Return Policy: How Endowment Effect Improve the Effectiveness of Return Policy

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ABSTRACT

The influence of return policies on consumers' behaviour is significant when determining the success of the guidelines. Lenient return policies ensure consumers' rights after purchase behaviour, so they may be more enthusiastic about repurchasing or choosing not to return. The behavioural economic theory, the endowment effect, suggests that consumers may find themselves less determined to make the return decision as time goes by. This is because people are more likely to give the objects they own a higher value. This reviewed article investigated how the endowment effect triggered by return policies manipulates consumers' behaviours and how the strength of the endowment effect is changing due to influence from three dimensions (time, financial refunds, effort). Implications from the analysis can give potential to businesses when making return policies. The key purpose of structuring suitable return policies is to raise aggregate consumption by adopting lenient return policies in different dimensions.

Keywords: *return policy, psychological ownership, affective reaction, endowment effect, time leniency, monetary leniency, effort leniency*

1. INTRODUCTION

In modern society, an increasing number of retailers are providing services for the return or exchange of the product. For example, many US retailers use "no-questions-asked" full refund policy, which can indicate their confidence in the quality and attractiveness of their products—it shows the consumers that they are not afraid of giving greater financial returns, as if they know that not many consumers will return it. So the fact is. Although there may still be a tremendous amount of free-renters, most businesses generally do not fail due to this lenient return policy. Comparatively, in China, especially the e-retailers on Alibaba.com usually only allow a 7-day "no-question-asked" full refund, and the objects returned need to be complete and do not influence the next sale [1]. It seems that the return policy is much more strict in China. Based on the country's situation, including the literacy level, income level and the nature of goods sold, both policies seem to work well for firms from both countries.

The difference in return policies between China and the US mentioned above can be classified into three dimensions. The 7-day restriction in China is an example of a time effect that influence the effectiveness of return policies; the "no-question-asked" and "defective product cannot return" are categorized as effort effect, which measures the complexity of the return process; the full refund is a type of financial return given in the return process. In this article, these three dimensions will be discussed, introducing how they affect the return rate and purchase rate, therefore benefiting the business. Besides, implications and suggestions on returned policy setting strategies will also be mentioned.

The returned policy used by businesses attempts to maximize their profit as a final goal. Moorthy and Srinivasan [2] suggested that the lenient policies in every dimension mentioned above can represent a good quality of the products, which can help build an excellent brand image and raise customer loyalty. The retailers try to use the endowment effect produced to manipulate consumers' return and purchase behaviours.

The endowment effect is one of the most renowned findings in behavioural economics. It reveals that individuals are more inclined to value an object they own higher; usually, it will be higher than its market value. Knetsch [3] is the first person who raised the 'endowment effect 'demonstration, in which most subjects chose to randomly assign their objects as opposed to trading them for others' objects. Since then, many economists have

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done numerous studies to check to what extent can the negative results caused by this effect be eliminated or at least reduced. There are recent findings illustrate that among market-experienced subjects[4], lab subjects who are required to trade[5], or within particular experimental processes[6], this effect has the possibility of shrinking or disappearing. Köszegi and Rabin [7] also raised one specific scenario where the endowment effect and be eliminated- reference points are given by expectations alone. This suggestion had become an essential wave in the development of the endowment effect theory.

In this reviewed article, psychological ownership and affective reactions are going to be investigated as two representative factors that trigger the presence of the endowment effect. Psychological ownership, take it literally, is the feeling that something belongs to oneself [8]. It is able to pretence independently from legal ownership—this means that without having the legal ownership of a particular good, for instance, before actually purchasing the goods, psychological ownership can still exist and catalyses the strength of the endowment effect. Affective reactions are defined as emotional reactions such as pleasure, arousal or hatred. Pleasure and arousal are two emotions that make the return policies more effective, and they are the emotions that the sellers wish the consumers to have. Further explanation and how these two factors (psychological ownership and affective reactions) are going to be discussed in the following section.

2. HOW ENDOWMENT EFFECT MANIPULATES CONSUMERS ' BEHAVIOR

2.1 Psychological ownership

In daily consumption, the consumers may not always have legal ownership of certain products. However, they may still consider these objects as their own properties—this circumstance exists when psychological ownership establish. Psychological ownership is characterized as the feeling that something belongs to oneself [8]. When people are touching, watching or even just imagining the goods in their mind before they purchase certain products, they could still have a sense of ownership, although they have not become the legal owners yet [9,10].

Applying this effect to the policy in question—the return policy, the consumers are inclined to produce a sense of ownership when they hold the products. Although they knew that they had the chance to return and get refunds, they would value the things they once owned more highly due to the presence of psychological ownership. Thereby they would be reluctant to return them back[1].

The strength of psychological ownership can be determined by various restrictive factors. For example, Davis, Hagerty, and Gerstner[11] mentioned that receipts or original packages required for return, the objected returned (cash or exchanges), the visible signs of use allowed, as well as the time limits can all influence individuals 'return behaviour. Heiman, McWilliams, and Zilberman[12] cited similar dimensions in their research. How these influential factors manipulates consumers' behaviors and benefits the retailers will be analysed in the section 3 of this review article.

2.2 Affective reaction

The affective reaction is another factor that triggers the endowment effect to exist. Consumers' affective reaction can be categorized into two aspects: pleasure and arousal [13]. Here pleasure is clarified as the degree of consumers' joy and happiness, while arousal is defined as how excited the consumers feel [14].

Scherer[15] reveals that affective reactions such as emotions can influence a consumer's post-purchase decision, for example, maintenance and loss. The consumers' loyalty and satisfaction would be changed ultimately[13]. The changes in these psychological dimensions can influence the consumers' willingness to return the products they purchased. Usually, the more negative emotions and responses the consumers have, they are less inclined to keep and maintain the product[16], after which they are more likely to return the things they purchased.

3. FACTORS THAT INFLUENCED THE RETURN DECISIONS

3.1 Time

Most retailers will clarify deadlines for return—after which consumers can no longer return or change the products they already purchased. Return policies that have loosened time limitations before returning are regarded as more lenient [17]. In conventional endowment effect experiments, the results often show that the sense of ownership, a catalyst of the endowment effect, is created almost immediately with the receipt of the object, and it continues to be strengthened as time goes by [18].

People who have owned the object for a longer time will value it more compared to those who only possessed it for a short time. Researchers [17,19] also found that more extended deadlines for returning can increase the endowment effect, after which the consumers may choose to postpone or delay their return decisions. The meta-analysis carried out by Janakiraman and Ordón˜ez [17]also suggests that time as a factor has a positive correlation with the purchase proclivity, i.e. as the returned deadline is more extended, the consumers will have a higher tendency to consume this object. Meanwhile, the time negatively correlates with the return proclivity, which means that the more extended return deadlines are more likely to result in a lower tendency to return the product.

It is suggested that the strength of ownership is very likely to increase over time[20]. When there is no endowment effect, the consumers may need more time to consider whether to keep or return the product [1] based on objective deliberation. However, when the endowment effect exists, they become very likely to take a shorter deliberation time because of the sense of ownership created during the time they possessed the objects. Wang also suggested that giving a loosened time limit on the return process is going to support the object's high quality. Even after receiving the products, this impression may still affect their judgements: people are more inclined to keep high-quality products. The results of Wood's [21] experiment also give support to the hypothesis that more extended deadlines for return will increase the likelihood of consumption as it shortens the deliberation time in the purchase process.

3.2 Actual Financial return

The measures of return also varied between different retailers, especially when consumers are shopping online. When discussing monetary leniency, a return with a full financial refund is classified as a loosened returned policy. In contrast, policies that require consumers to take charge of fees for shipping or taxes are known as strict return policies, after which the consumers can only get part of the purchase price [17].

Wang. X [1] also defined the lenient returned policies as giving consumers a money-back guarantee. According to the study conducted by Moorthy and Srinivasan [2], lenient policies can represent the good quality of the products. As long as the transaction cost in the return process cannot be eliminated, the manufacturers and retailers may also be less inclined to offer loosened policies [1]—imaging the goods only worth 4 dollars and the cost for return is 8 dollars. Definitely no one wants to continue this money-losing business. This can also give the consumers good impressions and reduce the level of negative affective reactions, thereby increasing the endowment effect even before they actually receive the objects and eventually lowering the rate of return. In the general consumption model, consumers are more inclined to hold the goods whose valuation is higher than the refund. Under this assumption, a higher refund can lead to a higher return rate as well. [22]

3.3 Return restrictions

The retailers often create a series of barriers to the return process. For instance, they usually require consumers to provide receipts, tags or the original package if they want to return or change the objects they purchased. This is actually how the retailers attempt to avoid the full or partial financial return[22]. As a result, the consumers need the effort to return the objects, and the return policies which require less effort are classified as a more lenient one [17]. Janakiraman and Ordóñez's research also finds out that consumers are sensitive to the return restriction when they are in the purchase stage—they would consider the difficulties of return in the future beforehand, and thereby their purchase and post-purchase decision would be influenced by this consideration.

Intellectual property (i.e. effort spent when making decisions) can trigger the existence of the endowment effect. Especially when some effort has been put into the obtain process of a particular object, the endowment effect can be exacerbated due to the influence of effort spent[23]. In return behaviours, if the consumers need to keep all those evidence(receipts, tags, etc.) carefully or make sure the goods are still functioning properly as the requirements for return, they have already spent a lot of effort taking care of this specific object and the other evidence related to it. Under this situation, the endowment effect is even exaggerated compared to simply obtaining this artefact without considering a return.

4. IMPLICATIONS OF MARKETING STRATEGY

4.1 Adjust the time limits for return

Huseyn, Ketzenberg, and Abbey[24] also suggested that retailers who follow a more time lenient return policy have a higher probability of earning more legitimate profit as well as more opportunistic return, especially when the price of products sold are below a certain threshold. They suggested that people are less likely to return if the products are already relatively cheap—the time and effort cost in the return process may be even higher than the final financial return they received. The authors also point out that the optimal return deadlines should obtain consideration about the product life-cycle. Generally, products with shorter life expectancy can be returned by a tentative date (if they break down within a relatively short time, it may be hard to justify a properly fixed return date—the objects may already be broken before the date set by the retailers, which no doubt increase its cost), whereas it is more reasonable to give a specific decline of return for those products with longer life expectancy. Besides, for products whose return rates in the past are already low, retailers can also choose to obtain indefinite return deadlines. [25]

In order to maximize profit, a more extended deadline may help a lot. An ideal situation is where the consumer is reluctant to return the goods as soon as they receive them. Thereby there is no need for the manager to worried about the retune-related process and consequences[1]. For the retailers, they can both lower the cost of return products (maybe defective during operation or transportation) and increase the sales of high-quality-imaged products, thereby maximize their profits.

However, they may still have some problems. For instance, if some customers still choose to return the products and the end of extended deadlines, the products may have already defected, which can increase the retailer's cost as a result. To overcome these conflicts, the retailers can change this strategy due to the economic environment and the kind of products they are actually selling. For example, e-retailers in China usually allow a 7-day restriction as to their return policy[1]. Based on the lower cost of transportation in China, these retailers are unlikely to fail in this return process—except for some deprived areas this policy does not cover. This can also be clarified by the adjustment due to the real-life setting.

4.2 Adjust the amount of money return

As mentioned above, a monetary lenient product is very likely to increase consumption because the more financial return may represent the products' higher quality—it seems that the sellers are more confident with their products as most people may not choose to return. However, a full financial refund may have concerns such as the "free-riders". Those people used the monetary lenient policies deliberately, using the products for some time and then returning them with a fabricated reason, which means they used this product with no rent [22].

Davis et al.[26] suggested that if the retailers can benefit from accepting the application for return is more than the cost for consumers to return the products, and the retailer should accept the return request. The benefit earned from these returns can be a good brand image, higher customer loyalty, and thereby increased the demand for the particular product, leading to higher revenue and profit. Especially if the quality of the product is not easy to justify, the retailers need to be more monetary lenient (i.e. more financial refund), which can show its high quality successfully.

However, for those retailers who sell low-price products, a full financial refund can be too costly [22]. Like other factors, the amount of money returned still depends on reality.

4.3 Adjust the effort required to return

According to the research [17], it is said that future return restriction is one of the most significant factors consumers pay attention to when they are purchasing the objects, and those with more straightforward return requirements can increase their consumption to some extent. In the presence of the endowment effect, one of the critical catalysts is affective emotion. Zhou, Wenyan; Hinz, Oliver; Benlian, and Alexander [13] also mentioned in their research that retailers should pay more attention to the emotions of consumers—generally more pleasant the consumers are, the higher probability they are going to purchase the products.

The effort lenient return policies mean that the consumers do not need to take good care of the accessory objects such as tags and receipts, which means that they can be more relaxed when utilizing the objects with a higher level of happiness and pleasure. However, with the data provided in Janakiraman's study, the return policies with higher effort leniency seem to increase the probability of consumption only, while the customers' return behaviour would not reduce [17].

5. CONCLUSION

This review article summarizes the mechanism of the endowment effect from two respects: psychological ownership and affective reaction. The three leniencies questioned in this article—time leniency, monetary leniency and effort leniency are all trying to extend or magnify the strength of the endowment effect through manipulations of these two factors. From a business perspective, the use of a return policy contributes to the higher revenue and profit for the business, either by lower the cost of return or raising the aggregate demand for the products they sell. To summarize, the time leniency, which strengthens the endowment effect by increasing the level of psychological ownership over time, is attributed to lower return rates. While the monetary and effort leniency, which both indicate the better qualities and release some pressure on consumers, are more inclined to boost total consumption since they provide more positive and relaxed affective reactions in the information grabbing sections.

The implications of how to set an appropriate return policy can be extracted from these three leniencies. In most circumstances, if the retailers choose to loosen the deadlines for returns, give as many financial refunds as they can pay without facing a loss, and set fewer barriers, all examples of lenient returned policy. Consumers are more likely to obtain positive emotions and feelings if they do not need to keep the goods on tenterhooks, worrying about how to keep all the purchase evidence neat and safe in case they want to return it sometime in the future. Usually, it is not possible to fulfil all three dimensions in one business—there will always be unexpected costs, and firms should make themselves break even. Free-renters when businesses are offering more lenient monetary return policies, defective goods returned by consumers after a long period bring extra costs to the firms, as well as frauds using objects from other retailers to ask for financial return without receipts to prove the source of goods. In reality, lenient return policies may cause more complex problems.

Nevertheless, the return policies still need to focus on the specific situation. For instance, many fruit sellers also implement return policy as their marketing strategies. They advertise that “unpalatable fruit is for free” and give the consumers financial return as placebo. For fruit that has already rotten or eaten, there is neither need and possibility for the consumers to return these perishable goods back to the sellers. What the return policy makers need to consider include the culture difference in the region the goods are selling in, the government interventions such as rules and regulations set on return policies as well.

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