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strategic insight

Reverse Logistics

hold 'em or fold 'em?

Some companies are turning a tidy profit by reselling returned products that were once consigned to the scrap heap. The trick, they say, is figuring out what's junk and what's worth a second look.

By [Mark B. Solomon](#)From the [December 2008](#) issue
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For years, Cisco Systems Inc.'s product returns operation was pretty straightforward stuff. The merchandise arrived, and with few exceptions, it was thrown out. From 1995 to 2005, Cisco discarded more than 95 percent of its returned goods. According to company estimates, the Web networking giant in 2005 dumped \$500 million worth of returns, junking enough product to cover 12 football fields knee-deep. By 2005, Cisco's returns business was a bona fide cost center. That year, it spent \$8 million more to process returns than it generated in revenue from selling some of the items at residual raw material value.

Dan Gilbert, Cisco's vice president, supply chain field operations, thought there was a better way. But he couldn't be sure until he instructed staffers to visit one of Cisco's receiving warehouses and pull a cross-section of returned goods off the conveyor belts. The employees were told to visually inspect the merchandise and dispatch those items that passed muster to company



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engineers for further testing.

The results were revealing: About 80 percent of the products analyzed were in good operating condition, with half needing some cosmetic work. If that sample reflected Cisco's total returns activity, Gilbert reasoned, most of its returns could gain what he called a "second or third life" before being tossed.

Gilbert embarked on what would become a three-year mission to rewrite Cisco's reverse logistics playbook. He started by exploding the myths that all returns were defective scrap, that the returns process was a "hairball" that could not be improved, and that the company's supply chain was good enough to manage what was in place.

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Gilbert created a profit & loss statement to give the returns process financial accountability. He built collaborative relationships with Cisco's sales, marketing, and financial arms, and developed a plan to support Cisco's global network of 500 supply depots. He assembled channels to receive returns, which can be roughly classified as follows: products that can be repaired and consigned as spare parts for Cisco's supply network; products destined to be sold into secondary markets; products that can be reused as refurbishing gear in the company's laboratories or for customer demonstrations; and products that can be donated for

Today, about 40 percent of Cisco's returns are reused, an eight-fold increase from three years ago. Operating expenses, measured as a percentage of recovered value, have been pared to 39 percent from 119 percent. For Cisco's 2008 fiscal year, which ended July 28, the returns process contributed \$100 million in net profit to its bottom line. Most of the contribution, Gilbert notes, came from increased revenue streams rather than from deeper cost savings.

"One of the myths is that you should treat all returns the same," Gilbert told the Council of Supply Chain Management Professionals' annual global conference in October. "The reality is there is a huge variation in the products you receive. You really have to dig into the details."

"No trouble found"

Companies that dig are more than likely to find products worth reusing. As much as 80 percent of all returns are classified as "no trouble found," meaning they are functional in their existing condition or at most, just need to be refurbished, according to DEX Systems, a Camarillo, Calif.-based company that inspects returns and develops software applications to analyze their value. Buyer's remorse is by far the primary factor influencing a return, DEX says.

The percentage is even higher in the consumer electronics category. Approximately 95 percent of all returned consumer electronics products worldwide are free of defects that would require some type of repair, according to data from consulting firm Accenture. Wireless handset returns, in particular, are almost always remanufactured or refurbished because of their high component value, the firm says.

Many challenges

In a world of heightened environmental awareness, separating the returns wheat from the chaff has taken on elevated prominence as a "green" issue. According to the U.S. Environmental Protection Agency, consumers got rid of about 372.7 million electronic items such as television sets, computer equipment, and cell phones in 2006 and 2007. Of those, 304.2 million units were thrown out; only 68.5 million units were recycled, according to EPA data.

Despite that, evaluating which returns have a profitable afterlife and which should be consigned to the scrap heap remains, in the view of many in the industry, a business issue. And it's not a particularly easy business issue to manage. Unlike the forward logistics process, returns are inherently unpredictable. Each shipment is often touched multiple times, with a flow of so-called "decision points" that can add cost at each juncture.

The challenges are compounded by the short shelf lives of many products. This is especially true in the high-tech and electronics sectors, where life cycles are now measured in months instead of years.

Another factor is the globalization of manufacturing, which has brought overseas producers—many of them Asian-based— into a loop they may not yet be ready to enter, some experts say. A strong returns process "starts with infrastructure, and companies in Asia do not have the physical returns programs in place" to connect the dots with their supply chain partners, says Ronald Kula, vice president of business development for DEX.

Terry Steger, senior executive for Accenture's electronics and high-tech group, says Asian producers may not fully understand the implications of product returns on current and future revenue streams. But the biggest problem is a lack of timely communication between intercontinental partners, Steger contends. The communication gap is keenly felt when there is a costly product defect requiring a significant change in future manufacturing processes, he adds.

Cultural turf wars also come into play. Marketing folks are in business to push the newest generation of products and often have little incentive to focus on older merchandise, Kula says. In addition, top management may choose to scrap returns because it's too costly and timeconsuming to explore alternatives. "It's not like they are taking the easy way out," he adds. "It is the only way they know."

No more failure to communicate

The ideal solution is to dissuade buyers from returning the product at all. However, once the companies have returned goods in hand, they must play the cards they're dealt. The general rule is that a remanufactured or refurbished product must be resold for 70 to 80 cents for each dollar of current value to justify the cost of the work. Many older products have fallen to such low price points that it makes more economic sense to junk them than spend the time to even inspect them for their fitness.

As is often the case, IT tools can ease the decision-making process. RedPrairie Corp., a leading supply chain software provider, has integrated a reverse logistics module into what it calls its execution management platform. RedPrairie says its integrated model gives the recipient a companywide window on the return rather than treating the process in isolation. This enables broader visibility and better advance planning since the recipient sees how the return affects the entire organization, according to Tom Kozneski, vice president, product strategy.

For example, if the recipient of a returned product is unaware it has been discontinued or is out of warranty, that item may be labeled a good product and stored for processing, Kozneski says. As a result, labor and space are unproductively allocated, and a credit would be mistakenly issued, he says. "The returns system is based on integration with all other aspects of your business systems, so your returns staff gets current detail on whether the item should be processed at all or discarded," Kozneski says. "If there is information in your main database about the latest updates on SKU status, that detail is reflected at the returns processing station and it guides the subsequent action. It eliminates a lot of confusion and wasted effort up front when the returned items are checked in."

At DEX Systems, "economic triage," in Kula's words, is performed on returned products. DEX will visually inspect the product to determine its general condition and then conduct diagnostic tests to gauge the work that would be required—if any—and assess its monetary value.

Kula says DEX is guided by what he calls the "clip level," a pre-set ceiling on what will be spent to repair or refurbish a returned product. Products whose repair costs exceed the clip level are usually disposed of; Kula notes that many returns don't make the first cut.

"The first question that's often asked is 'Do we want to do anything?'" he says. "If the answer is yes, we will push the product down the line. If not, it may be disposed of."

ClearOrbit Corp., another company that supplies reverse logistics solutions, has developed software that separates returned components during the intake process and then asks the recipient a series of questions to help determine how the components can be disposed of. Based on the information derived from the responses, the company can repackage, reship, or reconfigure those items that have value, and the products then can be shipped or scrapped. "The recovery process now becomes a revenue source for resale of products that otherwise would have been thrown away," says Pat Anderson, senior solutions architect for ClearOrbit.

One ClearOrbit customer, a major manufacturer of automated teller machines, uses the software to refurbish older machines by evaluating the components on returned units that have been placed out of service. Instead of tossing the parts, the company has been able to update some of the components and resell products that might have been junked, Anderson says.

The ClearOrbit example underscores the notion of returns processes and technology converging on one goal: to assign a value to each return rather than lumping them together as a homogenous mass. As more manufacturers embrace this mindset, they may be pleasantly surprised to find there's gold in that junk pile.

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Mark Solomon has spent 25 years in the transportation, logistics and supply chain management fields as a journalist and public relations professional. From 1989 to 1994, he worked in Washington as a reporter for the *Journal of Commerce*, covering the aviation and trucking industries, the Department of Transportation, Congress and the U.S. Supreme Court. Prior to that, he worked for *Traffic World* for seven years in a similar role. From 1994 to 2008, Mr. Solomon ran Media-Based Solutions, a public relations firm based in Atlanta. Mr. Solomon graduated in 1978 with a B.A. in journalism from The American University in Washington, D.C.

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