SAP White Paper

ENABLING EFFICIENT CHARGEBACK MANAGEMENT

CONTENTS

Executive Summary 4
Today's Chargeback Process: Clear As Mud 5
Plugging the Leaks in the Chargeback Process 6
Improving Efficiency Through an Integrated Approach 7
A Chargeback Management Solution from SAP 8
Case Study: Graybar Electric 9
Conclusion 10

EXECUTIVE SUMMARY

In wholesale distribution, someone always seems to be willing to cut prices to win even the smallest order. Many companies use various types of chargebacks – including claims, rebates, special pricing agreements (SPAs), ship and debit, deviated billings, reported sales, and sheltered income to accomplish this goal. Yet chargebacks have become a significant challenge for distributors. For starters, companies end up competing on price instead of value, which leads to lower margins, higher selling costs, and associated administrative fees. In addition, chargeback programs are becoming increasingly complex and sophisticated, with several parties involved in the process, including distributors, manufacturers, group purchasing organizations, and end customers.

Many chargeback programs are managed in silos outside the central business system using Microsoft Excel spreadsheets and calculators, making it extremely difficult to view the programs within the overall context of the business. Moreover, the volume of transactions pumped through chargeback programs is rapidly becoming more than these manual systems can bear, resulting in a growing error rate and huge losses as distributors fail to recover all of the earned income they are due. In addition, the siloed approach makes it challenging for distributors to comply with accounting standards and regulations, such as the Sarbanes-Oxley Act, because it is difficult or impossible to track and report how income is booked against chargeback programs.

Simply eliminating chargebacks would solve many of these problems, but that is not likely to happen, as chargebacks are a significant source of revenue to the distributor. Rather, distributors must automate and streamline the chargeback process to cut out unnecessary costs and improve efficiency. With a single, integrated enterprise solution that can efficiently and effectively manage chargeback programs within the company's existing business systems, distributors can reduce errors that result in revenue leakage and missed opportunities, accelerate cost recovery, and reduce vendor accounts receivable balances. The result? Improved performance and a solidified competitive advantage.

This white paper will illustrate today's chargeback process in detail, pinpoint areas where distributors can improve their chargeback process, and describe the benefits of an integrated enterprise chargeback solution.

TODAY'S CHARGEBACK PROCESS: CLEAR AS MUD

Theoretically, the chargeback process is simple and straightforward: The distributor negotiates a performance contract with the manufacturer or supplier. The end customer places an order with the distributor and pays the distributor's price for the product. The distributor submits a chargeback claim with the manufacturer or supplier. The supplier processes the claim, and finally, the distributor reconciles it and posts the payment.

But, in reality, the process is not so straightforward, and many distributors waste not only time but also money with a manually intensive and error-prone chargeback process. Because agreements change constantly, it is difficult for distributors to maximize recoveries and reduce incorrect claims. Inadequate data sent to the supplier results in high dispute levels and delayed payments. And every delay can mean the difference between profit and loss due to chargeback leakage. Just like days sales outstanding, the number of days chargeback outstanding is an important measure of financial performance to distributors.

An overall lack of visibility into the order-to-cash cycle results in pricing errors and deductions that create problems in accounts receivable. Most companies cannot determine the root cause of chargeback discrepancies because they do not have a central repository or database for agreements. In addition, many agreement definitions are inflexible, making it difficult to combine customer, vendor, and product attributes. Because many systems cannot support both purchase- and sales-based performance rebates, the chargeback process is further slowed. Without automatic postings for chargeback accruals, it is difficult to determine the profitability of each agreement, and the limited number of reconciliation tools results in earned income leakage, high reserves, a large number of write-offs, and increased days chargeback outstanding.

The inefficiency of and lack of visibility into the chargeback process affects the ability of distributors to comply with government regulatory requirements, such as the Sarbanes-Oxley Act. Frequently, misallocated costs and revenue create financial reporting problems and restatements and hinder distributors' ability to trace every financial posting related to chargebacks.

PLUGGING THE LEAKS IN THE CHARGEBACK PROCESS

Given the importance of chargebacks to the distributor's financial success, evaluation of the chargeback process is critical to financial performance. There are four key areas on which distributors should focus:

- **Integration between accounting and auditing, transactions, and compliance systems**
  There are numerous potential integration points in managing chargebacks, from pricing, billing, and cost accounting to supply chain and inventory valuation. By integrating accounting and auditing, transactions, and compliance systems, distributors can make the chargeback process more effective than manual operations.

- **Ability to conduct business analytics**
  Many companies today believe that summarized transaction reports provide a good understanding of the business. However, chargebacks are a complicating factor. The ability to manipulate and examine data from many perspectives – customer, SKU, program, and channel – using business analytics allows the distributor to implement and manage these programs more effectively. Typically, nonintegrated manual environments do not support this kind of analysis.

- **Staffing requirements**
  If the personnel time required to monitor weekly and monthly price changes and to manage chargebacks and requests for proof-of-purchase documents represents a significant overhead cost, then the distributor is not taking full advantage of internal process systems integration. This integration is often overlooked because much of the dispute resolution, accounting, and other administrative work associated with earned income each takes up a large part of many people's days. Ultimately, this manual handling causes distributors to invest in people rather than in process improvement. An integrated enterprise resource planning (ERP) solution with chargeback management allows the distributor to utilize its people in more productive ways, thereby driving top- or bottom-line revenue.

- **External integration with manufacturers, vendors, and trading partners**
  With externally integrated systems that allow timely and accurate exchange of key trade program, transaction, and inventory information, distributors can share and exploit channel partner information for mutual economic gain. However, few distributors have gone beyond electronic data interchange (EDI) to implement processes that make this happen. By focusing on integration of and collaboration with higher-volume, higher-margin partners, distributors can reap significant benefits. Midsized and smaller partners can be engaged through portals and other types of standardized interfaces, rather than relying on faxes and traditional "green bar" reports to share information.

IMPROVING EFFICIENCY THROUGH AN INTEGRATED APPROACH

To meet analytics and supply chain management needs and reduce total cost of ownership, distributors should look to implement an integrated enterprise solution for chargeback management. With such a solution, distributors can identify, compute, administer, and settle all types of chargebacks, rebates, and incentives due to the distributor for meeting volume commitments, as well as incentives owed to customers based on performance targets they have met. Distributors can better track and administer their sales commissions.

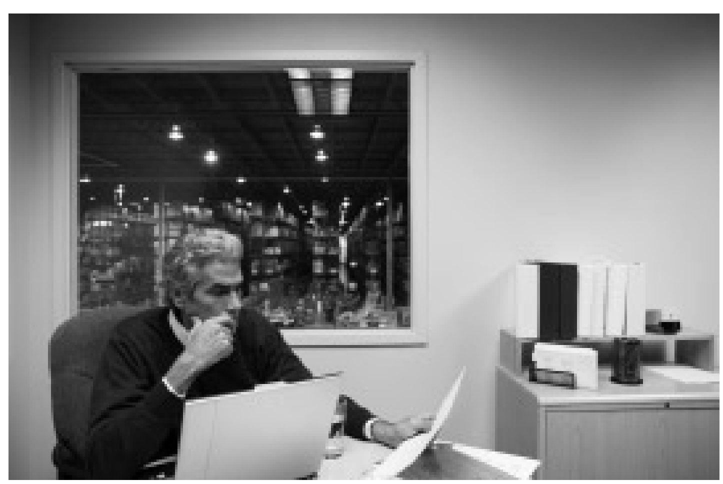
For example, Distributor A is entitled to a chargeback of $1.30 per case for every unit of a product sold during a given period. Distributor A can configure rules to account for this rebate through an integrated financial posting. When Distributor A books this chargeback, the system creates an associated accrual, which is immediately reflected in the cost of goods sold. The chargeback is held in accrual until settlement according to the terms agreed upon with the vendor. After settlement, Distributor A can debit the vendor or post a receivable.

Further, by deploying an integrated enterprise solution for chargeback management, distributors can gain a holistic view of the entire chargeback process, including its contract library, before processing outgoing claims to manufacturers as well as incoming claims submitted by distributors. Distributors have the flexibility to define a set of rules to calculate chargebacks in a way that is appropriate for their business. For instance, rebate calculations can be set up in terms of units, percentages, or product groups. Similarly, rules for settling claims can be set to occur weekly, monthly, or quarterly. And if the distributor must settle with a business partner, the integrated system still allows the distributor to accrue the dollars and reflect this revenue in the financial statement.

Embedding these functions into the standard sales and purchasing processes ultimately results in higher sales and lower procurement costs. An integrated system can track the chargebacks earned and accrued by the distributor to date and calculate the next potential payout, providing greater visibility into how the distributor can maximize the rebate. For example, Distributor B has purchased nearly $90,000 of goods from a manufacturer and is entitled to a 1% rebate. However, if Distributor B buys an additional $10,000 of goods, the vendor will increase its payout to 3%. Armed with this information in advance, Distributor B can significantly improve the company's performance.

Additionally, because the software is workflow-enabled, operating costs are reduced because less manual administrative work is required. Only exceptions, discrepancies, or reconciliation items that do not conform to internal preset parameters or tolerances set up in the rules are flagged for manual intervention.

Sophisticated tools included in the enterprise solution allow distributors to plan, design, create or modify agreements. These agreements and claims are automated through the use of various communication methods. Claims can also be viewed, reconciled, and processed over a Web portal to expedite processing and revenue recognition.



A CHARGEBACK MANAGEMENT SOLUTION FROM SAP

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 a comprehensive, integrated chargeback management solution designed for all wholesale distributors.

With SAP Paybacks and Chargebacks, 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 distributors to manage the entire chargeback life cycle – from initiation to settlement – and minimize manual intervention to bring new levels of efficiency and accuracy to the chargeback process.

SAP Paybacks and Chargebacks enables distributors to:

- Create and manage a variety of agreements with multiple suppliers and customers
- Apply evolving agreements on an ongoing basis to maximize chargeback recovery
- Automatically submit claims using flexible settlement parameters and calendars
- Communicate with partners via EDI or Web portal technology
- Park documents to give suppliers a broader opportunity to review and approve claims
- Handle interim settlements to accept approved amounts quickly without waiting for final resolution
- Produce timely reports and establish a full audit trail for chargeback activity to support corporate accounting and compliance efforts
- Use multiple currencies and units of measure in the chargeback process
- Monitor and reconcile outstanding chargeback claims using flexible search criteria
- Support a multitier distribution model in which initial shipments are received in consolidation centers and subsequently shipped to branch locations, and onward to end customers
- Use the reported chargeback data to control various performance programs, such as administration fees, market share rebates, and so on
- Aggregate chargeback document data in logistics information structures and provide extract structures for use in a data warehouse
- 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 in the SAP ERP application. That means distributors can include documents from other enterprise processes, such as sales and procurement, in the chargeback process. And they can easily use chargeback information in their finance, controlling, and compensation processes. For example, chargeback recovery may affect incentive payouts to employees.

The complete integration of Vistex and SAP software also means there are no interfaces or up-front integration costs to manage. Ongoing maintenance and upgrades are seamless. Because SAP ERP is powered by the SAP NetWeaver® platform, distributors are assured of easy integration and flexibility in virtually any IT environment – all of which help ensure a low total cost of ownership.

CASE STUDY: GRAYBAR ELECTRIC

Graybar Electric Company Inc. is a specialist in supply chain management services and the leading North American distributor of high-quality components, equipment, and materials for the electrical and telecommunications industries. With 2005 revenue of nearly US$4.3 billion, Graybar employs nearly 8,000 staff at more than 250 distribution centers throughout the United States, Canada, Mexico, and Puerto Rico.

Chargebacks represent a significant portion of Graybar's margin dollars, so it is important for the company to manage them effectively. As a major distributor, it has about 29,000 active customer and product deals and has handled nearly 124,000 deals since 2003. In 2006, the company expected to process four million line item rebate claims. Thanks to the functionality now found in SAP Paybacks and Chargebacks, 98% of these claims require no human intervention and the company has seen an improvement in claim accuracy, thereby reducing costly rework.

However, Graybar was not always this efficient. For many years, the company operated in a siloed environment, which automated many of its chargeback processes but did not enable it to take advantage of claims in a timely manner. Claims could only be automatically linked to an order if they were included in an explicit pricing instruction for a customer. To make a claim or create a claim for a vendor, it was necessary to maintain discrete pricing for that customer. If that data did not exist in the system, no recovery was made, even if the sale qualified for the program. In addition, inaccuracy led to denied claims and vendor disputes.

Since deploying the integrated enterprise chargebacks solution in 2003, the company has experienced greater efficiency and improved revenue recognition. Most of the chargebacks with its two largest vendors are loaded automatically. Centralized teams in the company's district offices handle the input and administration of deals that must still be loaded manually.

A nightly batch program reviews all billing documents or customer invoices for that day, determines which deals apply, and ascertains how claims should be calculated. Most paper claims are submitted weekly or monthly, and the company sets dollar caps within the software to enable it to close out any deal in which significant money has accumulated and quickly recover the funds from the vendor. Graybar also runs automated programs to review older billing documents to glean deal information from vendors that may be delayed.

Claim processing, submission, and response have been streamlined using EDI technology. Only responses that fall outside tolerances now require manual intervention, and these exceptions are routed to a workbench for reconciliation by centralized teams.

CONCLUSION

Chargebacks are a critical component of profit margin that can be leveraged for financial and market success. By investing in an integrated enterprise solution for chargeback management, such as the SAP Paybacks and Chargebacks application, distributors can improve earned income collection from vendors, reduce administrative costs, and lower headcount required to manage the process. The net result? Increased profit margins and improved competitive advantage.

In addition, because distributors can trace every financial posting related to chargebacks, they can maintain regulatory compliance and avoid financial reporting problems and restatements.

For more information on how SAP Paybacks and Chargebacks can help recover lost chargeback income, visit our Web site at www.sap.com/usa/industries/wholesaledistribution.

www.sap.com/contactsap

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