Enabling Efficient Chargeback Management in Wholesale Distribution
For Improved Gross Margins
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Industry data confirms that roughly 40% of distributors’ profit is now based on vendor cost recovery programs. Chargebacks, then, are essential to doing business today. But these programs come in different shapes and sizes, and there’s no question that they can be inefficient and costly to manage. What if distributors could find a way to manage chargeback programs efficiently and effectively, reducing operating expenses? What if leakage related to errors and missed opportunities were eliminated, reducing cost of goods sold?
Vendor cost recovery programs in the wholesale distribution industry are growing more complex and sophisticated. Multiple parties are involved in the process, including distributors, manufacturers, customers, and group purchasing organizations or buying groups. Additionally, the volume of transactions being driven through these programs is rising rapidly.

Many of these programs are managed in silos outside the central business system, using either spreadsheets or point solutions. Consequently, they can be extremely challenging to view within the overall context of the business. Frequently, wholesale distributors fail to recover all the chargebacks due them, and recovery error rates are high. Further complicating matters are the exacting accounting standards and regulations for these programs, which have come under scrutiny with the Sarbanes-Oxley Act.

In an ideal scenario, distributors would employ a single, integrated enterprise technology solution to efficiently and effectively manage chargeback programs. Data flow and workflow would be synchronized, so that all the handoffs associated with cost recovery processes would be executed smoothly. The chargeback programs would be seamlessly interwoven with the rest of the business. All the eligible transactions would be captured and filed on a timely basis, accelerating cost recovery and reducing vendor accounts-receivable balances. Leakage associated with errors and missed opportunities would be eliminated. With such a solution, distributors would increase their efficiency and enjoy improved margins.
The Cost Recovery Dilemma

Vendor cost recovery programs present distributors with a dilemma. Program payments from manufacturers have become an increasingly important source of cost-of-goods-sold reduction for distributors, but these programs can be costly, time consuming, and cumbersome to manage.

**CHARGEBACKS: DEFINING A KEY ELEMENT OF DOING BUSINESS**

Ask wholesale distributors to define “chargebacks” and, chances are, each will come up with a slightly different name for the process. Depending on the subindustry, distributors may refer to chargebacks as deviated pricing, SPAs, ship and debit, reported sales, deletion allowances, and so on. But broadly speaking, chargebacks can be defined as all monies received from manufacturers by distributors based on specific sales performance. The distributors file claims with the manufacturer resulting from customer sales transactions that adhere to specific vendor agreements. These claims are often paid over a specified period via checks, fund draw-downs, or credits.

Although this concept appears to be straightforward, in reality it is not – which explains the variance in terminology. Various program agreements can have several parts that generate an allowance. There are many types of allowances, which may be driven through the customer, the distributor’s headquarters, or the local distribution branch facility. In addition to sale-side chargeback programs, there may also be purchase-side rebate programs.

One type of chargeback involves a negotiated price for a product shipped from a distributor to a customer. Then the distributor files a claim, or chargeback, for the difference between the distributor’s vendor agreement cost and the cost at which the product was shipped to the customer.

Another type of chargeback is a straight volume-based rebate for purchases from the manufacturer. The distributor may negotiate a percentage of revenue or a per-pound or per-case rebate with the manufacturer, which then pays the distributor accordingly.

A third type is a process whereby the distributor receives marketing funds to promote the manufacturer’s product. The distributor submits a claim to the manufacturer to verify proper use of the funds, which is usually subject to an audit.

**The Downside: Complexity Creates Costs and Errors**

For most distributors, it’s a daunting task to keep track of the vendor cost recovery programs in place, the validity dates, and the associated SKUs. Considering all their permutations, chargeback programs are a very complex method of developing business, providing incentives for sales, and compensating distributors based on performance.

The lack of data standards adds to the complexity. Syndicated data feeds – company-specific or other types – are not harmonized around common definitions, time frames, or metadata. Late and error-prone data drives up administrative costs, which are usually pushed to distributors that end up having to resolve disputes over inherited billing and payment cycles.

**The Upside: Payments Mean Profit**

Wholesale distributors typically earn, on average, about 3% in net income. Yet, industry data confirms that, on average, 40% of distributors’ profit is now based on vendor chargebacks. Even the best-run distributors depend heavily on vendor cost recovery for success. For some distributors, their entire net profit results from these vendor payments.
Critical to financial success on one hand, complex and costly on the other, vendor cost recovery programs must be well managed relative to processes, data flows, and responsibilities. This has become even more imperative as regulators focus their spotlights on chargeback controls and reporting.

FINDING THE LEAKS
Wholesale distributors must evaluate their approach to managing chargebacks – finding the leaks and identifying areas for improvement. As a first step, they should assess the extent to which their systems for handling accounting and auditing, transactions, and compliance are integrated. Integrated systems and processes are far more effective than manual operations, spreadsheets, and decentralized operating rules. There are dozens of potential integration points in managing chargebacks – from pricing, billing, and cost accounting to supply chain and inventory valuation. Having a single, integrated approach at the process and systems level is a good indicator that the distributor is headed in the right direction.

Another important consideration is whether chargeback data can be used to perform business analytics. Many companies today believe that summarized transaction reports provide them with a good understanding of their business. Yet, chargebacks are a complicating factor. The ability to manipulate and examine data from many perspectives – customer, SKU, program, and channel – allows the distributor to implement and manage these programs more effectively. Nonintegrated environments relying on manual operations tend to be unable to support that kind of analysis.

Next, distributors should review their staffing requirements and costs for monitoring weekly and monthly price changes, as well as managing agreements and operator requests for proof-of-purchase (claim) documents. If the costs required to manage these processes constitute significant overhead, then the distributor probably is not taking full advantage of internal-process systems integration. These costs are often overlooked because much of the dispute resolution, accounting, and other administrative work associated with chargeback management takes up small parts of many employees’ days – small parts that add up quickly. Ultimately, time and money is wasted, as employees are distracted from performing more value-adding tasks.

Distributors should also determine whether their systems are externally integrated with manufacturers and other trading partners to allow timely and accurate exchange of key contracts, transactions, and inventory information. Few distributors have gone beyond electronic data interchange to implement processes and technology for sharing and exploiting trading-partner information for mutual economic and market gain.

External integration may not be possible for all trading partners, but distributors can focus their efforts on higher-volume and higher-margin partners. Midsize and smaller partners can be engaged through portals and other kinds of standardized interfaces, rather than relying on faxes and traditional “green-bar” reports.
Three Quick Wins

Short of launching a major project to improve chargeback management, wholesale distributors can take advantage of three quick-win opportunities. First, manufacturers frequently request proof-of-sale documents from a distributor for both a group purchasing organization and an individual account because the distributor is a member of both. Distributors can eliminate internal paperwork and avoid duplication by getting one request from these vendors.

Second, distributors can reduce the lag time between shipping chargeback-eligible items to customers and sending the chargeback claims to vendors. When claims are not promptly submitted, the lag often has a significant impact on margins by increasing days chargebacks outstanding.

Third, distributors can improve pricing updates with manufacturers. Most disputes are the result of errors that occur when weekly and monthly price changes are not updated by the manufacturer on time. Improvements can be achieved by synchronizing the timing and information exchange between the distributors and key partners.

The tools embedded within the solution enable proactive communication with vendors about programs and transactions.
Vendor cost recovery is a critical source of profitability that can be used for financial and market success. Ultimately, this is best achieved by investing in the systems, people, and processes needed to manage chargebacks efficiently. With this investment come additional payoffs: better decision making and collaboration within the business as well as with trading partners.

Despite improvements that can be made, such as those discussed previously, any solution outside a distributor’s central business system will lack optimal efficiency because the distributor must extract transactions before processing them. Many interfaces need to be developed and maintained, which is a significant burden, especially for small to midsize distributors.

A better approach is to implement a single, integrated enterprise solution. The entire chargeback process is interwoven throughout the order-to-cash or procure-to-pay cycle. Only an integrated solution can efficiently manage all the interaction points and processes, including pricing to inventory, financial planning, sales execution, cost accounting, billing, and purchasing.

An integrated solution can support both the distributor’s and the manufacturer’s perspective. The distributor’s claims can appear in the manufacturer’s system as paybacks through system integration, reducing errors and making the process more effective and efficient.

**IMPROVING THE SALES-BASED PERSPECTIVE**
From the sales-based program perspective, the distributor can use an integrated solution to record agreements with its vendor and use sales transaction records to file chargeback claims. The distributor has the flexibility to set up rules and configure them as they should be applied to business transactions.

The distributor might configure a rule for a straight chargeback based on either a vendor-material combination or a customer combination. Rules can also be based on a vendor’s agreement to protect the distributor up to a certain monetary amount in costs. Rules can be set up many ways: on a per-case basis, as a percentage or a percentage-based recovery, or as a recovery based on the case or the pound.

With an integrated solution, distributors have the flexibility to define how often they file claims and handle discrepancies. They can decide whether to allow a vendor to review claims before they debit or request payment from the vendor. Postclaim processes are also supported.

**IMPROVING THE PURCHASE-BASED PERSPECTIVE**
From the purchase-based program perspective, the distributor can use an integrated solution to model and create rebate and incentive plans based on all the transactions it executes with its vendors. The eligibility of the transactions, as well as the rebates accrued at the transaction level, can be built into these models.
Purchase rebates may be calculated in several ways. With standard rebates, the distributor earns a percentage of a given dollar amount in purchases. A flat rebate entitles the distributor to a percentage when it buys a given volume of the product. Retroactive rebates allow the distributor to claim a rebate on all its purchases once these reach a specified volume threshold.

An integrated solution provides visibility into what the distributor has actually earned as well as its potential earnings from these programs. An integrated solution automatically tracks purchases and rebates and makes this information easily available.

TYING CHARGEBACK MANAGEMENT TO BUSINESS PROCESSES

Vendor cost recovery is an important component of a wholesale distributor’s profit. Since many companies operate within a nonintegrated systems environment, they frequently submit erroneous claims and miss opportunities to participate in these programs to greatest advantage.

An enterprise solution enables distributors to integrate chargeback management with their business processes. In doing so, managers can gain a better understanding of the company’s performance. All purchases and sales filter through to one application, and eligible transactions are housed in a single solution.

This approach streamlines the chargeback management process, increases efficiency, and reduces the headcount required to manage the programs. The tools embedded within the solution enable proactive communication with vendors about programs and transactions. This improves relationships with trading partners and accelerates the order-to-cash cycle. It also enables companies to maintain regulatory compliance.

The entire chargeback process is interwoven throughout the order-to-cash or procure-to-pay cycle.
Enabling Efficient Chargeback Management in Wholesale Distribution

SAP has developed an integrated application that helps companies collect and track all the revenue to which they are entitled. The SAP® Paybacks and Chargebacks application by Vistex is comprehensive, integrated software designed for wholesale distributors.

SAP Paybacks and Chargebacks enables wholesale distributors to:

- Create and manage a variety of agreements with multiple suppliers and customers and apply evolving agreements on an ongoing basis to maximize chargeback recovery
- Automatically submit claims using flexible settlement parameters and calendars
- Communicate with partners via electronic data interchange or Web portal technology
- Produce timely reports and establish a full audit trail for chargeback activity to support corporate accounting and compliance efforts
- Use the reported chargeback data to control various performance programs, such as administration fees, market share rebates, and so on
- Provide a holistic overview of chargeback agreements with complete visibility at the customer and product level using a checkbook approach

SAP Paybacks and Chargebacks is fully integrated with the SAP S/4HANA Enterprise Management solution. That means documents can be included from other enterprise processes, such as sales and procurement, in the chargeback process. And distributors can easily use chargeback information in their finance, controlling, and compensation processes. For example, chargebacks may affect incentive payouts to employees.

The complete integration of SAP Paybacks and Chargebacks with SAP enterprise software also means there are no interfaces or up-front integration costs to manage; ongoing maintenance and upgrades are straightforward. And because SAP S/4HANA Enterprise Management is powered by the SAP HANA® platform, integration and flexibility in virtually any IT environment contribute to a low total cost of ownership.

LEARN MORE
With the SAP Paybacks and Chargebacks application, distributors can capture chargeback data, manage claims, control varied and changing chargeback agreements, and ultimately transform chargeback management into a systematic and effective process. The software allows management of the entire chargeback lifecycle – from initiation to settlement. And it minimizes manual intervention to bring new levels of efficiency and accuracy to the process.

For more information on how SAP Paybacks and Chargebacks can help you improve chargeback management and take full advantage of opportunities, visit our Web site at www.sap.com/usa/industries/wholesaledistribution.