from those metrics and their yield of forecasted requirements at the item and activity level for the reverse logistics operation. Visibility to the roadmap for achieving the desired future state, the requirements for any potential provider and its range of cost begins to form at this stage.

Key 3: Consultation — how do we verify and expand upon our strategic and tactical plans?

The specific nature of services, performance thresholds and geographies under strategic and tactical plans will narrow the list of viable third-party providers. The logistics world has, however, grown more consultative rather than commodity-oriented in recent years. Service providers, and the consultants who comment on the industry, bring more to the table than in the past and

this drives greater value for users of those services. As an example, service providers experienced in delivering value add reverse logistics solutions will assist in modelling the desired operation, its functionality, performance expectations and estimated cost. Those services may range from the array of customer support functions, refurbishment, disposition and inventory management, to the traditional pick-up and delivery services associated with logistics. It is commonly the case that the full array of outsourced services available, and the associated cost and performance metrics, are not fully understood until these consultations commence. Of course, while the challenges at hand make this collaboration all the more valuable, it is important to take care to guard against disclosure of confidential or strategically sensitive information.

Key 4: Preparation — how do we unify internally before going out to market?

It is increasingly the case that input from a wide range of internal stakeholders is important to the development of reverse logistics procurement strategies due to the high impact of those plans and the cross-functional character of the resulting operations. Effective execution requires buy-in from many different departments and personalities that may express strong views and seek divergent goals. Those who tend to have the strongest opinions on the contractual side of reverse logistics often sit in legal, risk management, trade compliance, tax and finance departments. Internal alignment will increase the speed of bid, negotiation and onboarding processes. It will present an opportunity to update bid planning, request for quotations (RFQs) and term sheets for maximum effect and elimination of surprise. As with seeking expert consultation, this internal exercise will also add value by recognising otherwise unseen opportunities, obstacles and unintended consequences to further refine the reverse logistics plan in alignment with the overall vision.

Key 5: Negotiation — what are we really trying to achieve through contract negotiation?

Contract drafting and negotiation is often a time-consuming process for logistics procurement and the complexities of those tasks only increase with reverse logistics. The scope of work and its range of value add services, service level agreements (SLAs) and key performance indicators (KPIs) are data driven and require a high attention to detail. Forecasting of inbound and outbound volumes, together with the anticipated services, must be prepared at the item level for determination of staffing levels and service fees. Inventory controls must be determined similar to a traditional warehousing operation, with agreement on the book of record, reporting, shrinkage allowances and the like. Standard operating procedures for the delivery of receipt, testing, refurbishing, relabelling, repackaging and reshipping must be negotiated. The cost structure may also be capital intensive with real estate, facilities, material handling equipment and information technology. It is not uncommon to have early termination penalties with amortisation of those costs and possibly title transfer to the user of the services. With so much at stake, wisely balancing time, risk and return are critical to avoid becoming bogged down in contract negotiation or accepting detrimental terms.

This is precisely the point when clear vision, planning, consultation and preparation pay off. A firm understanding of current best practices and prioritised risks can mean the difference of weeks, and even months, when it comes to closing out deals. In the heat of negotiation three options will always be available to all sides: accepting the terms presented, finding common ground and problem solving or walking away. Many of the issues that arise during negotiation can be solved with additional spend, but that is not always the solution for staying within project objectives. As always, if we are to 'play our right cards' then we need to know precisely what we are working to achieve. Risk-based perspectives can help to narrow the range of material issues by focusing on relative risk, value and the potential impact of supply chain interruption in the event of service provider failure.

Key 6: Administration — how will we achieve success after the contract is inked?

Since reverse logistics operations share characteristics with production, strong provider relationships together with open and honest communication and reporting (just as with internal teams) often maximise the value of spend. The development and use of SLAs and KPIs, in addition to establishing management meeting schedules, escalation plans and root cause analysis requirements, can yield opportunities for strong 'partnership' with service providers while still respecting the buy and sell sides of the relationships. These structures always benefit from management diligence in communication of issues, both positive and negative, so that isolated instances of emergency and long-term trends may be addressed. This allows for the adjustment of operational performance as data becomes available. Compensation structures may be tied to these performance metrics so that desired behaviour and outcomes are incentivised in a manner that aligns the interests of both parties.

Effective administration is a long game that is, above all other keys, dependent on the vigilance and persistence of internal stakeholders. Hard-fought contract tools such as SLAs and KPIs do nothing if they are not monitored and exercised. This is essential to achieving success and is, in reality, very similar to the management of performance that one would exercise over an entirely in-sourced reverse logistics operation.

FORWARD-LOOKING TAILORING AND DYNAMIC ADJUSTMENT

Strategic endeavours require clarity on the measure of success that is intended to be achieved. The development, implementation and management of a third-party reverse logistics system is no different. Just as with forward logistics, each exercise requires tailored approaches in order to refine service delivery in the interest of maximising potential while meeting corporate goals and objectives. Reverse logistics strategies likewise require dynamic adjustment over time as performance is realised and manifest in reported data and customer feedback. The true measure of success will be found in the degree to which reverse logistics operations further overall corporate goals and objectives. This is a pragmatic and dynamically changing target under threat from external and internal influences, but that is the nature of all operational challenges.

RECOGNISING NEED AND SEIZING OPPORTUNITY

The significance of reverse logistics, particularly for the growth of e-commerce, and its impact on customer experience is now critical to market value propositions. Increases in customer satisfaction, in inventory accuracy and in the quality of products routed through the reverse logistics system, as just a few examples, can convert the returns process — which was once begrudged by both retailer and customer — into a true value add that squarely aligns with brand equity. In response, enterprises are challenged to think creatively about reverse logistics and the means of confronting operational variance in the reverse supply chain.

The starting point for refashioning corporate goals and objectives for this contemporary environment, and developing complementary reverse logistics strategies, is to fully understand the nature of reverse logistics both commercially as well as its unique operational character. The resulting buy versus build decision often balances toward buying significant services and expertise from providers with core competencies in reverse logistics systems. This decision toward outsourcing is increasingly common through visionary supply chain leaders, strong procurement professionals and respectful yet carefully crafted relationships with service providers.

Simply put, reverse logistics is emerging as a function for which great impact may be gained and for many enterprises this return is achieved from the operations of third-party service providers. Clear milestones exist on the path for launching a reverse logistics strategy that relies upon experienced third parties: vision, planning, consultation, preparation, negotiation and administration. The discipline and pragmatism inherent in this framework is particularly valuable for reverse logistics, where the production-like complexity and cost associated with the variance of essential services can be as material as the potential competitive gains.

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