

# Study on firms' return policies offers guidance on pricing, returns, refunds

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Because customers who shop online cannot try on their purchases, a third of all Internet sales get returned. But handling these returns is costly, giving retailers that have both physical stores and digital sales a clear

advantage over retailers that operate only online. A new study examined the decisions around the pricing and return policies of a retailer with both stores and online sales to help explain why some firms opt to fully refund customers for their returns while others charge a fee for online returns. The findings offer guidance to retailers about pricing and policies on returns and refunds.

Conducted by researchers at Carnegie Mellon University and the University of Washington, the study appears in *Management Science*.

"Our study can help firms with stores and online sales decide when to offer full refunds or charge a fee for online returns," says Soo-Haeng Cho, Associate Professor of Operations Management at Carnegie Mellon University's Tepper School of Business, who coauthored the study. "Our work shows that firms should consider offering full refunds whenever they can salvage online returns at mild discounts or if most of their customers choose to visit their stores before purchasing. They may also want to charge a fee for online returns to push customers toward using free in-store returns."

Researchers examined a retailer that sold a product through two channels—in stores and online—to customers who faced uncertainty about the valuation of the product—that is, they didn't know how much they would like the product. The customers differed in how they resolved that uncertainty—some evaluated the product in person at a store before deciding to purchase it while others bought the product online with the option of returning it if it did not fit. The cost of a product was the same whether it was purchased in the store or online, and the firm allowed free returns to its stores, but charged a fee for some products returned by mail (referred to as online returns).

The study found that when customers returned products online, the optimal refund given by a firm with both store and online sales was more

generous than refunds given by firms that sell their products only online or only in a store. The refunds were often larger than the salvage value (how much the firm can get from the product after it is returned, either by selling it again or by recycling it) and may even have been a full refund. The findings help explain why some firms with both stores and online sales choose to offer full refunds while others charge a fee for online returns.

Specifically, the study found that firms with both physical stores and online sales that have good salvage partners (companies that will buy returned items for a reasonable price) for online returns (e.g., Nordstrom and firms like it that own their own outlet stores) and those with more customers who use their physical stores (e.g., Macy's) may offer full refunds. Similarly, the study found that firms have incentives to offer full refunds for products that customers are more likely to inspect in store (e.g., Express for footwear).

The authors suggest that firms with a significant network of stores and better in-[store](#) salvage opportunities (e.g., J.C. Penney) might be better off charging a fee for online returns to encourage customers to return items in stores. But they note that firms with both stores and online sales should be cautious in making the return process more convenient and improving accessibility to its stores because these seemingly beneficial policies, when combined with a policy offering partial refunds, could undermine firms' overall profit.

"Our work is a first step in capturing the complex dynamics that motivate different firms' choices surrounding return policies," explains Leela Nageswaran, Assistant Professor of Operations Management at the University of Washington, who coauthored the study (Nageswaran received her Ph.D. from the Tepper School of Business). "Return policies can be a valuable tool for firms with both stores and [online sales](#), especially when [firms](#) use them to sway customers' choice of the way

they return items as well as how they purchase products."

**More information:** Leela Nageswaran et al, Consumer Return Policies in Omnichannel Operations, *Management Science* (2020). [DOI: 10.1287/mnsc.2019.3492](https://doi.org/10.1287/mnsc.2019.3492)

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