First Thoughts

By Dan Gilmore - Editor-in-Chief

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Thinking about Supply Chain Chargebacks

I have been thinking a lot lately about "chargebacks" for lack of supply chain performance, and find that in one sense it is among the most odd subjects in supply chain, partly because it is one that is clearly under discussed.

I have several triggers for why I am writing this column on chargebacks, and several anecdotes as well.

First, I will note some readers in the industrial sectors may have little idea what I am even talking about. Chargebacks are primarily – but not exclusively – a retail industry phenomenon (more on that below) in which the retailer through some mechanism tracks a vendor's performance against a small or wide range of criteria, ranging from labeling to advanced ship notices to on-time delivery and more. When a supplier fails to deliver, they are levied fines or chargebacks for that failure, fees that vary from small to large and everything in between depending on the offense and the retailer.

At one point in the 1990s, Kmart used to just take 2% off the invoice just on the assumption every supplier would have violations and the automatic deduction was just the easiest approach.

Some triggers for this piece:

I hope you have noticed, but over the last few years we have done a series of Videocasts in partnership with **Compliance Networks**, and they have been outstanding. We have a new series of them for 2010 on Best Practices in retail supply chains, featuring **Dr. Brian Gibson** on Auburn University, information about which can be **found here**. Last year, we had a great series on "New Ways of Working Together in the Consumer Goods Supply Chain," featuring in part **Jim Flannery** of Procter & Gamble, and those can be found on our **Videocast Upcoming and On-Demand Schedule** under the Consumer Goods/Retail section.

Second, last year we did some reporting on growing challenges for manufacturers in meeting retail carton label requirements. Along the way, let's just say we heard something along the lines from some industry groups that retailers might be interested in talking about improvements, but "don't let anyone think you are getting in the way of the retailers' chargebacks."

> **Gilmore Says:**
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> "Should non-retailers consider similar programs, especially if the answer is that this supply chain stick is needed to really get suppliers on board?"
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Message understood.

Some anecdotes:

When our Materials Handling Editor **Cliff Holste** and I were working on a project for totes in the late 1990s, we visited a distribution center for Isotoner, which totes had just acquired. The DC manager had left after the deal, as DCs were being consolidated. In an empty office, here and there we found deduction notices for $180,000 for the quarter from this department store, $130,000 for another, etc.

It's not too hard to come up with a cost justification for a new Warehouse Management System or other technology that can get those chargeback dollars down, and historically, in consumer goods, that's how many systems were sold. Manhattan Associates actually

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got its start specifically by meeting the operational challenges of UCC-128 labeling, ASN's, carton contents labeling, etc., when these requirements first started rolling out.

A couple of years ago at a CSCMP session on transportation, there was a long discussion on better collaboration between the retail industry panelists and their suppliers. At one point, several consumer goods company transportation managers in the audience started to say something like "If you are all about this collaboration, why don't you stop some of these ridiculous chargebacks for many violations that are out of our control!"

The lack of response by the panelists was deafening.

In retail, the approach to chargebacks varies dramatically by sector. The department store chains and some mass merchants generally have been most aggressive about chargebacks, but that concept has certainly spread to other sectors. However, they are not prevalent in the grocery industry, or at the same level, as one example. Some retailers have specifically eschewed compliance penalties for their suppliers.

Walmart was never as aggressive as its competitors in the chargeback game. It has some agreements with suppliers that end chargebacks for specific violations (a few other retailers are open to this as well). Still, in February of this year, Walmart announced that suppliers which fall below a 90% monthly threshold of delivering within a four-day window leading up to its Must-Arrive-By-Date (MABD) will incur an invoice deduction that is equal to 3% of cost of goods sold (COGS). Ouch!

So the key but rarely discussed question: are these chargebacks primarily a revenue/profit source for retailers, or a true mechanism to improve supply chain performance, some of both, something else?

And should non-retailers consider similar programs, especially if the answer is that this supply chain stick is needed to really get suppliers on board?

From my view, the answer to the question above is "some of both." Clearly, there are some retailers who are more revenue-focused on their compliance programs than others. It came as no surprise to many when in the terrible retail climate of 2009, all of a sudden chargeback violations started climbing. It is known some retailers have specific DC staff, sometimes outside employees, who scout for violations.

Yet…can you run a flow through DC operation well if labeling is bad, ASNs are inaccurate or shipments don't meet delivery dates? The simple answer: No.

In one of those videocasts, we featured **Jim Rawlins**, senior vice president of distribution and logistics at The Bon-Ton Stores, who both on and off the tape made a persuasive case that their compliance program and technology (Compliance Networks) was supply chain driven, and how the chargebacks reflected real costs to Bon-Ton's supply chain when vendors didn't meet their expectations. Manually handling cartons in the DC is expensive.

Which brings me to this: should more companies outside of retail be using chargebacks to get supplier performance better in line, and even increase supply chain visibility?

Two years ago, another CSCMP session featured several industrial companies, including John Deere, which just getting started with taking control of inbound freight – and struggling to get vendor compliance to routing guides. Were any considering chargebacks for non-compliance? Not quite yet, but maybe.

Manufacturers are almost all "Scorecard" driven. Meaning, they meet with suppliers and review performance along key performance dimensions. They also tend to have just a few suppliers – maybe as little as one – for most purchase categories. Many of those relationships are of a strategic nature, a concept not really found in the retail industry. Can a strategic relationship, collaboration, and chargebacks all exist at the same time?

One point I have learned from these videocasts is that the technology for tracking "violations" has a tremendous value whether or not fines are associated with it. Scorecard data by i is dated, and doesn't much help solving today's problems. Looking at compliance in the same level of detail as a retailer does, even without the penalties, may bring a lot of benefits to a company's supply chain. In retail, "violations" are often communicated to vendors as they occur – maybe helping to solve a problem earlier than the quarterly scorecard method would achieve, for example. Such an approach can provide detailed level of real-time supply chain visibility.

This is a hard subject for me, and think in retail and non-retail, the answer as usual is "it depends."

But in both areas I think we clearly need more discussion and research for this somewhat "taboo" topic. Be curious as always on your thoughts.

What are your thoughts on chargebacks? Do you agree the subject is under discussed? How can the basic concept be applied outside of retail – or should it? Let us know your thoughts at the Feedback button below (confidentiality observed upon request).

Dan Gilmore

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Feedback

2010-05-14

Chargebacks should only be used with great consideration mainly. For example, did a late delivery not due to weather, accident or natural causes result in the retailer losing sales that exceeded what they normally would have sold?

I think too many are playing the chargeback game as profit center, which most of our fathers or grandfathers would consider unethical.

Paul Soper
Refrigerated Delivery Service

2010-05-14

As a transportation manager within the food industry, I see the chargebacks for late delivery being levied by both our Retail and Foodservice customers. Mr. Gilmore has a pretty good grasp on the subject. My answer to his question would be that other industries should not adopt the chargeback practices of retailers, at least as they currently are being done.

Some of the inequities I see are:

- *The chargebacks are frequently out of proportion to any efficiencies that may be caused.* For example, one customer has a penalty of $1000 per day for late delivery, even on LTL quantity orders where the transit time can routinely vary, and even if they are notified in advance. Within the food industry, this sort of penalty can easily exceed the profit margin or even the total invoice value on small orders.
- *The chargebacks are incurred for reasons outside the manufacturer`s control.* Many of these penalties apply in the case of weather delays, unavailability of receiving appointments, or even when the purchase order is submitted to us with inadequate lead time! In many cases I have seen chargebacks incorrectly applied due to errors in the customer`s system, such as misidentified arrival dates or purchase order numbers.
- *The chargebacks are a one-way street.* I have never heard of the shippers being compensated when the receiver causes inefficiency. What happens when the trucks are delayed at the receiving dock because three guys called in sick, no lumpers are available, or the WMS crashed? Does the customer pick up the detention charges, or the late delivery penalties that may be incurred for other orders on the same truck?

In my opinion, this practice amounts to establishing just another profit center for the retailers. Eventually these charges must be rolled back into a manufacturer`s pricing, and added to the consumer`s cost.

Mark Wilder
Distribution Manager
T. Marzetti Company

2010-05-14

Obviously manufacturers and retailers are different animals. If Boeing can't get fasteners, customers may not get 787's and lots of employees (and other suppliers) will have nothing to do. If WalMart can't get Campbell's Pork and Beans customer will probably just buy Van Camp's instead. Yes there is lost efficiency, but it is not as big a deal as undeliverable 787s.

That being said, everyone wants to receive the perfect order – on time, right quantity, damage free, right documentation - it doesn't matter where in the chain you sit. But beating the supplier into submission through chargebacks does not work any better than it does with your children. Instead, consider the win-win strategy outlined by Vested Outsourcing where suppliers and their customers understand and work toward a common set of desirable outcomes. Both profit when planes are flying through the air and beans are flying off of the shelf.

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