# II. Study 1: The Paper Deal

Before exploring the possibility that reputational forces drive sellers to systematically deviate from the paper deal in favor of consumers, Study 1 investigates whether reputational considerations can incentivize sellers to offer better terms on paper.

This study focuses on two sets of questions. First, it explores whether retail sellers’ return policies vary in ways that allow consumers to engage in meaningful comparison shopping for better terms. Second, it explores the possible determinants of the contents of retail stores’ return policies. While few studies have documented a meaningful degree of variation within consumer contracts in several markets, the determinants of said variation remain generally under-explored. In particular, except for limited evidence that a few salient contract terms (e.g., warranty provisions) are correlated with product prices,[[1]](#footnote-1) this author is not familiar with studies that find correlation between contract and product quality. This study is targeted at exploring whether, all else equal, reputational concerns drive more luxurious and established stores to offer more generous return policies, either as a signal of product quality or in order to meet their customers’ expectations.[[2]](#footnote-2)

## Do Return Policies Vary across Stores?

Do the terms of standardized agreements in consumer markets vary across sellers? Preliminary evidence suggests that, at least in the contexts of software license agreements, residential leases, and insurance policies, contract terms vary across sellers to a non-negligible degree. Studies have shown that these contracts often deviate from the governing regulatory frameworks (whether they take the form of default rules, mandatory regulations, or third-party guidelines) in the direction of the seller.[[3]](#footnote-3) The evidence suggests that the terms of these contracts vary, but that the observed variation is largely the result of systematic deviations towards more one-sided, pro-seller terms, compared to the regulatory benchmark.

The question that arises is therefore whether—absent regulation, market forces (namely competition and reputation) could be trusted to ensure variation in the terms of standardized agreements across sellers. On one view, we should not expect such variation to persist. Consumers do not read or pay attention to contract terms, hence sellers have no incentive to vary these terms. In view of these informational asymmetries we should expect to see only “lemon-type”, one-sided, terms in consumer contracts. On this view, even in perfectly competitive markets we should find almost no variation in the contents of standardized agreements, since sellers compete over the perceived price rather than on unread contract terms.[[4]](#footnote-4) On another account, however, (in competitive markets) we should expect to see variation in contracts, at least with respect to terms that are important to consumers, since some consumers will be willing to pay higher prices for better contract terms. Yet, with narrow exceptions,[[5]](#footnote-5) evidence that competitive forces can sufficiently discipline sellers from using uniformly one-sided terms is scarce.

This study contributes to the literature by exploring the extent that return policies vary across sellers, even within the same product market. This research is timely in view of the ongoing regulatory debate surrounding the need to regulate consumers’ withdrawal rights. Currently, in the U.S. there are almost no background rules governing consumers’ rights to return non-defective goods to stores.[[6]](#footnote-6) A consumer’s default contract with a retail seller is *caveat emptor*, and consumers have no right to return items to the seller unless the seller’s contract specifies otherwise. Against this legal backdrop, scholars and policymakers continuously debate the desirability of regulating consumers’ rights to cancel transactions. While some have proposed adopting either a mandatory or a default right to withdraw,[[7]](#footnote-7) others believe that statutory intervention may not be warranted due to market incentives already in place.[[8]](#footnote-8) This research sheds light on the ability of market incentives to ensure that sellers offer varying policies terms to consumers, thereby enabling them to comparison shop for better contract terms.

### Sample & Methodology

The sample consists of 169 clothing retail and general merchandize stores operating in Chicago at the time of data collection. Sixty-four percent of the stores in the sample are national retail chains and 36% are local stores.[[9]](#footnote-9) The list of national chain stores was compiled using business research and reference tools, including ReferenceUSA and Hoover’s Company Directories’ databases, as well as publicly available sources like Wikipedia.[[10]](#footnote-10) All of these firms do business in the U.S., while some also have operations overseas.[[11]](#footnote-11) The list of non-chain stores was compiled using Chicago shopping websites and directories.[[12]](#footnote-12) The market share reports generated by IBISWorld were used to confirm that the sample includes the top clothing retail stores operating in Chicago.

Table 1 reports basic summary statistics of the characteristics of the companies in the sample, including annual revenues (based on the 2018 fiscal year) and age (defined as 2019 minus the year of incorporation or founding). Mean annual revenues are $290 million. The average company age is 53 years, but the sample includes both younger firms and long-established companies (age ranges from 4 to 201 years). Publicly traded firms make up 50% of the sample.

*Table 1. Retail Stores’ Summary Statistics*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Mean  (SD) | Min | Median | Max |
| Annual Revenue (millions of $) | 290 | 0.006 | 1 | 16,702 |
| Age (years since incorporation) | 52.5 | 4 | 41 | 201 |
| Number of Employees | 20,029 | 2 | 3,700 | 360,000 |

### Note: Firm data, including revenue, public versus private status, and years since incorporation, were obtained primarily from Bloomberg Law and Hoover’s Company Directories’ databases. Age refers to the number of years since incorporation, and size refers to number of employees as of 2019.

In order to study variation across return policies, a database of the sampled stores’ return policies, as posted on their websites, in-store signs, and receipts, was established.[[13]](#footnote-13) The sampled stores’ return policies were then read and coded by two law students according to the author’s detailed coding instructions.[[14]](#footnote-14)

### In order to test for variation in the contents and leniency of the sampled return policies, a simple index was constructed.[[15]](#footnote-15) In developing the return policy leniency index, this author relied on existing marketing research on return policies.[[16]](#footnote-16) Although existing studies significantly vary in how they measure return policy leniency, they typically include the same main classifications.[[17]](#footnote-17) Taking these classifications into account, the index used in this study analyzes and grades the sampled return policies according to thirteen dimensions, which are grouped into four categories: money, effort, time, and scope.

### The first category is *money leniency*. While some retailers offer cash refunds, others offer store credit or product exchange for the returned item. Return policies that allow cash refunds are considered more lenient than those that limit returns to store credit or exchange. The second category is *effort leniency.* Retailers vary in the hassles they impose on consumers seeking to return goods. For example, some require consumers to show original receipts, only accept returns of items with tags attached or in their original packaging, and so forth. Return policies requiring less effort from consumers are considered, all else equal, more lenient than policies that require more effort in order to return a product successfully to the store. The third category, *time leniency*, refers to the length of time in which consumers are entitled to return non-defective products to the store. Retailers commonly specify deadlines (such as a 30-day time limit) for returns in their return policies. All else equal, return policies that provide a longer length of time in which to return products are regarded as more lenient.[[18]](#footnote-18) The fourth category is *scope leniency*. Importantly, the scope of retailers’ return policies may vary across several dimensions. For example, stores may limit the types of items that are eligible for returns, allow themselves the discretion to refuse, deny, or limit returns, and so forth.[[19]](#footnote-19)

### Across all categories, the sampled policies were given a score of “-1”, “0”, or “+1” in thirteen dimensions, where a “+1” score reflects a lenient policy term, a “-1” score indicates a more stringent policy term, and a score of “0” means that the policy was silent on that dimension. Table 2 lists all the categories and dimensions being tracked and describes how each is graded in detail.

*Table 2: Leniency Score Index*

|  |  |  |
| --- | --- | --- |
| **Category** | **Issue** | **Coding Instructions** |
| **Exchange Leniency** | 1. Is cash refund allowed? | Yes = 1  No (exchange/credit only or no returns) = -1 |
| **Time Leniency** | 1. What is the return period length? | Longer than 60 days (including lifetime guarantees) = 1  The standard (30-60 days) market norm[[20]](#footnote-20) = 0  Shorter than 30 days (including no returns) = -1 |
| **Effort Leniency** | 1. Is receipt required? | Yes = - 1  No = 1 |
| 1. Does item have to be in original packaging in order to be returned? | Yes = -1  No mention = 0 |
| 1. Does item have to be with tags attached in order to be returned? | Yes = -1  No mention = 0 |
| **Scope Leniency** | 1. Can defective/damaged products be returned? | Yes = 1  No mention = 0 |
| 1. Are final sale/ “as is”/ clearance items eligible for returns? | Yes (sale items are eligible) = 1  No Mention = 0  No = -1 |
| 1. Are gifts (accompanied by gift receipts) eligible for a refund? | Yes = 1  No Mention = 0  No = -1 |
| 1. Are gift cards refundable? | Yes (gift cards are refundable) = 1  No Mention = 0  No (only eligible for store credit/exchange) = -1 |
| 1. What is the outcome of non-receipted returns? | Returns not accepted = -1  No Mention = 0  Returns Accepted (for exchange/store credit) = 1 |
| 1. What is the outcome of post-period returns? | Returns not accepted = -1  No Mention = 0  Returns Accepted (for exchange/store credit) = 1 |
| 1. Can the store refuse, deny or limit returns at its discretion? | Yes = -1  No = 1 |
| 1. Is price adjustment allowed? | Yes = 1  No = -1 |

Once all the thirteen dimensions were graded in this manner, the grades were added to form an overall leniency score for each retailer. This is, of course, a rough and simplistic measure of retailers’ return policies’ leniency. Admittedly, while some variables are undoubtedly more important to consumers than others, this grading method assigns the same weight to all of them. Yet, this method was chosen as it is more parsimonious and requires only a minimal degree of coding discretion.[[21]](#footnote-21)

### Results

The results reveal a wide variation in return policy leniency across stores, even within the same product market (clothing). Figure 1 shows the distribution of the overall leniency score. As constructed, the maximum attainable overall leniency score is +13 (which would reflect a policy allowing for cash refunds, providing a lengthy return period, allowing for non-receipted returns, and so on), and the minimum attainable score is -13 (which would reflect a policy denying cash refunds, providing a short return period, refusing to accept non-receipted returns, and so on).

As the figure shows, although none of the sampled policies reaches the two extremes, the degree of return policies’ leniency varies considerably across stores. Leniency scores range between -7 and +3 (with a median of -1, a mean of -1.06 and a standard deviation of 2.15).[[22]](#footnote-22)



*Figure 1: Variation in Leniency Score across Return Policies*

The sampled return policies varied considerably across the four leniency dimensions. In terms of *time leniency,* return periods range from 10 days to a lifetime guarantee. The mean return period is 55 days and the median is 37.5 days.[[23]](#footnote-23)



*Figure 2: Distribution of Return Periods across Policies*. This figure shows the variation in return period length across stores. Stores with a lifetime guarantee (n = 2) were excluded from the figure.

In terms of money leniency, 81% of the sampled stores explicitly allowed for cash refund (provided that the consumer meets the specified return requirements), while 17% of the stores only allowed for exchange or store credit, and 2% of the stores did not mention whether refund is allowed or not.

In terms of effort leniency, 84% of the stores required a receipt to make the returns, 52% required that the item be returned in its original packaging or with tags attached, and 78% required that the item be returned unused.

In terms of scope leniency, 33% of the stores explicitly accepted returns of defective products, while 1% explicitly refused to accept such products; 45% stipulate that sale, “as is,” or clearance items are not eligible for returns, while 4% explicitly allow customers to return such items; 36% refuse to provide a cash refund in case the customer returns a gift, and only 11% explicitly allow for a refund in this case; 4% allow customers to return a gift card for a refund, while 25% explicitly deny refunds in these cases. In terms of discretion to refuse returns, 34% of the stores explicitly stipulate that the store can deny or limit returns at its sole discretion. Finally, 40% of stores allow consumers to obtain a partial refund of the purchase price of an item if it is sold for a lower price within a designated time period, while the remaining 60% do not allow for price adjustments.

To sum, the findings reveal that stores significantly vary in the terms of the return policies they offer on paper. While some offer extremely generous return policies, including lifetime “money back” guarantees and “no hassle” returns, others offer considerably harsh policies, including policies that strictly deny refunds, require receipts for any return or exchange, and allow for a very short return window.

What could explain the observed variation? The next section turns to explore this question.

## What Determines the Observed Variation across Policies?

This section explores potential drivers of variation across return policies. In particular, it explores whether older, more established, and more luxurious stores are more likely to offer better policy terms than younger and more casual stores, and whether chain stores are more likely to offer better terms than local stores.

The study hypothesized that, all else equal, reputational forces will drive luxury stores to offer better terms to consumers, compared to more casual—mainstream and discount stores. There are two main reasons for this prediction. First, retailers’ return policies might serve as a signaling mechanism, enabling more experienced and higher-end stores to credibly signal product quality through a generous return policy.[[24]](#footnote-24) Second, luxury stores may seek to cater to their consumers’ expectations, and customers who buy items from luxury sellers may expect to be treated leniently when making returns. While luxury stores’ reputation may build on the quality of both their products and their policy terms, discount and bargain stores’ reputation is for supplying products for lower prices. Therefore, they are expected to adopt harsher return policies. In addition, lower-end stores typically incur higher process costs and their items have low salvage values associated with returns.

Similarly, the study predicted that larger, older, and chain stores—that typically incur lower depreciation costs and are more easily able to resell non-defective items or return them to the supplier—would generally offer more lenient return policies to consumers, than smaller, younger, and local stores.

### Methodology

In order to explore the potential drivers of variation in return policy leniency across stores, a series of multivariate regressions was conducted. The overall leniency index score was used as the dependent variable in these regressions, and the explanatory variables were the following store characteristics:

*(1) Luxuriousness*—Stores were classified as discount, mainstream, or luxury stores based on the median prices of clothing items posted on their websites.[[25]](#footnote-25) Discount stores are defined as all stores whose items’ median prices were in the lower 25th percentile (i.e., lower than $26). Mainstream stores are defined as all stores whose median prices were between the 25th and 75th percentile (i.e., between $26 and $70), and luxury stores are defined as all stores whose median prices were in the upper 25th percentile (i.e., between $70 and $450).

*(2) Organizational Structure*—whether the store is local (defined as a store that has less than three locations, all in Illinois) or part of a chain.

(3) *Experience/Age*—as proxied by years since establishment.

(4) *Size*—as proxied by annual revenues.

### Results

The results reveal that return policies’ leniency scores are significantly correlated with store quality (across all three specifications). Luxury stores score, on average, one point higher on the leniency scale than do mainstream stores; and mainstream stores score, on average, 0.8 points higher than do discount stores. Table 2 shows that, as expected, higher-end stores offer, on average, more lenient return policies to their customers. Older and (controlling for age) smaller stores also offer more lenient return policies to their customers.

*Table 3. Regressions of Leniency Score on Store Characteristics*

[table to be added]

These findings inform the debate on the need to regulate consumers’ withdrawal rights. They provide support for the proposition that competitive forces incentivize sellers to compete over the terms of their return policies, and not only on product quality and price. This is because return policy terms are *salient* to consumers, not only ex post, but also *ex ante.* Since sellers recognize that overly harsh policies might discourage consumers from shopping at their stores, they are often willing to bear the high processing and depreciation costs associated with product returns.

These results should be interpreted with caution, however. While the terms of a seller’s return policy are important and salient to consumers, the majority of the terms that consumers encounter are not nearly as salient, at least at the *ex ante*—pre-purchasestage. Take choice of forum clauses or arbitration provisions, for example. In most types of contracts, these clauses are unlikely to affect consumers’ contracting decisions. Consequently, even competitive forces (such as reputation) are unlikely to discipline sellers from inserting one-sided choice of law or forum clauses into their contracts. And indeed, for terms about which most consumers do not care, there is simply no evidence of market impact whatsoever.[[26]](#footnote-26)

Therefore, the results of the current study should not be interpreted as offering support for the proposition that sellers compete over all contract terms, even non-salient clauses that largely go unnoticed by consumers at the time of entering the transaction. Rather, the results could be taken to suggest that when terms are *salient* to consumers, such that they might impact their purchasing decisions, sellers will refrain from using uniformly one-sided terms. The results show that some consumers are willing to pay more for better terms, and therefore better terms are offered in the market.

Importantly, luxury stores (and more experienced stores) offer significantly better terms than less luxurious, more mainstream or discount stores. These results suggest that sellers may use contract terms, such as withdrawal rights, to signal product quality. These findings are consistent with previous literature suggesting that generous warranties might be used to signal product quality.

More importantly, these findings indicate that contract quality is positively correlated with product quality. This, in turn, may indicate that, at least in the context of return policies, consumers value contract terms and are willing to pay more for better terms; and that sellers respond to consumers’ preferences by providing better terms.

1. *See, e.g.,* Yair Listokin; Marotta-Wurgler, What’s in a Standard Form Contract, at 710 (finding no correlation between product prices and their contracts’ overall one-sidedness in the context of software license agreements. The only terms that were significantly correlated with price were warranty provisions). [↑](#footnote-ref-1)
2. While research on the relationship between retail stores’ characteristics and return policy leniency is scarce, there is evidence that lenient return policies enhance consumers’ quality perceptions of the product. See, e.g., Wood, Stacy L. (2001), “Remote Purchase Environments: The Influence of Return Policy Leniency on Two-Stage Decision Processes,” Journal of Marketing Research, 38 (2), 157–69*.* [↑](#footnote-ref-2)
3. Marotta-Wurgler, 2007; Schwartz, 2011; Marotta-Wurgler JLS Privacy study and other Privacy Paper; Furth-Matzkin 2017. [↑](#footnote-ref-3)
4. *See, e.g.,* Bar-Gill, 2012; Ben-Shahar & Schneider, 2014. [↑](#footnote-ref-4)
5. For notable exception see Wurgler’s JLS privacy study (finding that “elementary competitive forces are having a more detectable impact” on the terms offered by privacy policies, while acknowledging that “there remains a great deal of unexplained variation in privacy terms for future work to address.” [↑](#footnote-ref-5)
6. [explain what does exist]. [↑](#footnote-ref-6)
7. *See, e.g.*, Omri Ben-Shahar & Eric A. Posner, “The Right to Withdraw in Contract Law,” 40 J. Legal Stud. 115, 139–40 (2011) (advocating for a default right to withdraw); Zamir & Teichman, at 292 (discussing the desirability of regulating the right to withdraw from a behaviorally informed perspective, and suggesting that “[a]t the very least, contract terms that unreasonably raise the costs of exercising the return option appear to warrant regulation.”); *see also* Shmuel I.Becher & Tal Z. Zarsky, “Open Doors, Trap Doors, and the Law,” 74 L. & Contemp. Probs. 63, 63–64, 89 (2011) (suggesting that regulators who embrace “the open door dynamic”—i.e., those who promote mandatory or default rights of withdrawal—may misunderstand “crucial elements” of consumer psychology that explain consumers’ reluctance or inability to invoke those rights in practice); Jeff Sovern, “Toward a New Model of Consumer Protection: The Problem of Inflated Transaction Costs,” 47 Wm. & Mary L. Rev. 1635 (2006) (arguing that sellers are often financially incentivized to inflate—rather than reduce—consumer transaction costs). [↑](#footnote-ref-7)
8. *See, e.g.*, Jan M. Smits, “Rethinking the Usefulness of Mandatory Rights of Withdrawal in Consumer Contract Law: The Right to Change Your Mind?” 29 Penn. State Int’l L. Rev. 671, 678–83 (2011) (questioning the utility of imposing mandatory withdrawal rights, due to their ability to undermine sellers’ incentives to grant withdrawal rights anyway for the purposes of “creating trust and attracting consumers”). [↑](#footnote-ref-8)
9. This generally reflects the market share division between local and chain stores in Chicago. The most current study has found that individual retailers control about 30% of the market share. See, <https://www.forbes.com/sites/nicoleleinbachreyhle/2014/07/03/celebrating-independent-retailers-their-strong-future/> and <http://nebula.wsimg.com/f42d4bd0ae82451a25f78cdd23abbb9d?AccessKeyId=8E410A17553441C49302&disposition=0&alloworigin=1> [↑](#footnote-ref-9)
10. *See* “Clothing Retailers of the United States,” Wikipedia (n.d.), available at https://en.wikipedia.org/w/index.php?title=Category:Clothing\_retailers\_of\_the\_United\_States&pageuntil=Rocawear#mw-pages (last accessed Mar. 12, 2019). [↑](#footnote-ref-10)
11. Stores that did not have a Chicago location were excluded from the sample, since receipts and in-store signs could not be collected from stores outside of Chicago. [↑](#footnote-ref-11)
12. See, e.g., Frommers, “The Top Shopping Streets & Neighborhoods in Chicago,” Frommers Media, LLC (2019), available at https://www.frommers.com/destinations/chicago/the-top-shopping-streets--neighborhoods (last accessed July 10, 2019). [↑](#footnote-ref-12)
13. For the purpose of documenting in-store signs and receipts, research assistants (“RAs”) were sent to the sampled stores. Each store was audited by two RAs. The RAs were instructed to look for a return policy sign and take a clear photo of any sign they managed to locate. Subsequently, they purchased a clothing item or accessory in each store and scanned the receipt. Immediately upon leaving the store, the RAs completed a form reporting whether they had observed a sign describing the store’s return policy, how difficult it was to find the sign (on a 5-item scale, from “very easy” to “very difficult”), and how large the font of the return policy sign was (on a 5-item scale, from “very small” to “very large”). The two responses were then averaged, and the average ranking was used for coding purposes. They also classified the store as discount, mainstream, or luxury, and the overall prices of the items in the store (on a 5-item scale, from “very cheap” to “very expensive”), based on their overall impressions. The survey form that the RAs completed is provided in full in Appendix 1. [↑](#footnote-ref-13)
14. The coders first noted, for each store, whether its policy was posted on its website, the back of the receipt, an in-store sign, or a combination thereof. Some stores (n = 3) only contained information regarding their *online* return policies on their websites. In these cases, coders were instructed to code the store’s return policy based on the information provided on the in-store sign and receipt only. If there were any discrepancies between informational sources, coders were instructed to note these discrepancies. Any inter-coder discrepancies were resolved either by a third law student or by the author. Cohen’s kappa measure of integrated disparities is \_\_\_. [↑](#footnote-ref-14)
15. For a similar index in the context of EULAs, see Florencia Marotta-Wurgler, “What’s in a Standard Form Contract,” 4 J. Empirical Legal Stud. 677 (2007). [↑](#footnote-ref-15)
16. For a meta-analytic review of this literature see Janakiraman, Syrdal, & Freling, *supra* note 14, at 228 (this review classifies return policy leniency as varying along five main dimensions: time leniency, monetary leniency, effort leniency, scope leniency, and exchange leniency). For similar classifications and typologies, see also Suwelack & Kraft, *supra* note 14; Davis, Hagerty, & Gerstner, *supra* note 14. Existing marketing research is mainly targeted at exploring the relationships between return policy leniency and consumer purchase and return decisions. [↑](#footnote-ref-16)
17. Copy from effect study p 228 – typology section the two other studies and their classifications [↑](#footnote-ref-17)
18. *See, e.g.*,Janakiraman, Syrdal, & Freling, *supra* note 14, at 228; Davis, Hagerty, & Gerstner, *supra* note 14; Amir Heiman, Bruce McWilliams, & David Zilberman, “Demonstrations and Money-back Guarantees: Market Mechanisms to Reduce Uncertainty,” 54 J. Business Res. 71 (2001). [↑](#footnote-ref-18)
19. In such circumstances, some retailers promise to refund the difference between the price the consumer paid and the price in which the product is being sold. [↑](#footnote-ref-19)
20. For marketing literature treating the “30 days” period as the prevailing market norm in the clothing retail industry, see, *e.g.*, Anderson & Simester, *The Option Value of Returns: Theory and Empirical Evidence,* Marketing Science (2009). [↑](#footnote-ref-20)
21. For a discussion of the strength and limitations of this coding method, seeDaniel Schwarcz, “Reevaluating Standardized Insurance Policies,” 78 U. Chi. L. Rev. 1263 (2011); Zamir & Farkash, *supra* note 13. [↑](#footnote-ref-21)
22. There is no legal nor normative benchmark, so the fact that the mean is negative does not necessarily mean that return policies are skewed in favor of the seller. The findings should only be interpreted as suggesting that there is variation (albeit limited) in return policies across stores. [↑](#footnote-ref-22)
23. Stores whose policies did not mention any time limit on returns (n = 5) or whose receipts and websites mentioned different return periods (n = 5) were excluded from this analysis. Stores that offered a lifetime guarantee (n = 2) were also excluded for the purposes of computing the mean return period. [↑](#footnote-ref-23)
24. The signaling literature typically focuses on warranty terms as a signaling mechanisms, but recent marketing literature provides evidence that return policies affect consumers’ quality and price perceptions. See, e.g., Wood; Hansen & Simester, at 3. [↑](#footnote-ref-24)
25. Python was used to scrape the stores’ websites. Some stores blocked access to their websites, and were therefore manually coded. [explain how the median price calculation was done]. [↑](#footnote-ref-25)
26. See, e.g., Eyal Zamir, Contract Law and Theory: Three Views of the Cathedral, 81 U. Chi. L. Rev. 2077, 2102-05 (2014). [↑](#footnote-ref-26)