

Formalization of reverse logistics programs: A strategy for managing liberalized returns

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Abstract

The ability to manage returns has become a critical success factor for many firms. Liberal returns policies are encouraging large volumes of returns, and reverse logistics programs are being used to recover returned assets that would otherwise be lost. However, lack of formal policy may inhibit reverse logistics effectiveness. This research examines the relationships between formalization, liberal policies, and related capabilities and overall effectiveness of reverse logistics programs for a sample of firms in the automobile aftermarket parts industry.

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1. Introduction

Products flow in the reverse direction in supply chains—from consumer to producer—every day. In some industries, over 1/5 of all goods that are sold are eventually returned to the vendor (Rogers & Tibben-Lembke, 1999). As a result, some firms are implementing reverse logistics programs to handle the returned merchandise. However, many firms appear to have no consistent game plan in place to deal with returns. In one recent study, more than a third of survey respondents indicated that inadequate and/or misdirected formal policy represents a major barrier to reverse logistics program success (Rogers & Tibben-Lembke, 1999). Considering that process formalization is generally believed to be related to firm performance (Walker & Ruekert, 1987), and given the massive volumes of returns modern companies face, the lack of formalized reverse logistics programs/processes is somewhat surprising.

In general, formalization of business processes such as reverse logistics can improve firm efficiency by standardizing repetitive activities and transactions (Ruekert, Walker, & Roering, 1985). This is especially true in the modern

hypercompetitive marketplace, where firms vigorously compete on the basis of customer service, and as a result are more liberal than ever before in allowing returns (Cottrill, 2003; Merritt, 2001). Many firms will accept almost anything sent back up the channel, regardless of reason or condition, if they perceive that doing so could benefit the customer relationship (Merritt, 2001; Stock, 1998). However, while reverse logistics volume/demands may be difficult to predict, the components of a reverse logistics system—involving bringing product back or arranging alternate disposition—can be routinized. Thus, reverse logistics, by its very nature, would seem to be an ideal candidate for developing formalized methods of handling.

The current research was undertaken in order to gain greater insight into the impact of reverse logistics formalization by exploring the relationships between formalization and liberalized returns policies, reverse logistics capabilities, and performance. In the following sections, a brief overview of these topics is provided. Then, research hypotheses are specified and empirically examined, and results are discussed.

2. Reverse logistics

Effective reverse logistics focuses on the backward flow of materials from customer to supplier (or alternate

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disposition) with the goals of maximizing value from the returned item and/or assuring its proper disposal (Rogers & Tibben-Lembke, 1999; Stock, 1998). This may include product returns, source reduction, recycling, materials substitution, reuse of materials, waste disposal, refurbishing, repair, and remanufacturing (Stock, 1998). Reverse logistics processes—and reverse logistics research—has traditionally emphasized green logistics, i.e., the use of environmentally conscious logistics strategies (Carter & Ellram, 1998; Green, Morton, & New, 1998; Murray, 2000; Stock, 1998; van Hoek, 1999). While environmental aspects of reverse logistics are critically important, many firms are also recognizing the economic impact of reverse logistics (Klausner & Hendrickson, 2000; Ritchie, Burnes, Whittle, & Hey, 2000). Recent research suggests that companies can recapture value through an efficient and effective returns process (Autry, Daugherty, & Richey, 2001).

Effective reverse logistics is believed to result in improved firm outcomes. Firms that effectively manage the reverse flow of goods benefit through decreased resource investment levels and cost reductions, i.e., storage and distribution (Andel, 1997; Giuntini & Andel, 1995a). Additionally, reverse logistics-related remanufacturing, repair, reconfiguration, and recycling have been shown to impact a company's bottom line through value reclamation (Andel, 1997; Clendenin, 1997; Giuntini & Andel, 1995b; South, 1998).

Quick and efficient handling of returned product can also be critical in sustaining relationships and creating repeat purchases. For this reason, firms are more willing than ever to accept returns from customers. Reverse logistics allows companies an opportunity to differentiate themselves, builds consumer confidence in the company brand, and positively influences customer satisfaction (Blumberg, 1999). As a result, liberal return policies have become a standard marketing practice and a major component of the corporate image for many firms in both business-to-business and business-to-consumer markets. The complexity of managing damaged or defective merchandise, product recalls, maintenance and repairs, and recycling should make reverse logistics programs a high priority.

3. Formalization

Formalization refers to the degree to which control mechanisms such as rules, processes, or procedures guide intra-firm or inter-firm (i.e., supply chain) operations (Ruekert et al., 1985; Van de Ven & Ferry, 1980). Generally, formalization implies that control mechanisms take the form of written regulations or contractual obligations (Van de Ven & Ferry, 1980). Within the current context, this means that suppliers who are highly formalized will have “spelled out” standard operating procedures for reverse logistics before they are needed. For example, they may provide instructions to their customers specifying how returned merchandise is

to be shipped (U.S. Postal Service, UPS, etc.), who pays for the shipping costs, and where to return merchandise (manufacturer's facility, retailer's distribution center, etc.). With a highly formalized organization, the approach to handling specific returns-related events is defined in advance.

Formalization of control mechanisms has been associated with increased efficiency in operations occurring both within and between firms (Ruekert et al., 1985; Walker & Ruekert, 1987). Internal operations are formalized (and thereby made more efficient) through the establishment of workplace rules or standard operating procedures. Alternatively, formalization of external operations leads to efficiencies by defining firms' reciprocal expectations in detail, e.g., a written contract, such that misunderstandings and other problems between trading partners are minimized (Ruekert et al., 1985).

Formalization has been recognized as a key attribute in firms that are considered to be leading-edge in terms of logistics practices. Bowersox et al. contend that formalized control mechanisms allow logistics operations to realize advantages in terms of efficiency (Bowersox, Daugherty, Dröge, Germain, & Rogers, 1992; Bowersox & Daugherty, 1992):

Formalization is a strategy of control (that) provides a structure for directing logistics operations. Traditional organizational research suggests that a high level of formalization may inhibit innovation... this was not found to be the case in terms of logistical performance. In logistics, formalization improved operating flexibility (and) the achievement of operating efficiency. Efficiency is improved because formal rules and procedures eliminate the need to treat every event as a new decision (1992, p. 76).

Hence, the establishment of formalized logistics programs is thought to have an effect on firm-level logistics program performance (Bowersox et al., 1992).

4. Research hypotheses

The current study explores the following research questions to assess relationships between formalization, liberalized policies, and strategic capabilities and performance within the reverse logistics process:

- (1) Does liberalization of returns policies influence the firm's reverse logistics capabilities?
- (2) Is the development of reverse logistics capabilities associated with reverse logistics performance improvements?
- (3) Does the formalization of the reverse logistics process enhance the development of capabilities or performance improvements?

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