Revenue Cycle Management

BEST PRACTICES

PROACTIVE STEPS TO REDUCE PROFIT LOSSES DUE TO SHIPMENT SHORTAGE DEDUCTIONS

A SMYYTH / CREDITEK WHITE PAPER

November 2016

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OVERVIEW

BEST PRACTICES: PROACTIVE STEPS TO REDUCE PROFIT LOSSES DUE TO SHIPMENT SHORTAGE DEDUCTIONS

Chargebacks for shortages materially dilute manufacturer profits, and has been exacerbated by more complex customer (especially retailer), EDI, order and documentation requirements. Shortage deductions are caused by ignoring purchase order requirements, inaccurate billing, labeling and shipping documentation, shipper's warehouse pick-pack errors, and errors or pilferage in transit as well as in customer receiving departments.

We are talking about a lot of money here, and *in many cases* **shortages are the second largest deduction revenue loss** for the manufacturer, after trade promotion expense.

#1 Trade Promotion Expense

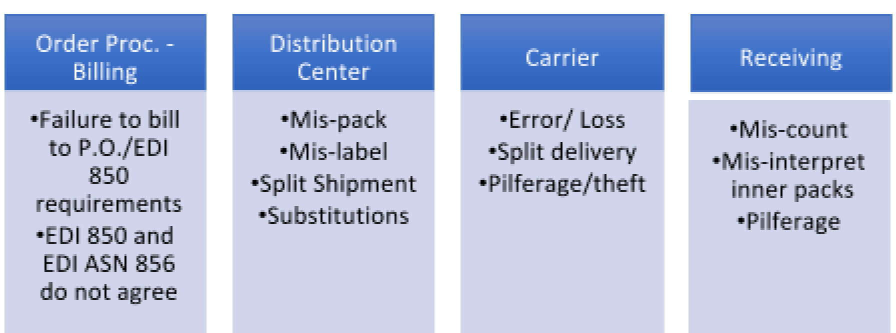
#2 Shortage Claims and Deductions

#3 All other deduction categories

Frequently, these deductions languish until they are stale and hard or difficult to figure out. Many are considered too small to spend any time on. The result is usually a write-off and loss of profit.

Regardless of the cause, this amounts to a lot of "revenue leakage" and paperwork, but *there is no question that it can be reduced with proactive management.*

There are three parties potentially liable for these losses: Shipper, Carrier, or the Customer. Many shortage deductions can be complicated to unravel, but regardless of the FOB shipping terms **the onus is almost always on the shipper**, since it is the shipper that is owed the money for the sale.



I. RESEARCH AND TRACK SHORTAGE CAUSES

A. As with other types of customer deductions, your research will determine many shortage deductions to be overstated or even completely invalid. In addition, unless you thoroughly investigate and uncover the root causes, how can you correct a systemic problem that will continue to cause revenue losses?

B. Or, perhaps enable you to identify a trucker or customer that has their own systemic problems, who then will continue forever deducting for excessive shortages due to miscounts or misinterpretations in receiving? Many of these shipment shortages are preventable with proactive steps that we have outlined below for your consideration.

C. **Benchmark Shortage Deductions**. Numbers are your friends. Begin by comparing shortage deduction experience ratios by type of shortage, customer, carrier and distribution center. Gather the prior year's statistics for major customers, distribution center locations, transportation carriers, manufacturers and customer receiving center locations.

D. **Keep Detailed Records**. Keep accurate records of shortages for all customers. If your accounts receivable system can accommodate it, differentiate between case shortages, concealed shortages, and shipper load and count, using specific reason codes. Over time, you may find that one customer may be claiming 3% for concealed shortages, Vs. your company's overall experience of 0.05%, which might mean they have systemic process errors, or even intentional abuse. You can recoup the excess deducted if you have solid data, and this data will also be invaluable when your sales department negotiates next year's price contract.

E. **Establish a Shipping Dock Audit Function**. A Shipping Audit Function will prevent shipping errors and combat unjustified deductions, and help identify customers that abuse shortage claims. You can use the results to disprove or verify claims for damages, improper placement of bar codes, improper packing, etc. This will target the customers that are most frequently taking these deductions, based on your examination of the data discussed above.

II. PREVENT-SOLVE CONCEALED SHORTAGES

To combat concealed shortage deductions, you can take a number of steps to reduce your exposure.

A. You must use and maintain highly calibrated scales with print verification.

B. You must use printed security tape.

C. You should use an IPad or similar to photograph both unsealed and sealed cartons before they leave your dock if you ship very high value goods, and especially for all deduction-prone customers. If you include an image of the label(s), you can access the document set with OCR after you upload the day's activity to the "cloud", to a free Google Drive account, for example.

D. Photographs also help with vendor compliance claims (which by themselves could amount to one percent or more of revenues), such as for labeling or marking "errors". Check that scales are accurately calibrated, and shrink-wrap, weigh and photograph pallets too. In the event of trucker-carrier claims, having the packing evidence eliminates the arguments over who is at fault, and will assure quicker freight claims processing and payment.

E. A frequent source of in-carton "shortages" is when you are billing "eaches" in a pack or inner carton of, say 6, and the customer receiving department picks it up as 1 item (vs 6) received. The expected pack unit is shown on the purchase order; if your billing and shipping does not match this, you are guaranteeing you will have trouble. Make sure your billing and packing matches the purchase order/ EDI 850 requirements.

F. Make sure your carton labelling complies with the customer purchase order requirements, and that it is applied on the carton where the customer specified.

G. Do not substitute for SKU, Size, Color. The customer will deduct for the missing units, and will probably not credit you for the substituted units.

H. To avoid deductions due to misinterpretations our billing and shipping configurations must match the purchase order. That is, the details on the EDI ASN 856 shipping notice and EDI 850 purchase order must match up.

I. Except for SL&C, require drivers to be present to observe loading and sign for the carton count (not the pallet count).

J. Have both the loader and the dock supervisor sign off on load manifests and/or bills of lading.

III. SPLIT SHIPMENTS/ SPLIT DELIVERIES

A. Carton shortage deductions can be due to either split shipments or split deliveries and are a problem to be on alert for. If 9 of a 10-carton shipment arrive on Monday, you will be written up for a one carton shortage. If Carton #10 shows up on Friday, it may end up as an unmatched overage for which you may not receive credit.

B. Carton shortages can be a loss/ theft, or course, but most frequently they are due to misrouting, and often found later and delivered, sometimes even weeks later. When you trace and/or file a carrier claim for the shortage, you will frequently discover it was delivered to your customer. They probably will not have credited you for it, as the purchase order had already been closed out, with a shortage and a deduction.

IV. ON HAND GOODS NOTICES

Act quickly when you receive notice of On Hand Goods stored by a carrier because they were either refused or goods found without adequate identification. If you don't act, the goods will be auctioned off to pay the storage fees.

V. SHIPPERS LOAD AND COUNT

Shippers Load & Count (SLC) shortages are usually contentious and consist of inconclusive "he said-she said" arguments. Since these tend to be large dollars, it pays to take preventive steps.

A. Do use SLC for LTL shipments, where a truck is mixed for various delivery points. Only use SL&C for full truckloads.

B. Have two shipping personnel sign off on SLC truck contents as they are loaded.

C. Do not use SLC unless the trailer has a numbered, recorded (on the BoL) seal applied, and record then USDOT information of the trailer.

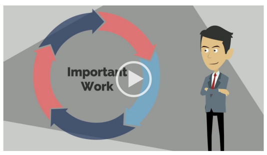
D. Photograph/film the pallets as they are loaded, and then of the loaded trailer before the doors close. Buy a time/motion video camera to record the loading. It's a small price to pay for protection for a high value shipment, especially where you have a history of problems.

E. Use uniquely marked shrink wrap so if a carrier rewraps it, it will be evident, and indicates someone opened the pallet, which could account for the shortage. If you can't do special shrink wrap, apply your printed shipping tape around the shrink wrap.

F. If the customer received the right number of pallets but there was a significant shortage, they could have received a pallet intended for someone else. They deducted the "shortage" but did return or credit the erroneous pallet? Don't count on it.

VI. AUTOMATION SOLUTIONS

Your company should be exploring automated systems that could have a major impact on reducing deduction losses. For example, the writer's company has developed a Software as a Service (Carixa ™) that *automatically* extracts shortage and all other deduction data from retailer systems, and *automatically* reconciles it against purchase order, shipment, invoice and credit memo data, and initiates and tracks the forms and workflow needed to resolve a deduction.



VII. FILING CARRIER CLAIMS

If you have negotiated contracts with your carriers, they will typically specify the liability of the parties. In the absence of a contract, the carrier's bill of lading or filed tariff will govern. Your company may consider "Inland Marine Insurance", which may give you some protection if the carrier does not pay or your contract has a low liability limit. This subject will be discussed in more depth in a separate paper.

VIII. UNDERSTAND HOW YOUR CUSTOMERS OPERATE

Knowing your customer counterparts, and understanding how they do business will ensure greater success in your efforts to stop these money-wasting problems. Visit the offending customers, tour their receiving operations, and show your evidence from your statistics and audit process. If you have the evidence, they will most likely improve their practices and even pay you back.

IX. FLAT ALLOWANCES FOR CONCEALED SHORTAGES?

Some retailers are suggesting a predetermined concealed shortage allowance instead of handling shortages individually. *Be warned, as these agreements generally only work in one direction – the customer's.*

A. If you agree to a percentage allowance, if the aggregate incurred loss is *less* than the percentage allowance, it benefits the customer. If the actual loss is *greater* than the allowance, the retailer will demand an increase in the allowance; again, this allowance ultimately only works in favor of the customer. This allowance can only grow.

B. Some may try to convince you to do it based on prospective administrative savings from not having to handle the shortage paperwork. However, consider that if you do not research shortages, you will never find out what is causing them, creating a self-sustaining and growing problem.

C. If you go forward anyway, even with these cautionary notes, before agreeing to a percentage, carefully examine the historical experience from your records.

1. In arriving at an allowance percentage, the customer will show you data on total shortages, but will not show the shortages that were paid back to you.

2. When reviewing deduction experience, remember that there is a lag of months in getting money back for erroneous deductions, so if you are looking at a specific period for deductions, it will not include the matching, related paybacks for that period.

3. Lastly, write in an "opt-out" so that if you find it is not working for you, you have a way get out of a bad deal.

X. SUMMARY

Controlling and reducing shipment shortages is a relatively straightforward business problem and can be addressed once you have supporting data and understand the causes, and take the steps outlined. These solutions are easy to implement and are not expensive. Just follow these proactive, commonsense steps, and with a bit of focus and a small investment the effort will pay off handsomely in increased profits for your company.

About the authors. This paper was prepared by the Revenue Cycle Consultants at Smyyth/Creditek

Smyyth and its Creditek division provide world-class end-to-end Order-to-Cash SaaS Technology (Carixa), Managed Outsourced Services, and Consulting to enable companies to attain extraordinary cash flow and profits using best practices for managing credit, accounts receivable, collections, deductions, disputes and cash application.

The Carixa™ Order to Cash platform streamlines operations, slashes costs, and increases profits. Smyyth technology and services are built on Six Sigma principles and are Safe Harbor and SSAE16 compliant. www.smyyth.com

Carixa is a modular or an end-to-end solution for order-to-cash and is scalable from mid-market to global enterprise. For the far-flung organization, it comes with instant consolidation of subsidiary credit risks and receivables management providing local independence and operating power within a corporate policy framework. Need to centralize, decentralize, or outsource? No problem, just set the policy and rules and it's done. Carixa integrates order-to-cash....credit, collections, deductions, reconciliation, EIPP, cash application, customer portals, and more.

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