

Deduction Management

*An Oracle White Paper
September 2002*

ORACLE®

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EXECUTIVE OVERVIEW

Manufacturers distribute their products to their customers who in turn sell them to end consumers. Manufacturers invoice their customers at pre-agreed rates. In many cases, however, the customer remits less than the invoiced amount, citing some reason for withholding part of the payment. Amounts so withheld are called *deductions*.

The numbers are staggering. Companies in the U.S. are inundated with in excess of \$10 billion in deductions annually. Deductions are growing at 20% per year, which could be 10-15% faster than the sales growth rate of most companies. On average 14% of them are invalid and as much as 5% is written off. They drain time and resources from marketing, sales, credit, collections, accounts receivables, customer service and distribution personnel as they need to research and resolve deductions. Overall, a sizable percentage of lost profits can be attributable to deductions.

The deduction problem is a prevalent one. It can exist in any B2B companies but is most pervasive in industries that sell through trade channels¹. It exists for any number of reasons – at any point throughout the whole demand-generation and order-to-cash cycles, anything that goes amiss can cause a deduction. The problem is as widespread across industries as it is within a company.

The repercussions go beyond the explicit costs incurred. Time and resources spent on resolving deductions could otherwise be spent on more value added activities. Certain deductions may inherently reflect some form of breakdown in your customer relationships – customers may be deducting because your reimbursement processes are not fast enough, and disputes endanger relationships and engender resentment. And for as long as an invalid deduction stays unsettled, the company is, in effect providing a zero-interest loan to the customer. Managing such risks imposed by deductions will be especially crucial during a down turn in the economy. All these are opportunity costs that lower a company's profitability.

Effective deduction management is an achievable goal. With management buy-in, the right processes, the right people and the right tools, a company take control of deductions from cradle to grave and benefit from cutting research time, freeing up tied-up cash flows, collecting invalid deductions and reducing receivable write-offs. This will have a positive impact on both the top line and the bottom line and is a goal worth achieving.

¹ Trade channels can be a company's resellers, partners, wholesalers, distributors, brokers and retailers.

INTRODUCTION

This paper discusses the deduction problem, and ways it can be managed, in detail. As a first step towards the goal of deduction management, a company must gain executive buy-in – recognition and commitment to solve it. Since deductions can happen due to many factors contributed by various departments, and since the company as a whole may lack a systematic approach to account for them, management may not necessarily recognize the magnitude of the problem. It is necessary then to first alert management to the magnitude of the problem, while the next steps to achieve the goal of controlling deductions will be to align processes, people and tools.

THE PROBLEM WITH DEDUCTIONS

MACRO VIEW

This section will look at the history of the problem, its current status and the reasons that it has sustained over the years and will be here to stay.

Historically, the problem with deductions originated in one particular sector but has since spread to many others. In the 1970s, retailers started demanding resolution of their invoices (whether for promotions, invoicing errors, returns or any other reasons) within 30 days. Since many manufacturers lacked the controls necessary to manage their paper flow, this was really an unattainable goal. Based on these delays, retailers started to short pay on their remittances to the manufacturers. As time goes on, we moved into the 80's, large department stores such as Sears and K Mart started charging manufacturers penalties and fees for a variety of reasons when orders were not shipped exactly as specified. At the same time, the increased use of trade promotions put heavy pressure on the manufacturers' payment systems. Reimbursement of such promotional expenses continued to lag for 30 days, 60 days, 90 days as a result of which retailers continue the vicious cycle of deductions. Soon all channel retailers – mass merchandisers, grocery chains, and drug stores – followed suit. Some of them deduct large amounts with the full knowledge that a manufacturer cannot react quickly enough – truly a way to obtain cash inflows around year-end. Over the past few decades, the problem has reached beyond the traditional consumer goods sector.

Today deductions exist in many industries with varying degrees of severity. This is no longer a problem for consumable goods only. It can happen to any B2B company due to many reasons such as shipping errors and shortages. The problem is more severe for companies which depend on distribution channels – distributors, partners, and retailers. Such companies extend channel incentives in

the form of trade promotions, which are often settled through deductions.

Evidence abounds:

- Industry experts concur that traditional consumer goods companies settle 90-95% of their trade promotions through deductions.
- Industry research shows that the percentage for durable consumer goods companies such as in high tech is lower – still, roughly one third of their trade promotions is settled through deductions.
- Home textile manufacturers expect retailers to deduct 10% for every order².
- In the pharmaceutical sector, Bristol Myers/Squibb wrote off 95% of its deductions a few years back³.
- In the electronic games sector, Sega of America Dreamcast sued Kmart for \$2.2 million in deductions representing about 9% of purchases totaling \$25 million⁴.

The list goes on and on.

One reason this problem has been sustained over the years is the increasing market power of the retail distribution channels, the so-called “category killers” such as Walmart, Target, Home Depot, etc. This growth in market power is attributable in part to massive consolidation. Consider the concentration of market shares of the top 5 retail companies in various sectors today – 30% for supermarkets, 60% for department stores, 67% for discount stores, 54% for toy stores⁵. But size aside, the substitutability of manufacturers’ products and retailers’ ownership of consumer data have also strengthened the market power of retailers.

The problem is here to stay for various reasons:

1. Of all causes of deduction, settlement of trade promotions is the major one. Manufacturers need trade promotions as a tool to motivate their retailers, and they need pricing flexibility in order to accommodate the varying needs of different accounts. The problem with such flexibility is that it can cause invoice errors and hence deductions.

There have been efforts over the years to simplify pricing, such as Procter & Gamble’s Every Day Low Pricing (EDLP) attempts, begun in early 1990s; but such strategies do not work for every product and every company. For example, products for which demand fluctuates seasonally are unlikely to sustain EDLP. Even Procter & Gamble (P&G) has only achieved mixed results with its value pricing strategy and has to revert back to the use of promotions in many cases. If a

² Source: Home Textiles Today, October 2001

³ Source: National Association of Credit Management, September 2000

⁴ Source: New York Times, August 2001

⁵ Source: Standard & Poors Industry Surveys, June 2002

company as big as P&G cannot make this work the reality is that such promotional practices are not going away.

2. In a downturn economy, retailers operate in an increasingly competitive market. They will press manufacturers even harder for pricing advantages, and at the same time will take a more aggressive approach in deducting. Both practices, once started, may not be reverted even after the economy improves.

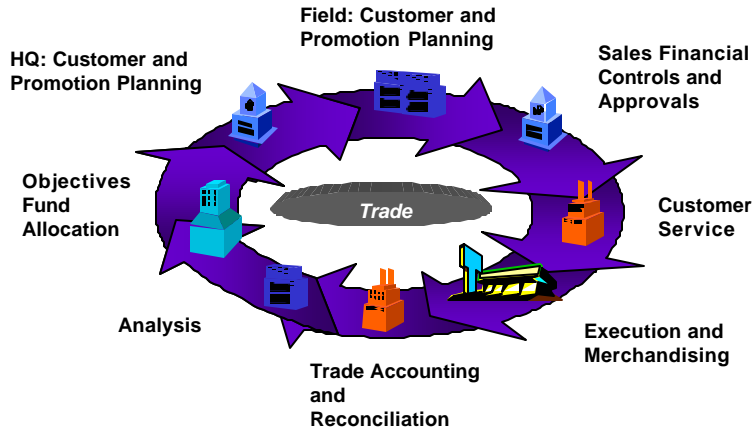
3. In an upturn economy, on the other hand, the costs that deductions impose on a company are masked. As a result, companies often neglect to implement processes to deal with the problem and deductions remain un-resolved indefinitely. A study shows that about 46% of companies have no time limit to get a deduction resolved⁶.

To summarize: the deduction problem has been around for a long time, it persists today, and it is likely to become more serious in the future if not dealt with.

MICRO VIEW

This section considers in greater detail the possible root causes of the deduction problem, how manufacturers deal with it, and the potential pitfalls as well as true costs a manufacturer may confront if it does not manage the problem properly.

The root causes of deduction problems can be traced back to many departments inside a company. Consider the following demand generation, to order to cash cycle. Imagine it as a chain, and each daily operation within the chain as a link. A deduction means that one such link has broken, and when that happens it impacts the whole cycle:



⁶ Source: Credit Research Foundation, Business Credit Magazine, February 2001

Some of the more common deduction categories are summarized as follows:

1. Trade promotions are a leading cause of deduction for consumer goods companies. The lack of integration between sales and marketing, and the back end processes lead to wasted time and resources in determining the validity of a deduction. Overly complex promotional structures also lead to pricing errors.

Promotional allowances given in the form of delayed discounts, or accruals, often times result in deductions. Sales reps who promise such promotions to their customers may or may not have communicated them properly or in a timely fashion to the traditional back end offices. As a result, clerical office employees cannot easily determine the validity of deductions which remain un-tracked, un-managed, and unresolved.

But the lack of communication and information cuts both ways. Without an effective system to control deductions, a manufacturer's sales and marketing staff may be oblivious to the downstream impact of complicated pricing and promotional arrangements, how they can easily lead to pricing errors on invoices.

2. Pricing errors, which may be related to trade promotions or not, present discrepancies to customers between what they are charged and what they expect to be charged. They give reasons to customers to resort to deductions. When investigating the problem of pricing errors, a manufacturer found that there was as low as a 60% match only on pricing with a customer account. Such errors can be caused by dilapidated systems for pricing, ordering and invoicing, or they could be caused by simple human error. A customer service rep (CSR) taking orders may not understand the full impact of entering an order or price incorrectly — that, if a mistake is entered, it may lead a customer to deduct, thus necessitating a team of people in accounts receivable, credit management, and/or sales to figure out what led to the deduction.

3. Quality problems are another major cause of deductions as they are widely interpretive—damaged packaging, spoilage or product defects, any of which may lead to a deduction as soon as a customer receives a shipment. Even after items have been received in good order, a retailer may later deduct on the basis of any such concern. Thousands of times a day a scenario like this one is played out: a consumer walks into a retail store, opens up a package while no one is watching, examines the item within, and puts it back with or without repackaging it. This may very well come back to the manufacturer as a returned item and a deduction due to poor quality in packaging.

4. Distribution and shipping discrepancies—ranging from shortages, unpaid freight to incompliance with carrier or other shipping specifications—lend themselves to penalty charges and deductions to settle these charges. When a shipping clerk loads the wrong quantity or otherwise departs from the strict letter of the customer's shipping instructions, the customer will consider that a deviation from their

instructions and may penalize the manufacturer. Many times the wrong product is shipped causing a discrepancy from what the invoice should have been for. These kinds of errors can be most difficult to research and correct.

5, Post-audit deductions are taken when customers, sometimes hiring third party auditors for the purpose, go back several years to identify reasons for deductions. If the company lacks a good tracking system for all the related documents as proof, such post-audits can exploit it and generate invalid deductions which a company, with inadequate record keeping, has no choice but to write off.

6, Customers may levy various penalty charges for any number of reasons such as handling charges, any incompliance with purchase orders or deviation from sales contract terms. Depending on the specific nature of the business, other factors prompting deductions may include errors in tax calculations, re-pricing of products, and so on.

Faced with such a myriad of problems, companies currently often respond with reactive measures, sustaining a manual and paper based resolution process. Such reactive measures may include:

- Automatic write off thresholds
- Assigning employees to research the problem only when it is large enough or has lasted long enough
- Assigning responsibility to different departments on an adhoc basis
- Arbitrarily converting deductions into transactions without knowing the validity only to create more transactions to correct them later on
- And so on and so forth.

Coupled with these reactive measures, the deduction resolution process itself may be manual and paper based. The company and its customers, or even various groups within the company, may rely on exchanging mountains of paperwork and messages back and forth through mail, email, fax and calls to resolve a single problem, each taking backup copies of the documents and spending unnecessary time in organizing them to circumvent the lack of a central system and process. In a nutshell, many companies fail to take a proactive approach in managing the problem.

Each of the reactive measures has many pitfalls. Automatic write off thresholds alone without corresponding control and analyses, for example, can easily lead to customers abusing the system. Sophisticated customers may develop ways to test these thresholds and deduct just below the tolerance so that automatic write offs are triggered. Likewise, if the company only assigns employees to research a deduction when it is big enough or has lasted long enough, customers can detect the pattern over time and take advantage of it. Adhoc assignment of the research responsibility to various departments treats only the symptoms instead of the root causes of deductions. For example, if a deduction appears to happen due to

delayed shipment, the responsibility may not simply rest on the shipping department alone – perhaps the credit department did not release credit holds in a timely fashion, perhaps the customer service rep taking the order did not record the required ship by date properly, etc. Many companies assign sales people the responsibility to resolve deductions, the result of which is that the number of open deductions explodes and the companies lose control of the problem. Another reactive measure is the practice of arbitrarily converting mass overpayments and deductions into transactions without their validity verified or a means to accurately tie them back to trade promotions. Such measures aside, having a manual and paper based process cripples the company from handling increasingly large volumes of transactions, let alone time and resources for control and analyses. All these pitfalls could cost a company heavily.

With the lack of proactive measures and an integrated, automated resolution process, administrative and write off costs alone can amount to many millions of dollars. Product-quality problems may lead to deductions and returns that will require re-stocking fees. There are also a lot of hidden costs and opportunity costs incurred. Since with deductions, customers are assumed innocent until proven guilty, the manufacturer may very well be financing its customers with zero interest loans. And since the manufacturer is not likely to be in the financing business as well, it will inevitably carry more financial risks than it is capable of managing. Without investigating certain customers' open deductions and disputes, the manufacturer may be extending credit lines that are too high. Tied up cash flows may negatively impact the valuation of a company and curb its expansion opportunities. Without an effective deduction control system, such costs cannot be readily identified or reduced.

Most manufacturers, if they take a hard look at their deductions, will find many different reasons for the problem, each perpetuated by the inadequacy of their current management system that often undermines the true costs. In finding a solution, therefore, it is paramount to take a holistic approach.

FINDING A SOLUTION

Finding a solution to all this disarray is an attainable goal. Best practice solutions must embrace clear ownership of deductions from cradle to grave, a centralized system for all promotional funds and spending, sales team's buy-in to cooperate in controlling deduction and finally measures to pre-empt deductions. To find a best practice solution, a company must align its processes, people and tools. This needs to be done throughout the company, consistently and persistently.

MANAGING THE WHOLE PROCESS

To tackle the deduction problem effectively, a company must find a way to manage the entire process as a whole—from promotional planning to order to cash. There are few novel ideas under the sun, and front end – back end integration is hardly one of them. Yet many companies have not translated this concept into systematic processes. Such processes are crucial both in accelerating the resolution of valid deductions (e.g. when a customer has promotional accruals), as well as in preventing or correcting invalid ones.

Traditional barriers to cross-departmental communication and information access may prohibit a company from managing the deduction resolution process. To find a solution, the company must consider every link in the chain:

- If an excessively complex promotion and pricing structure causes many deductions, the company needs to prompt its sales and marketing departments to weigh the costs and benefits of such structures. Otherwise, some customers may get special discounts in some regions , then divert the products internally to other regions and still take a deduction and gain both ways.
- Sales and marketing need to communicate the deals they make with customers to their own pricing, order and billing offices, and they need to do so in a timely fashion, so that invoices can be error-free and discounts and accruals can be tracked accurately and in advance of an impending claim.
- Demand forecasts need to be communicated back to the supply chain so that the latter can handle as much production as the company can sell. Vice versa, inventory levels need to be visible to sales and marketing so they can better coordinate the timing of their promotions. Uncertainties on either side will not only cost the company in lost opportunities but will also jeopardize customer relationships. Customer dissatisfaction can cause deductions.
- Any information regarding customer requirements that a customer service department may capture during the ordering process needs to filter through the picking, packing and shipping procedures.
- The credit department should be able to access all information on a customer to appropriately release credit holds.
- Accounting needs to issue invoices that match customer orders.
- Pricing and order management need to communicate delayed discounts or accruals back to finance, sales and marketing so that they can tabulate such accruals and protect the company from being caught in a surprise situation where it has accrued less than is necessary to reimburse its customers. This information has tremendous value when it comes time to determine the validity of a deduction.

- When the accounts receivables department identifies a deduction, it needs to communicate the information so that right employees (be they in customer service, sales, credit or collections) can be identified at the same time to take ownership of research and resolution. Resolution will then in turn require these employees to communicate back to their A/R counterparts.
- Collections agents should be aware of invoices with deduction problems, and if other teams are already working on researching or negotiating with customers on them, should not duplicate the work or a customer will not be pleased to be contacted by different groups within a company for the same problem.
- Finance, sales and marketing need to be able to access all information on a customer in conducting meaningful customer profitability analyses. And this includes the customer's deductions and costs to resolve them.
- Employees assigned to analyze deduction data and to discover statistical trends need to disseminate the analyses not just to advise management but also to different groups within the company.

Throughout all these processes, across all these departments, communication and coordination need to happen with consistency and persistency.

CHOOSING THE RIGHT PEOPLE AS PROBLEM SOLVERS

Aligning the right people with the processes is important in managing deductions because assigning ownership is a first step towards problem solving, because to resolve deductions one needs to understand all major functions of a company, and because depending on the deduction scenarios, varying skill sets may be necessary.

Assigning ownership to the right people is a first, and important step in solving the problem. Without proper assignment, a deduction may lie idle without being investigated on. Again, while it lies idle, the company may be financing it as a zero interest loan. When assigning ownership, factors that need to be considered include customer attributes, locations, products purchased, amounts deducted, and reasons for deduction.

Since deductions can be attributable to many business activities in sales and marketing, pricing, order management, customer service, shipping, credit, accounting, collections etc., it is essential to build a team of people who collectively can understand all major functions of the company and can educate each other on them. The point of contact for each deduction, the "owner", also needs to possess the ability to coordinate tasks for various groups.

Depending on the deduction scenarios, different skill sets need to be present within these deduction control and monitoring teams. For example, to address issues with a customer's buyer, a deduction team member who is strong in

customer relationships may be an appropriate person versus someone strong in credit or collections analysis; to address issues with a customer's payables personnel, however, a deduction team member who is from or close to the credit department may be an appropriate person instead.

In general, the volume and complexity of deductions demand that people who research and resolve them be both efficient executors and, at the same time, problem solvers.

FIND THE RIGHT TOOLS: ORACLE'S SOLUTION

Without the right tools, the most carefully designed processes risk delays and disintegration, and the ablest people may end up spending all their time doing administrative or paper work instead of solving problems. Oracle's offering on deduction management has two key components – Oracle Trade Management (OTM) and Accounts Receivables (AR) – and together they provide a solution which addresses the very core of deductions and goes straight to treat the root causes, not just the symptoms.

Integration of Processes

Just as best practice deduction management deals with all processes inside a company as a whole, software tools should also enable managing all front end and back end processes as a whole chain of events, not isolated steps. It is only through such integration that a company can manage and analyze its customer relationships at all touch points, and overcome the restrictions on access to customer information that is so vital to success not just in managing its deductions but its business overall. Absent such integration, companies cannot get a true 360 degree view of their customers, and will always be spending money and time on piecing information together from dilapidated systems.

Oracle's offering embodies deduction management that integrates relevant processes across the full corporate spectrum:

1. OTM's Trade Planning functionalities provide sales and marketing managers a comprehensive set of tools to manage trade promotion planning, execution and analysis process. The tools provide the following benefits to a company in terms of deduction control:

- Such promotions or deals struck between a salesperson and a customer's buyer once entered through the user interface and approved, are immediately applicable and visible to the back end Pricing and Order Management systems. No more time lags, no more uncertain details.
- Any conflicting pricing rules can be detected at this stage to avoid an overly complex pricing structure that a company may not have intended

to build.

- Conditions can be defined so that these promotions can be accurately and automatically given to the right customers on the right products for the right quantity at the price. This minimizes pricing errors, increases customer satisfaction and decreases deductions.
- It is a tool that relieves sales and marketing of the burden to communicate their deals back and forth with finance and administration so they can focus their energy on value-added activities. It also assures sales and marketing's pricing and promotions are authorized and implemented accurately.
- An automated process from demand generation to orders can be achieved.

2, OTM's Funds and Budgets features further provide sales and marketing groups with the ability to administer, control, allocate, tabulate, and track promotional budgets and spending. No matter whose responsibility it is to resolve deductions, the information is all there in one system for users to access. The benefits of such features are as follows:

- The Budgets system tracks all rebates, co-op funds and any other promotional spending. It automatically extracts data from the Order Management system to tabulate the company's promotional liabilities based on customers' sales and performance. In turn, Budgets act as a central repository from which deduction resolution teams can easily access information on such accruals. All this can speed up and smooth out deduction investigations, as the lack of timely information is what often impedes them.
- Budgets and utilizations are automatically communicated to the Financials system with appropriate accounting entries. This removes the need for human administration and allows the company to understand its exact financial liabilities from its sales and marketing activities. Such visibility and proper tracking of liabilities can expedite the resolution of promotion-related deductions.
- Companies can allocate budgets to various sales territories while maintaining overall control via tools such as threshold alerts. These serve to warn sales and marketing management of any risk of over-spending and give them a chance to transfer funds if necessary to ensure that commitments to customers can be honored.

3, OTM's Claims module not only supports deductions but also bill back requests from customers. Such bill back requests can be anything that a customer regards as its open receivables items, such as advertising expenses and display allowances. This module provides these advantages to a manufacturer:

- Aligning promotions with payment options by check or credit enables the

company to meet customer terms. If their requirements are met and they are paid timely, customers are less likely to resort to deductions.

- As a proactive measure, a manufacturer can schedule automatic payments to reimburse customers regularly. If customers realize they are paid on a regular basis, they are again less likely to systematically transfer their receivables items to their payables system to take a deduction.

4. Once orders are placed, with correct pricing discounts applied, AR can automatically create invoices for them. The following are some of the benefits of such automation:

- Invoices will automatically contain all accurate information recorded with the transactions. With invoice accuracy, a customer can reduce its own administrative costs and hence deductions as well.
- Customer requirements on freight and handling instructions will automatically filter through the picking, packing and transportation procedures, thus reducing distribution and shipping related deductions.
- With a common customer database shared among all applications used by different departments, a company can easily keep customer information up to date. Invoices can then be sent out to the right customer mailing addresses for various purposes, avoiding delays and errors that may lead a customer to deduct.
- This completes a seamlessly integrated process from order to invoice.

Managing Accounts Receivables Balances

How a company manages its receivables and collections processes, and indicators such as Days Sales Outstanding (DSO), can impact its valuation. OTM and AR provide an integrated approach to help companies manage this problem:

- When a customer remits payments to the company and sends in a debit memo as well, the AR system can automatically create a receipt and a deduction and pass all payment and customer information to OTM. (Overpayment claims can also be created for OTM users to investigate along with deductions.) This automation reduces the time for the AR team to communicate the deduction problem for other teams to research on.
- The multiple invoices referenced on the remittance will have their balances fully applied while a deduction, considered a researchable item rather than a transaction, is created by AR. This integrated approach allows a company to effectively manage its accounts receivables balances.
- With a single customer database common among all Oracle applications, the Collections team can find out that invoice deductions are already being handled by deduction analysts. This avoids the possibility of

different internal teams calling on a customer for the same problem which can only aggravate customer dissatisfaction.

- The division of labor lets different teams do their jobs best based on their expertise – AR provides the transaction handling and most of the accounting-entry mechanism, while OTM provides the research, control and performance validation tools for deductions. A company benefits by increased overall productivity.

Owner Assignment

At the same time AR creates a deduction record, in the background OTM provides an assignment mechanism to appoint a right owner to it. This mechanism is an important first step to put the right people on the job of researching the deduction. It helps a company to more effectively and efficiently control deductions in the following ways:

- Assigning a single point of contact as the “owner” of a deduction clearly defines who has the responsibility to drive it to resolution. Where different people may be involved in carrying out tasks to research the deduction, this owner can also serve as the project coordinator. With clear ownership, arguments, and time spent on them, about who should be responsible for the deduction can be eliminated.
- Multiple attributes based on deduction type, reason, customer, product and geographical information are available in this assignment mechanism. Companies can therefore appoint the best people with the fittest skill sets to handle different deduction scenarios.

Research and Administration Tools

Research and proper administration drive the ultimate resolution. Whether a company can speedily identify valid deductions and settle them, increase the collectibility of the invalid ones, and resolve disputes with its customers depends on how diligent the research and the administration tasks are carried out. This in turn depends on robust research and administration tools such as what OTM provides:

- Types and reasons help put deductions into the right buckets. Bucketing is important not only for expediting the settlement process but also for helping manufacturers analyze the root causes of its deductions and pinpoint its improvement efforts in those problem areas.
- Customer 360-degree view gives full information on a customer – contact information, class of trade, channel, category, orders and returns, invoices, payments, service, all transactions and past activities. Such data are indispensable to research.

- An advanced but user-friendly database-querying tool makes available any information that a deduction investigator desires at his fingertip. This is for more sophisticated users. Alternatively, pre-built reports can also be made available for the average users. This can save all users an incredible amount of time and hassle digging through information which used to be paper-based or from dilapidated systems.
- Trade Planning tools allow for performance verification before a promotional deduction can be settled. Easy search into a customer's promotional accruals quickly matches them with the deduction.
- A comprehensive project-management tool, incorporating workflow management, coordinates the tasks of different parties involved in the research process. Pre-defined action templates serve to guide the settlement process.
- Each deduction record can store all related information and files that are acquired during the investigation process, such as proof of performance, copy of customer remittance, customer debit memo number, and the like. This provides a central repository for all documentation used to support the decision on a deduction.
- Leveraging Oracle's Trading Community Architecture, OTM can easily identify all related customer accounts (e.g., for bill to, ship to purposes) to the one on the deduction, and can search for and settle all related accruals and transactions. Such relationships may also be in the form of a buying group where different customers group themselves into a larger account to leverage their buying power.
- When a deduction has really occurred not for one reason but multiple ones, OTM users can perform splits to correctly categorize and settle the different components.
- Once a deduction record has been created, all changes to it can be tracked to provide a full audit trail.

Auto-resolution

While research helps a user reach a well informed and thought out decision on how to resolve a deduction, once a decision is made, the actual settlement process may involve processing a lot of transactions back in the AR system again. AR and OTM provide a powerful tool to conduct such transactional processing activities in an automated fashion, potentially saving tremendous amount of time and workload:

- At the initiation of the settlement process, OTM first routes a deduction for approvals via workflow integration and configurable approval rules which can be designed to fit a business' hierarchy and processes.

- Credit memos, whether given on a customer account or on an invoice specifically, can be created and/or applied automatically to settle valid deductions. Any invoice disputes will also be automatically taken off.
- Write off adjustments can automatically be made to invoices for deductions which are invalid or unknown.
- Chargebacks can be issued to a customer to collect the amount back for invalid deductions. This can be done on an invoice specifically or simply issued for the receipt. And through integration with the Collections application, a company can then get the money back.
- All overpayment claims can also be automatically settled by receipt write offs, on account credit and debit memos.
- AR performs most of the accounting entries throughout this process, while OTM performs those related to promotional accruals.

Reporting

Reporting and analyses are keys to deduction prevention and resolution. Through identifying the main problem areas, recognizing trends or patterns in customer behavior, spotting any outliers, discovering correlation between deduction types, evaluating true customer profitability, a company can focus its energy on the most problem-prone internal areas – be it in quality, shipping, order management, etc., as well as customers – e.g. customers whose deduction/sales ratios are higher than average, or whose rate of returns through reclamation centers is higher than average. Leveraging on a common database regardless of the applications used and regardless of which departments use them, companies using Oracle's solution can always have easy access to all information. This equips companies with the ability to better negotiate with their customers who are more likely to be reasonable when presented with facts and figures:

- The same querying tool that helps with deduction research can also provide benefits in reporting. This allows a company to access all data across departments in the same system and to design any reports in any format, thus providing a single source of truth without the need to patch together separate reports for analyses.
- Flexible and personalized searches let all users sort and group deductions by customers, transactional details, salesreps, amounts, type, reason or other deduction details, providing daily operational tracking capability.
- Aging reports by customers, by time periods and by dollar amounts help management identify the most problematic customer accounts.

RETURN ON INVESTMENTS

Investing in a system aligned with objectives for deduction control and management can yield immediate and significant financial returns: Such returns can come from a few areas of improvement:

1, Savings in time and resources conducting research.

To calculate the savings in this area, companies need to first measure what factors contribute to the costs here.

For example, if:

Average number of staff involved in resolving a deduction = W

Average time in hours each spends = X

Average hourly cost of their time = \$Y

Other costs (such as administration) incurred in the process = \$Z

Then, the total cost per deduction = $\$(W * X * Y + Z)$

Estimates from various industry sources suggest that with a deduction control and research system in place, the time to research a deduction can be lowered by as much as 90 days, while the cost of processing each deduction can be lowered by as much as \$100. In addition, while companies usually only consider the value of time in hard dollar terms, they really should consider who these people are and what they would be doing if they are not spending time on resolving deductions. 3M, for example, found that their average cost per deduction, regardless of its size, and regardless of its ultimate validity, was about \$200 without field sales people's involvement, but \$350 with field sales people's involvement⁷.

While the majority of deductions can be determined to be valid after research, without the proper tools to conduct such research, much time and resources will be lost. With the proper tools, claims' validity can be identified with much less time and resources, creating savings for the company.

2, Lower financing cost from reduced time required to identify and collect invalid deductions.

Deductions which, after research, are determined to be invalid, can be charged back to and collected from the customer. The problem is, without any deduction control and research system, during the time such deductions either sit idle without an appropriate owner or while it is going through a lengthy research process, the company incurs financing costs for it. Cash flows that are tied up as a result of these deductions could have been invested in other opportunities. The magnitude of such costs depends on the cash management policies of a company. An average money market fund return averaged 4 to 5% in the past five years. The

⁷ "Deduction Prevention", by The National Association for Promotional & Advertising Allowances (NAPAA)

difference between that and the cost of equity for a company thus represents its opportunity cost.

3. Lower costs from decreasing automatic write-offs.

Companies generally use automatic write offs to avoid incurring research costs for deductions of low value. In setting automatic write off thresholds, companies should consider the costs and returns of doing so, and set the threshold at where the costs equal the returns.

For example,

Research cost per deduction = \$V

Cost of monitoring abusers of automatic write offs + Other costs from having automatic write offs = \$W

Automatic write off threshold amount = \$X

% of these automatically written off deductions which could have been recouped (charged back to and collected from a customer) had it not been automatically written off = Y%

Cost of recouping a deduction = \$Z

Automatic write off threshold should therefore be set by:

$V - W = X * Y\% - Z$, i.e. the threshold = $\$(V - W + Z) / Y\%$

Methodologies far more or far less sophisticated may be in place to establish this threshold, but the general principle is that inhibitive deduction research costs drive these thresholds.

With the right tool, such research costs can be significantly lowered. As a result, companies may now be able to afford lowering these automatic write off thresholds and start getting some of the money back. Overall improvement in this area can range from 5% to 15%.

4. Lower costs from preventing deductions

Processing deductions more efficiently can lead to an increase in customer satisfaction which by itself can be a main factor of deduction prevention, but rigorous reporting and analysis can help companies further prevent deductions. With a solution such as Oracle's, where all deductions and customer data reside in one place, companies can easily extract reports for analysis purpose. Improvement in this area can be easily measured by the decrease in deductions from the numbers in the past.

CONCLUSION

Deduction is a problem that exists in many industries and many companies, but your company can take control of the problem by understanding its root causes

and by tackling it with the right process, people and tools. To be successful in controlling deductions, one must remember to take a holistic approach as the root causes may span across many departments. Streamlining your processes and facilitating communications between various departments will be paramount to success.

Finding a software package that understands this approach is equally important. Oracle Trade Management and Accounts Receivables is a solution that takes this same approach in providing you with not only the best-of-breed research, administration, analysis and settlement functionalities to resolve and pre-empt deductions, a central repository that tracks all promotional funds and spending, but also the system integration that will enable all groups within the company to communicate, to understand customers and to collaborate in satisfying their needs. Taking control of your deductions will improve your customer relationships and yields significant financial rewards to both your top line and bottom line.

The numbers are staggering. The opportunities for improvement, however, are more so.



Oracle Trade Management and Accounts Receivables
September 2002
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