Should Companies Allow Returns of Customised Goods?

By Anton S. Ovchinnikov , INSEAD

Allowing customers to return customised products can be a win-win for both consumers and business.

In the age of mass production, the demand for customisation is increasing. Customers prefer products catered to their individual needs and preferences over standard items – albeit at a cost. Fortunately, recent advances in information technology, advanced manufacturing processes such as robotics and 3D printing, and logistics have enabled firms to customise products at scale at a lower cost.

In the highly competitive sportswear landscape, for instance, Nike and Adidas offer customisable shoes while Puma sells only standard shoes. But even though the two sportswear giants seem to see the value of offering customised goods, their approaches to returns policy differ. At the time of writing, Adidas only allows returns of standard products while Nike accepts returns of both standard and customised products.

Returns of customised products is a tricky problem for businesses in practice. While standard products can be resold, it is usually not the case for customised products. After all, what is stylish to one may be outlandish to another. Moreover, who would buy a pair of sneakers embroidered with another person's name? In such cases, should firms allow returns of customised goods, and if so, under what conditions?

A three-dimensional problem

In deciding whether to allow product returns, dollars and cents matter. Put simply, companies need to balance the cost of product returns versus the potential increase in sales arising from allowing them. And we are not looking at trivial numbers. In the United States, **21 percent of online orders** worth some US$218 billion were returned in 2021, according to the National Retail Federation, up from 18 percent in 2020. In the clothing and shoes category, returns can hit 40 percent. The Covid-19-induced online shopping boom has only amplified the scale of this.

However, while consumers have come to expect lenient returns policies (thanks to the prevalence of online shopping), companies that offer only customised products tend to disallow returns as the value of these products cannot be salvaged. To the company, returned customised goods simply translate to high costs (or a lost cause).

For companies that offer both standard and customised products, the complexity is elevated – not only do they need to consider the prices, costs, demand and returns for standard and customised products separately, but also the interaction between products. These companies face a three-dimensional dilemma: how to coordinate pricing, product line and returns strategies that both increase profits and reduce returns. That is, they need to decide whether to offer standard, customised or a mix of both product types, as well as the respective product returns policies.

In a study on **customisation and returns**, my co-authors* and I developed a joint framework that captures the complexity of this three-dimensional trade-off. By modelling the interactions between standard and customised products, we enable product owners to jointly analyse product line strategy (customised and/or standard) and product returns strategy (allow or disallow returns and whether to impose restocking fees/penalties).

The push-pull effects of customisation

In addressing this three-dimensional problem, we took a consumer behaviour perspective, as opposed to prior studies that mainly focused on price, return refund and demand uncertainty. In a nutshell, consumers seek to maximise satisfaction derived from a product and should they feel dissatisfied by the experience, they would return it.

We examined the question via a model of strategic interactions (called the "Stackelberg game" model) in which the company decides the prices and returns policies for its customised and standard products. In response, consumers decide which product to buy and whether to return the product after experiencing it. Both parties act strategically: consumers consider possible returns in their purchase decisions, while the company incorporates the consumers' anticipated purchase and return response into its pricing and returns policy decisions.

Our findings show that manufacturers and retailers can reduce product returns – surprisingly, by relaxing returns policy of customised products. In general, the case for companies moving towards product customisation is clear: Consumers recognise the value of products tailored to their needs and are willing to pay more for them. By allowing returns of customised products, companies can boost demand by reducing consumers' risks of buying these relatively more expensive products.

For companies that offer a mix of standard and customised products, a more relaxed returns policy acts as a behavioural nudge that not only increases overall demand, but also pushes consumers to switch from standard products to customised ones, which are less likely to be returned. Conversely, should a company implement a no-returns policy for customised products, it pushes customers towards standard products, which are more likely to be returned.

Reducing uncertainty though customisation

Another rationale for companies to offer customised products is to reduce uncertainty. The huge volumes of consumer data generated from online shopping, user subscription and point-of-sale systems have helped companies to build more accurate profiles of their customers and therefore reduce uncertainty in demand.

Yet, while consumer data helps companies know their customers, consumers may sometimes not “know” themselves, especially when making a first purchase in a new product category. This can result in uncertainty in demand and returns behaviour. A **study** based on Nike’s customisable shoes shows that consumers who otherwise “lack precise knowledge of what they want” can “understand their preferences more clearly” through experimentation via a customisation interface.

The process of customisation is thus a journey of self-discovery for consumers. As consumers become more certain of their individual needs and preferences, they are more likely to find the product they customise a better match and are less likely to return it. In fact, companies that offer customised products report a significant reduction in product returns.

Win-win for companies and consumers

From the point of view of consumer behaviour, companies selling standard goods can increase customer satisfaction by offering customised products. To boost demand, they can nudge consumers to purchase these higher-value items by allowing returns.

The organisational barriers to customisation may also be lower than perceived. Our results show that while the addition of customised products would affect demand for the existing standard products, it may not affect the optimal pricing of these existing goods. Companies can also make customisation more feasible by making customised items more salvageable, adopting technology to lower costs, reducing customisation fees and improving the user interface for customers.

Our study shows that a win-win situation is achievable through a smart combination of customisation and returns strategies. If customers could be persuaded to purchase higher-value customised products with lower return rates instead of lower-value standard products with higher return rates, it sure looks like a win-win-win: higher profits, less product returns and more satisfied customers.

**Gökçe Esenduran, Purdue University, and Paolo Letizia, University of Tennessee*

*This article is adapted from “**Why You Should Allow Returns on Customized Products**” published in Harvard Business Review.*

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About the author(s)

Anton S. Ovchinnikov is a Visiting Professor of Decision Sciences as well as Technology and Operations Management at INSEAD. He is also a Distinguished Professor of Management Analytics and the Scotiabank Scholar of Customer Analytics at the Smith School of Business, Queen’s University in Canada.

About the research

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