



SAP White Paper



ENABLING EFFICIENT EARNED INCOME MANAGEMENT IN FOODSERVICE DISTRIBUTION

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EXECUTIVE SUMMARY

Earned income programs in the foodservice industry are growing more complex and sophisticated. Multiple parties are involved in the process, including distributors, manufacturers, customers, and group purchasing organizations. Moreover, the volume of transactions being pumped 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. Foodservice distributors frequently fail to recover rebates due them; the recovery error rate is high. Further complicating matters are the exacting accounting standards and regulations for these programs, which have come under new scrutiny with the Sarbanes-Oxley Act.

In an ideal scenario, distributors would employ a single, integrated enterprise technology solution to efficiently and effectively manage earned income programs. Data flow and workflow would be synchronized, so that all the handoffs associated with earned income processes would be executed smoothly. The earned income 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 performance and economic advantage.



THE EARNED INCOME DILEMMA

Earned income programs present distributors with a significant dilemma. These programs are costly, time-consuming, and difficult to manage, yet program payments from manufacturers have become an increasingly important source of revenue for distributors.

Earned Income and Allowances

Ask several foodservice distributors to define “earned income,” and chances are each will come up with something slightly different. But broadly speaking, earned income is all moneys from rebates, growth programs, purchasing programs, and marketing programs less expenses for promotional allowances paid to the sales force and customers as well as expenses for printing and trips.

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

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

Another type of allowance is deviated billing. In this case, the distributor ships product to a national account customer at a negotiated price. Then the distributor files for a rebate, or a charge-back, for the difference between the distributor’s cost and the cost at which the product was shipped to the customer.

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, who then audits it before paying the distributor.

The Downside: Complexity Creates Costs, Errors

For most distributors, keeping track of the programs that are in place, the periods for which they are valid, and the SKUs for which they apply is a daunting task. Considering all their permutations, earned income programs are a very complex method of shaping demand, providing incentives for pull purchasing, and compensating all of the manufacturers, vendors, and trading partners involved.

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 borne by distributors who end up having to resolve disputes over inherited billing and payment cycles.

The Upside: Payments Mean Profit

Foodservice distributors earn on average about 3% in net income. Yet a recent Foodservice Sales and Marketing Association study confirms that on average, 40% of distributors’ profit is now based on earned income program payments.¹ Even the best-run distributors depend heavily on earned income for success. And the entire profit of less-efficient, lower-performing distributors may come from these payments.

Given earned income programs’ importance to financial success on one hand and the complex and costly nature of their administration on the other, it is essential that program processes, data flows, and responsibilities be well managed. This has become even more imperative as regulators focus their spotlights on earned income controls and reporting.

1. The 22nd Annual IFDA Foodservice Distributor Productivity Financial Report, 2005 (www.ifdaonline.org).

FINDING THE LEAKS

Foodservice distributors must evaluate the way in which they manage earned income – 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 more effective than manual operations, spreadsheets, and decentralized operating rules. There are dozens of potential integration points in managing earned income – 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 earned income program 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 earned income is 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 deviated prices and operator requests for proof-of-purchase 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 earned income take 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 important tasks.

Distributors should also determine whether their systems are externally integrated with manufacturers, vendors, and trading partners in ways that allow timely and accurate exchange of key trade program, transaction, 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 earned income management, foodservice distributors can take advantage of three quick-win opportunities. First, operators frequently request proof-of-purchase documents for both a group purchasing organization and a national account because they are members of both. Similarly, they request a bid price on top of the national account program. Distributors can eliminate internal paperwork and avoid duplication by getting one request from these operators.

Second, distributors can reduce the lag time between shipping a deviated-price item to a national account and receiving payment on the price variance. When not corrected, this lag often has a significant impact on margins.

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.



INTEGRATION: THE BEST SOLUTION

Earned income is a critical source of revenue that can be leveraged for financial and market success. Ultimately, this is best achieved by investing in the systems, people, and processes needed to manage earned income 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 of a distributor's central business system is going to be less than optimally efficient 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 that handles all the interaction points and processes, including pricing to inventory, promotion planning and execution, sales execution, cost accounting, billing, and purchasing. The entire earned income process is interwoven throughout the order-to-cash or procure-to-pay cycle, and only an integrated solution can manage all the connections efficiently.

An integrated solution can support both the distributor's and the manufacturer's perspective. Purchase-based claims appear in the manufacturer's system as sales rebates, and sales-based chargebacks appear as bill-backs.

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 earned income 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. As an example, a distributor purchases \$10,000 worth of ketchup and is entitled to receive a 0.5% rebate from its vendor. If the distributor purchases \$100,000, it is entitled to receive a 3% rebate on all the ketchup it has purchased from this vendor. An integrated solution automatically tracks purchases and rebates and makes this information easily available.

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, also known as deviated billings. The distributor has the flexibility to set up rules and configure the way 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 dollar amount in costs. Rules can be set up many ways: on a per-case basis, as a percentage or a percent-based recovery, or as a recovery based on the case or the pound.

Say the distributor sells 10 cases of ketchup to a restaurant and is eligible for a 10% chargeback. The integrated solution reflects the sale based on what was shipped to the restaurant and automatically applies the earned income program rule, resulting in a chargeback to the ketchup vendor.

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.



CONCLUSION

Earned income is an important component of foodservice distributors' profit. Since many companies operate with 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 earned income programs 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 database.

This streamlines the earned income 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.



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 comprehensive, integrated software designed for 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 management of the entire chargeback life cycle – from initiation to settlement – and to minimize manual intervention to bring new levels of efficiency and accuracy to the process.

SAP Paybacks and Chargebacks enables foodservice distributors to do the following:

- 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 electronic data interchange 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 then 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 mySAP™ ERP application. 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, chargeback recovery may affect incentive payouts to employees.

The complete integration of Vistex and SAP software also means there are no interfaces and up-front integration costs to manage; ongoing maintenance and upgrades are seamless. And because mySAP ERP is powered by the SAP NetWeaver® platform, easy integration and flexibility is assured in virtually any IT environment, contributing to a low total cost of ownership.

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