

2010

Customer Returns *in the* **Retail Industry**



Introduction

The Retail Equation (TRE) is pleased to incorporate the results of the NRF 2010 Return Fraud Survey into the *2010 Customer Returns in the Retail Industry* report. This executive summary document provides return-related information that retailers may use to help compare and improve their business processes. Report objectives included:

- Identify retail industry return metrics—total return amounts, receipted/non-receipted percentages, and various forms of fraudulent and abusive returns, as identified by retail respondents.
- Uncover other shortfalls caused by return fraud, for example lost sales taxes.
- Understand current practices in the retail industry for processing customer returns.
- Compare the relative importance of return fraud issues.
- Generate industry discussion regarding best practices for accepting customer returns and controlling return fraud and abuse that help to maximize profits and minimize losses.

Participating Company Demographics

The NRF Return Fraud Survey was conducted by the National Retail Federation during October 2010 by polling loss prevention executives at 111 retail companies. Executives from discount stores, department stores, drug stores, supermarkets and specialty stores completed the survey.

The Retail Equation would like to thank all of the retailers who participated in this year's NRF Return Fraud Survey. You will notice that no retailer names are mentioned, per the NRF and the sponsoring company's commitment to maintain confidentiality of each organization's data.

Annual Merchandise Returns and Return Fraud

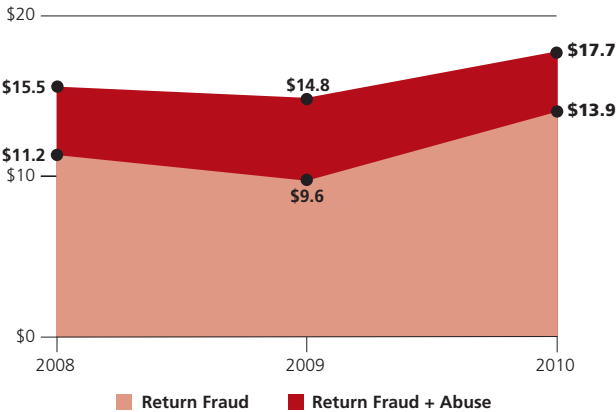
METRIC	2007	2008	2009	2010
NRF retail industry sales ⁽¹⁾	\$2,361	\$2,391	\$2,307	\$2,389 ⁽³⁾
Returns as a percent of total sales	7.26%	8.70%	8.04%	8.12%
Amount of merchandise returned	\$171.4	\$207.9	\$185.5	\$194.0
Percent of returns without a receipt			16.4%	15.7%
Return fraud as a percent of total returns	6.1%	5.4%	5.2%	7.2%
Estimated amount of fraudulent returns	\$10.5	\$11.2	\$9.6	\$13.9
Return fraud/abuse as a percent of total returns ⁽²⁾		8.2%	8.0%	9.1%
Estimated amount of return fraud and abuse		\$15.5	\$14.8	\$17.7

⁽¹⁾ NRF retail industry sales figures exclude autos, restaurants, and gas stations. Sales and returns are reported in billions of dollars.
⁽²⁾ Return fraud and abuse estimates come from trends established in previous issues of the *Customer Returns in the Retail Industry* report.
⁽³⁾ 2010 retail sales estimated by NRF.

Key Findings

- NRF estimates for return fraud dollars are up 45.4% over 2009, while total return dollars are only up 4.5%, meaning that return fraud is increasing at a rate almost 10 times faster than returns as a whole.
- Return rate percentage is only up 1% over last year, but is still up 11.8% over 2007, displaying an increased level of merchandise returns and more than \$194 billion in lost sales for retailers.
- The concepts of return abuse (sometimes called friendly fraud) and fraud in exchange transactions further extends the predicament of retail returns. Analyzed in several independent studies conducted between 2003 to 2007 (by KingRogers International and the Loss Prevention Research Council), retail return fraud and abuse figures are always higher than return fraud alone. We estimate an increase from 8.0% to 9.1%, meaning that the amount of fraudulent/abusive return dollars may be as high as \$17.7 billion.

Return Fraud and Abuse Impact (Billions of Dollars)



Holiday Returns and Return Fraud

METRIC	2007	2008	2009	2010
Amount of holiday merchandise returned ⁽¹⁾	\$39.7	\$43.6	\$42.6	\$43.8
Returns as a percent of holiday sales	8.77%	10.01%	9.75%	9.80%
Amount of fraudulent holiday returns	\$3.55	\$3.27	\$2.74	\$3.68
Return fraud as a percent of holiday returns	8.9%	7.5%	6.4%	8.4%

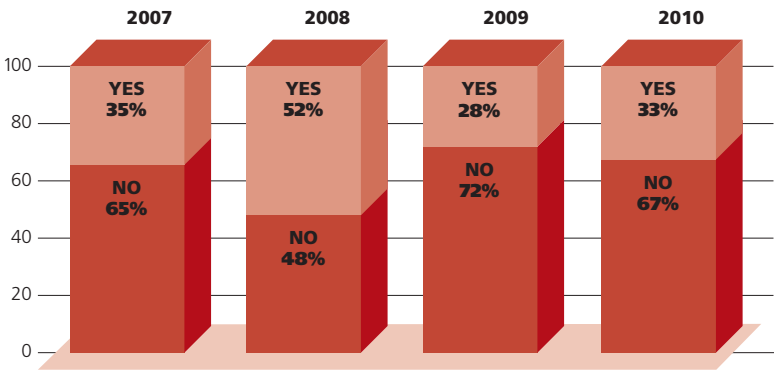
⁽¹⁾ NRF holiday sales are defined as retail industry sales in the full months of November and December. Sales and returns reported in billions of dollars.

Key Findings

- Why are NRF holiday return fraud estimates 17% above full year rates and 31% higher than 2009? It is due in large part to 1) elevated return rates—up 20% during holidays, 2) seasonal hiring practices focused on part-time, less experienced labor, and 3) an overall increase in return fraud.
- Total holiday merchandise return dollars in 2010 are at the highest figure reported—3% above 2009 and 10% more than 2007—a sign of ever increasing lost sales.
- According to an NRF survey of gift recipients from December 2009, one-third (32.9%) will return at least one gift item.

Holiday Return Policies

DOES YOUR RETURN POLICY BECOME MORE LENIENT DURING THE HOLIDAY SEASON TO ACCOMMODATE HOLIDAY RETURNS?



Key Findings

- Compared to last holiday season, the majority of retailers (83.6%) expect to keep their return policy the same as last year, while only 5.5% plan to loosen their policy.
- According to an NRF survey conducted last December, 87.9% of Americans feel retailers’ return policies are fair.

The Retail Equation Conclusions

- Return policies should be more lenient during the holiday season as a tactic to attract new shoppers and convert gift recipients. There are ways to protect and manage risk without compromising service at the return counter.

Financial Summary of Return Fraud and Abuse

CATEGORY	PERCENTAGE RATE	RETAIL INDUSTRY	EXAMPLE COMPANY (\$1 BILLION REVENUE)
Sales	100%	\$2,388,877,000,000	\$1,000,000,000
Returns	8.12%	\$193,976,812,400	\$81,200,000
Receipted	84.3%	\$163,444,862,128	\$68,419,120
Non-Receipted	15.7%	\$30,531,950,272	\$12,780,880
Return Fraud (low-end estimate)	7.2%	\$13,946,932,812	\$5,838,280
Return Fraud and Abuse (high-end estimate)	9.1%	\$17,651,889,928	\$7,389,200

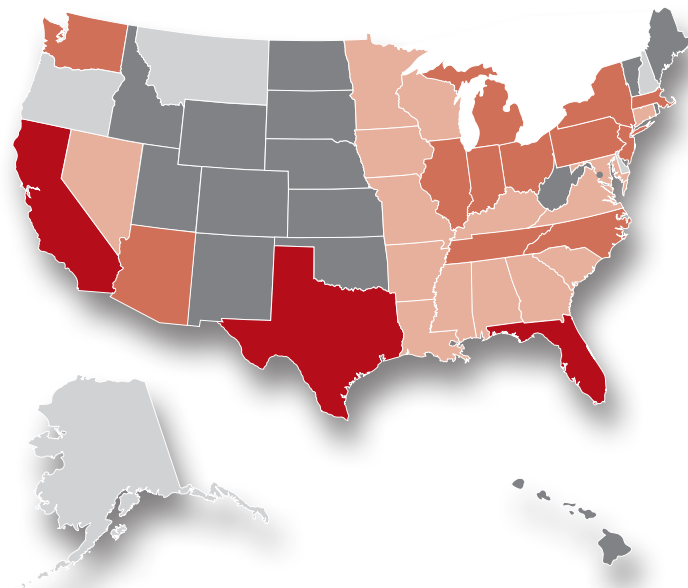
The Retail Equation Conclusions

- LP departments have begun to recover from the rampant budget and staff cuts over the prior 18 months. This has aided their visibility and monitoring of fraud across the organization, and is likely driving this year’s increased awareness of the impact of return fraud.
- Preventing fraud is only one of the challenges being contemplated at the return desk; improving the shopping experience is a new and rapidly growing trend. As seen above, many people think return policies are fair; the implication is also that the policies are uniform and no different from one retailer to the next. Therefore, differentiating the consumer experience during the return process—such as a return to “hassle free” returns—is often under consideration as a potential revenue driver. The ability to offer more flexible and lenient returns, while still mitigating the risk of fraud and abuse is critical.

Return fraud and abuse is estimated between \$13.9 and \$17.7 billion.

Lost Sales Tax Impact of Return Fraud and Abuse

MAP OF LOST SALES TAX BY STATE



Legend

- \$0 Lost sales tax revenue
- <\$10 Lost sales tax revenue
- \$10–\$24 Lost sales tax revenue
- \$25–\$49 Lost sales tax revenue
- \$50+ Lost sales tax revenue

Sales tax revenue in millions, based on high-end estimates from table.

STATE	% OF NATIONWIDE RETAIL SALES ⁽¹⁾	SALES	RETURNS	STATE SALES TAX RATE ⁽²⁾	LOW-END ESTIMATE		HIGH-END ESTIMATE	
					RETURN FRAUD	LOST SALES TAX REVENUE	RETURN FRAUD/ABUSE	LOST SALES TAX REVENUE
Alabama	1.50%	\$35,833,155,000	\$3,166,796,023	4.000%	\$227,692,634	\$9,107,705	\$288,178,438	\$11,527,138
Alaska	0.26%	\$6,211,080,200	\$548,911,311	0.000%	\$39,466,723	\$0	\$49,950,929	\$0
Arizona	2.24%	\$53,510,844,800	\$4,729,082,061	6.600%	\$340,021,000	\$22,441,386	\$430,346,468	\$28,402,867
Arkansas	0.91%	\$21,738,780,700	\$1,921,189,587	6.000%	\$138,133,531	\$8,288,012	\$174,828,252	\$10,489,695
California	11.90%	\$284,276,363,000	\$25,123,248,450	7.250%	\$1,806,361,564	\$130,961,213	\$2,286,215,609	\$165,750,632
Colorado	1.70%	\$40,610,909,000	\$3,589,035,493	2.900%	\$258,051,652	\$7,483,498	\$326,602,230	\$9,471,465
Connecticut	1.25%	\$29,860,962,500	\$2,638,996,686	6.000%	\$189,743,862	\$11,384,632	\$240,148,698	\$14,408,922
Dist. of Columbia	0.15%	\$3,583,315,500	\$316,679,602	6.000%	\$22,769,263	\$1,366,156	\$28,817,844	\$1,729,071
Delaware	0.37%	\$8,838,844,900	\$781,143,019	0.000%	\$56,164,183	\$0	\$71,084,015	\$0
Florida	7.30%	\$174,388,021,000	\$15,411,740,646	6.000%	\$1,108,104,152	\$66,486,249	\$1,402,468,399	\$84,148,104
Georgia	3.01%	\$71,905,197,700	\$6,354,704,020	4.000%	\$456,903,219	\$18,276,129	\$578,278,066	\$23,131,123
Hawaii	0.50%	\$11,944,385,000	\$1,055,598,674	4.000%	\$75,897,545	\$3,035,902	\$96,059,479	\$3,842,379
Idaho	0.51%	\$12,183,272,700	\$1,076,710,648	6.000%	\$77,415,496	\$4,644,930	\$97,980,669	\$5,878,840
Illinois	4.05%	\$96,749,518,500	\$8,550,349,262	6.250%	\$614,770,112	\$38,423,132	\$778,081,783	\$48,630,111
Indiana	1.99%	\$47,538,652,300	\$4,201,282,724	7.000%	\$302,072,228	\$21,145,056	\$382,316,728	\$26,762,171
Iowa	0.92%	\$21,977,668,400	\$1,942,301,561	6.000%	\$139,651,482	\$8,379,089	\$176,749,442	\$10,604,967
Kansas	0.79%	\$18,872,128,300	\$1,667,845,905	6.300%	\$119,918,121	\$7,554,842	\$151,773,977	\$9,561,761
Kentucky	1.26%	\$30,099,850,200	\$2,660,108,659	6.000%	\$191,261,813	\$11,475,709	\$242,069,888	\$14,524,193
Louisiana	1.33%	\$31,772,064,100	\$2,807,892,474	4.000%	\$201,887,469	\$8,075,499	\$255,518,215	\$10,220,729
Maine	0.51%	\$12,183,272,700	\$1,076,710,648	5.000%	\$77,415,496	\$3,870,775	\$97,980,669	\$4,899,033
Maryland	1.99%	\$47,538,652,300	\$4,201,282,724	6.000%	\$302,072,228	\$18,124,334	\$382,316,728	\$22,939,004
Massachusetts	2.34%	\$55,899,721,800	\$4,940,201,796	6.250%	\$355,200,509	\$22,200,032	\$449,558,363	\$28,097,398
Michigan	3.10%	\$74,055,187,000	\$6,544,711,781	6.000%	\$470,564,777	\$28,233,887	\$595,568,772	\$35,734,126
Minnesota	1.80%	\$42,999,786,000	\$3,800,155,228	6.875%	\$273,231,161	\$18,784,642	\$345,814,126	\$23,774,721
Mississippi	0.89%	\$21,261,005,300	\$1,878,965,640	7.000%	\$135,097,630	\$9,456,834	\$170,985,873	\$11,969,011
Missouri	1.97%	\$47,060,876,900	\$4,159,058,777	4.225%	\$299,036,326	\$12,634,285	\$378,474,349	\$15,990,541
Montana	0.36%	\$8,599,957,200	\$760,031,046	0.000%	\$54,646,232	\$0	\$69,162,825	\$0
Nebraska	0.62%	\$14,811,037,400	\$1,308,942,356	5.500%	\$94,112,955	\$5,176,213	\$119,113,754	\$6,551,256
Nevada	1.14%	\$27,233,197,800	\$2,406,764,978	6.850%	\$173,046,402	\$11,853,679	\$219,015,613	\$15,002,569
New Hampshire	0.67%	\$16,005,475,900	\$1,414,502,224	0.000%	\$101,702,710	\$0	\$128,719,702	\$0
New Jersey	3.12%	\$74,532,962,400	\$6,586,935,728	7.000%	\$473,600,679	\$33,152,048	\$599,411,151	\$41,958,781
New Mexico	0.62%	\$14,811,037,400	\$1,308,942,356	5.125%	\$94,112,955	\$4,823,289	\$119,113,754	\$6,104,580
New York	5.93%	\$141,660,406,100	\$12,519,400,278	4.000%	\$900,144,880	\$36,005,795	\$1,139,265,425	\$45,570,617
North Carolina	2.89%	\$69,038,545,300	\$6,101,360,338	5.750%	\$438,687,808	\$25,224,549	\$555,223,791	\$31,925,368
North Dakota	0.25%	\$5,972,192,500	\$527,799,337	5.000%	\$37,948,772	\$1,897,439	\$48,029,740	\$2,401,487
Ohio	3.39%	\$80,982,930,300	\$7,156,959,012	5.500%	\$514,585,353	\$28,302,194	\$651,283,270	\$35,820,580
Oklahoma	1.00%	\$23,888,770,000	\$2,111,197,349	4.500%	\$151,795,089	\$6,830,779	\$192,118,959	\$8,645,353
Oregon	1.27%	\$30,338,737,900	\$2,681,220,633	0.000%	\$192,779,764	\$0	\$243,991,078	\$0
Pennsylvania	4.07%	\$97,227,293,900	\$8,592,573,209	6.000%	\$617,806,014	\$37,068,361	\$781,924,162	\$46,915,450
Rhode Island	0.34%	\$8,122,181,800	\$717,807,099	7.000%	\$51,610,330	\$3,612,723	\$65,320,446	\$4,572,431
South Carolina	1.36%	\$32,488,727,200	\$2,871,228,394	6.000%	\$206,441,322	\$12,386,479	\$261,281,784	\$15,676,907
South Dakota	0.32%	\$7,644,406,400	\$675,583,152	4.000%	\$48,574,429	\$1,942,977	\$61,478,067	\$2,459,123
Tennessee	2.10%	\$50,166,417,000	\$4,433,514,432	7.000%	\$318,769,688	\$22,313,878	\$403,449,813	\$28,241,487
Texas	7.49%	\$178,926,887,300	\$15,812,868,142	6.250%	\$1,136,945,219	\$71,059,076	\$1,438,971,001	\$89,935,688
Utah	0.84%	\$20,066,566,800	\$1,773,405,773	4.700%	\$127,507,875	\$5,992,870	\$161,379,925	\$7,584,856
Vermont	0.25%	\$5,972,192,500	\$527,799,337	6.000%	\$37,948,772	\$2,276,926	\$48,029,740	\$2,881,784
Virginia	2.63%	\$62,827,465,100	\$5,552,449,027	4.000%	\$399,221,085	\$15,968,843	\$505,272,861	\$20,210,914
Washington	2.26%	\$53,988,620,200	\$4,771,306,008	6.500%	\$343,056,902	\$22,298,699	\$434,188,847	\$28,222,275
West Virginia	0.54%	\$12,899,935,800	\$1,140,046,568	6.000%	\$81,969,348	\$4,918,161	\$103,744,238	\$6,224,654
Wisconsin	1.80%	\$42,999,786,000	\$3,800,155,228	5.000%	\$273,231,161	\$13,661,558	\$345,814,126	\$17,290,706
Wyoming	0.21%	\$5,016,641,700	\$443,351,443	4.000%	\$31,876,969	\$1,275,079	\$40,344,981	\$1,613,799
Total						\$859,875,540		\$1,088,298,667

⁽¹⁾ Source: National Retail Federation

⁽²⁾ Source: Federation of Tax Administrators

Examples of Return Fraud

WHICH EXAMPLES OF RETURN FRAUD HAS YOUR COMPANY EXPERIENCED IN THE PAST YEAR?

	2007	2008	2009	2010
Return of stolen merchandise (shoplifting)	91.5%	88.9%	93.1%	93.5%
Returns using counterfeit receipts	50.8%	45.7%	43.1%	35.5%
Return of merchandise purchased with stolen/fraudulent tender	83.1%	74.1%	75.4%	68.2%
Wardrobing/renting	66.1%	64.2%	46.3%	61.7%
Internal/external collusion				88.8%

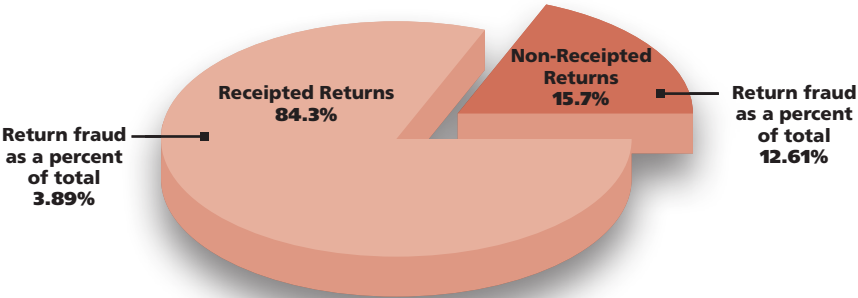
Key Findings

- Wardrobing/renting (returns of used, non-defective merchandise) saw a 15 point jump in occurrence, returning to the levels reported during 3 of the past 4 years.
- Internal/external collusion is a new question this year, a direct result from your feedback on previous surveys.

The Retail Equation Conclusions

- The link between associate fraud and return fraud/abuse presents a significant issue (89%), and implies that after-the-fact, exception reporting systems are not sufficiently preventing this type of fraud.
- Consistent drops in counterfeit receipts and stolen/fraudulent tenders are likely due to increased use of transaction look-up technology during the returns process.
- Shoplifting, wardrobing, and collusion are issues related to the individual, not the transaction, and are better addressed with solutions that focus on purchase and return behaviors and patterns.

Analysis of Return Fraud by Receipt



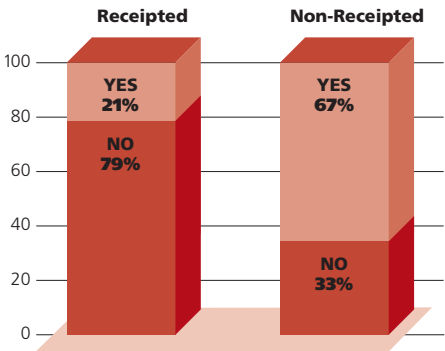
The Retail Equation Conclusions

- As noted above, more than one third of those surveyed (35%) found forged receipts used in committing return fraud this year, repeating a regular finding, which may render receipt-based return authorization systems more vulnerable to fraud.
- Another concern is that a receipt is being confused with a valid return. There are many instances where systems and policies are being abused by shoppers with valid receipts; be careful not to overlook larger revenue leakage occurring with receipted returns.

Current Return Processes

Understanding how the retail industry currently manages return fraud/abuse prevention is an important component of this survey.

DOES THE CUSTOMER NEED AN ID TO MAKE A RETURN?



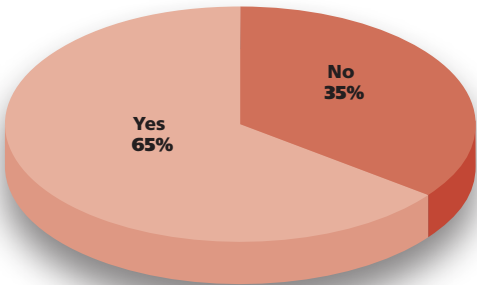
Key Findings

- 33% of retailers responded that they never require customers to show an ID.
- There is a dramatic difference between procedures for receipted and non-receipted returns.

The Retail Equation Conclusions

- The limited collection of ID on receipted returns, in conjunction with the perception on the previous page of less fraud on receipted returns, may be a key driver in the increase in return fraud and the consistently high occurrences of wardrobing/renting and internal/external collusion—both typically receipt-based transaction types.

HAVE YOU CHANGED YOUR RETURN POLICIES TO SPECIFICALLY ADDRESS RETURN FRAUD?



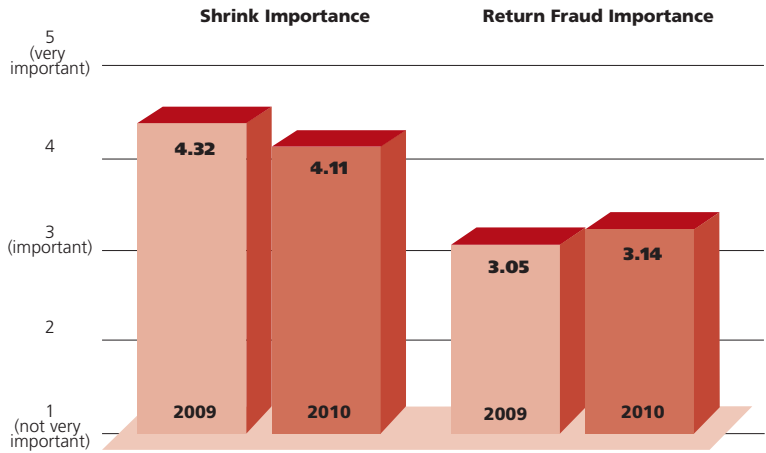
The Retail Equation Conclusions

- Organized retail crime *and* internal theft are more sophisticated—shoplifting, collusion, fraudulent receipts, and other techniques are making traditional methods of return fraud prevention less effective and leading to evolving return policies.

Impact of Return Fraud and Abuse

Beyond reporting metrics, a significant goal of this year's survey was to understand how retailers view and manage return fraud and abuse. How strategic is return fraud compared to something very well known like shrink?

HOW IMPORTANT IS THE ISSUE OF SHRINK FOR YOUR COMPANY?
HOW IMPORTANT IS THE ISSUE OF RETURN FRAUD FOR YOUR COMPANY?



Key Findings

- The importance of return fraud grew by 3% while shrink fell by -5% at the same time.
- Return fraud has gained in importance in the same year in which return fraud metrics have grown dramatically.

The Retail Equation Conclusions

- The directionality of shrink and return fraud importance may be an early indication of a fundamental shift. Shrink will always be a key metric and has been large focus for LP teams. But as the traditional tactics to reduce shrink are being played out, new territory is being discovered since return fraud and shrink are highly correlated.
- The growing importance of return fraud issues indicates that there may be a demand for improvement, typically represented by increased spending on systems and programs.

Summary

The sixth *Customer Returns in the Retail Industry* report represents the third year that The Retail Equation sponsored the NRF Annual Return Fraud Survey as a means to present a single source of metrics to the retail market. Specifically, the goal is to understand the extent of return fraud and abuse (estimated between \$13.9 and \$17.7 billion), thereby raising the awareness of the problem in order to stimulate a dialogue that will lead to best practices and solutions.

In the competitive world of retail it is critical to understand how returns and return fraud reduce net sales and contribute to inventory shortage (shrink)—clear causes of lost profits. The results within offer the industry's best look into the subject of merchandise return policies and procedures, as well as potential fraud and abuse. This information can be used by loss prevention professionals to compare and contrast their own program results to those reported here, with an eye towards reducing losses from this source.

When considering solutions, remember that broad policy-based initiatives impact everyone—possibly adversely affecting good customers as well as abusers, and consumer satisfaction may suffer as a result. Technology is also a tricky problem, since a system that is too restrictive risks alienating good customers, and one that is too lax risks encouraging abuse. Seek the counsel of a return expert to mitigate both extremes. Ultimately, implementing the right solution, combined with employee training that encourages diligent attention to the issue at the store level, will help result in reduced return fraud and abuse—leading to lower return rates, increased net sales, higher profits, and improved customer satisfaction.

For a copy of the 2010 NRF Return Fraud Survey results that generated portions of this executive summary report, please contact the National Retail Federation or [follow this link](#).

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