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Best Practices To Improve Payments and Reduce Unauthorized Deductions

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Surveys show customer deductions comprise 5% to 20% of revenues, depending on the industry, so even if only 10% of these deductions are unauthorized, a $100 million company could be losing $1 million or more of profits. Factor in the extra paperwork, overhead, and cost of money, and the bottom line takes a double hit. Using best practices in Deduction Management is key.

Deduction management is complicated, so it's easy for customers to make mistakes (it is interesting that mistakes almost always favor the customer). We also know that more than a few customers take advantage. Regardless of why they occur, a significant percentage of deductions are overstated, or outright wrong. Here are the five best ways to eliminate the problem of unauthorized deductions.

Deduction Categories

Trade Business Practices, such as Trade Promotions, Discounts, Markdowns, Approved Returns. This category represents the largest percentage of deductions taken although they still have a very high error rate (customer applied wrong price, deducted for too many units, etc.)

Preventable Deductions - and Process Errors, including as trade promotions not explained clearly, billing , EDI, and shipping errors are often systemic, and will continue happening forever unless the root causes are solved.

Unauthorized or Excessive Deductions, such as trade promotions not meeting the deal parameters, late discounts, or customer returns errors, pricing, receiving counting errors. Excessive amounts deducted on otherwise proper deductions are included here as well, including too-high returns pricing, incorrect quantities charged back, etc.

While most, maybe 80% of deduction expenses are legitimate, our experience is that <u>most debit memos</u> - even those that are part of "Agreed to" classification - contain errors that in the aggregate cost the creditor huge profits.

1. Inches and Miles. If your company ignores unauthorized deductions, customers will continue to take them and see how far they can push them. This includes the deductions you usually write off because you feel the amounts are too small to spend time on.

ACTION: Double check cash discounts and make sure customers have earned the discounts by following sales terms and conditions. Resolve any differences of interpretations by meeting, phone, or e-mail and confirm the agreement. Otherwise, these will become systemic drip of profits.

2. Trade Promotion and Pricing Misunderstandings. Trade Promotion and product pricing often represent most of the money and require special attention to make sure that your pricing deals were correctly interpreted. Because these deductions are so big, the errors also tend to be big.

ACTION: Double check all prices, terms, and conditions, ensuring that both parties understand the pricing deals. Iron out all differences and get e-mail confirmation or an amended order showing agreement.

3. Failing To Follow Instructions. Large retailers issue 100-page billing, packing and shipping "vendor compliance" instructions, then scrutinize the order for every violation, and deduct any oversights. Substandard packing and subsequent merchandise damage are other sources of deductions. Ditto for billing violations. For some companies, vendor compliance violation deductions amount to 1% of revenues.

ACTION: Build these vendor compliance rules into your systems and methods and instruct shipping department employees to follow retailer instructions to the letter, even if you have to modify your own practices to meet demands of your top customers. It could be that a simple change such as label re-positioning could save you big bucks.

4. Unnecessary Complexity. If discounts, incentives, and timing become too complex, you can bet customers will misinterpret them and make payment errors. Add in your salesmen providing verbal offers and your deductions will skyrocket.

ACTION: First, make sure all deals are written down. Second, keep all discounts and conditions simple and consistent to avoid confusion. Third, make sure paperwork goes to the correct person or department.

5. Assertive Collection Management. If you wait to take action until deductions or payments are 30 or 60 days past due, it only encourages customers to pay late, which will kill cash flow. Worse, the customers will take unauthorized deductions when they pay late.

ACTION: Streamline your collection management process, reducing delays, redundancies, and unproductive paper shuffling to keep on top of accounts. Review the paper trail to determine the status of unauthorized deductions and tackle disputes immediately. A little vigilance goes a long way and the sooner you resolve problems, the faster you will improve cash flow. If you find your company resources overwhelmed, outsource your collection of unauthorized deductions.

DO YOU KNOW? Many large companies use software that tracks how long it takes you to start calling for payment, and they adjust their payables rules based on that. Small companies may not use sophisticated software, but they keep track too. Ditto with deductions – if you do not follow up promptly, they can ignore you. This alone is reason enough for you to get on top of your game with collections and deduction management. **Act promptly and consistently, and you will have a major impact on your company's results**.

The Case For Outsourcing Deduction Management

Studies show that investigating, negotiating, and collecting unauthorized deductions can consume up to 75% of accounts receivable and credit management resources. One internal study in a Fortune 500 company determined that handling unauthorized deductions cost $250 per document plus using the sales force to track them down consumed 10% to 40% of the salesperson's time with paperwork.

A good professional accounts receivable and deduction management outsourcing service can clean up backlogs and recover aging receivables and unauthorized deductions that would otherwise be written off -- leaving your own accounts receivable department to deal with current receivables that will add to cash flow. A professional service can also make suggestions for process improvements specific to your company. Even minor improvements can yield impressive results and a complete audit can patch gaping holes in your cash flow process.

Plus you can expect that if you choose the right firm, the service will include top-notch collaborative workflow systems to streamline the entire accounts receivable, collection, and deduction management process.