

How to Reduce Chargebacks in Your Vendor Compliance Program

Retailer chargeback fines for non-compliant shipments are a profit-draining reality for many consumer goods manufacturers. But they don't have to be. Companies with the will and the resources to prevent and refute chargebacks can avoid hundreds of thousands, even millions, in lost profit. Success requires creating a vendor compliance capability – either internally or through a partnership with a third party logistics partner (3PL) experienced in retail distribution.

This paper provides background on the origins and rationale for chargebacks, followed by a 7-step process for avoiding or overturning these costly penalties.

Late shipment -
10% of
merchandise cost

Wrong bill of lading -
\$195/shipment

Incorrect label -
\$5/label

Invalid ASN -
\$10/carton



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When and Why Did Chargebacks Begin?

The history of chargebacks is a bit murky, but vendor compliance can be traced to the 1970s and the continued rise of the mass retail channel – Walmart, Target, Best Buy, Macy's and other big box chains. These companies recognized that their success depended on pushing huge volumes of inventory through their supply chain with maximum efficiency. So they invested in automated warehouses and sophisticated systems that allowed product to flow through with minimal human intervention. When a non-compliant shipment comes in, let's say boxes with labels that cannot be automatically scanned by an overhead bar code reader, it becomes an exception that requires manual intervention (AKA: cost).

Chargebacks became the retailers' answer to controlling these exceptions and keeping their supply chain machines running smoothly. In Walmart's U.S. operations alone, merchandise from 60,000 suppliers flows through 130 DCs to 4,400 stores. It's easy to see how non-compliant shipments could cripple efficiency.

Most frequent chargebacks by category

1. Early/late delivery
2. ASN/EDI violation
3. Improper label
4. Purchase order violation
5. Pricing error
6. Shortage in product shipped
7. Ticket issue

Source: VCF

Compliance requirements for each retailer are different and are spelled out in lengthy documents called routing guides – a set of procedures for suppliers on how goods are to be prepared and shipped. When these procedures are not followed, retailers issue a chargeback to cover the cost of the inefficiency created by the out-of-compliance shipment. A chargeback can be as much as 15%–20% of an invoice. With some invoices easily totaling hundreds of thousands of dollars, vendors can get hit with chargebacks of \$20,000 or more at a time. These chargebacks are not payments requested by retailers; they are automatically deducted from the supplier's invoice.

Compliance Enforcement: Part of the Retailer Bureaucracy

Some vendors rail, behind the scenes, that retailers use compliance as a profit center. Large retailers will tell you that

100% shipper compliance with routing guides would give them a huge profit boost. That's why they have full-time staff members who oversee compliance issues. Retailer enforcement of routing guide requirements has become a process as automated as their distribution centers.

Chargebacks are issued not because someone saw a mis-labeled box. They are triggered, mostly, by an automated report from a system that tracks exceptions. Let's say a truck leaves a vendor's warehouse at 8 am on its way to a retail distribution center. The retailer wants an advanced shipping notice (ASN) that details what products are coming and when so they can pre-plan for efficient receiving. If the truck arrives but the ASN has not, the system automatically issues a chargeback for all orders on the truck.

The problem with machine-driven processes is that machines make mistakes. But vendors, particularly smaller vendors who feel they lack leverage, are hesitant to challenge powerful retailers and simply accept the chargeback as a cost of doing business.

There is plenty that retail suppliers can do to bolster compliance capabilities and reduce chargebacks. But it will involve time, effort and focused resources.

7 Steps to Improve Compliance and Reduce Chargebacks

1. Quantify the financial impact of chargebacks.

Arrive at one, definitive and defensible number for your total chargeback costs. This won't solve the problem, but it will position you better to win support for investments in people and systems you may need. The information may be easier to get than you think. Accounting typically provides a report to logistics or the distribution center on chargebacks received. This will identify costs directly related to invoice reductions.

Other costs may be tougher to quantify. For instance, if a shipment is refused at the retailer's dock, the supplier absorbs not only a chargeback reduction but the freight cost to truck it back to the distribution center, the labor to re-palletize the product, and the cost of extending the cash cycle several days.

2. Invest in an advanced warehouse management system (WMS).

Staying one step ahead of retailer compliance requirements without an advanced WMS is like racing the Indy 500 in your dad's Buick. It's not a race you're going to win. Any paper-based process will require significant labor to stay compliant. And no amount of checks and re-checks will eliminate human error entirely. That's why you need a WMS to automate distribution and data transfer

tasks. Barcoding and RFID ensure a high level of accuracy, and picking and shipping errors are automatically identified. If you use a 3PL that lacks advanced WMS, chances are you're paying for this lack of automation with increased chargebacks.

3. Get EDI right. After early/late deliveries, by far the biggest source of retail chargebacks is late, unreadable, or incorrect advance shipping notices (ASNs) – information transmitted to a retailer in advance of delivery that details the products and volumes in the shipment. Address the ASN problem and you've licked a good percent of your chargeback issues. Of all the electronic data interchange (EDI) feeds retailers receive, ASNs are the most important. Having real-time facts on goods in transit enables retailers to:

- Pre-plan receiving to reduce labor costs
- Identify discrepancies between orders and shipments so they can reallocate inventory
- Cross dock freight to reduce storage costs and speed the flow of goods to stores

Retailers are keen to leverage these advantages and have little patience for non-compliance with EDI technology that has been around for over 20 years. Invest in the right systems to manage EDI, or outsource to a 3PL or other provider that specializes in EDI.

4. Make compliance someone's full or part-time job.

Who owns vendor compliance? Logistics? Sales? Accounts Receivable? With no clear owner, there is no clear plan. With no clear plan, compliance deteriorates into a cycle of repeated violations and finger-pointing. The responsibilities of a dedicated compliance resource are clear: all activities related to creating, implementing, and enforcing procedures required to meet retail routing guide requirements.

The right 3PL can take on shipping compliance requirements, allowing you to, in a sense, outsource vendor compliance (See sidebar: *Compliance: What Part Can Third Party Logistics Companies Play?*). 3PLs who ship to the same retailers on behalf of a large number of CPG customers can justify the cost of dedicated compliance resources.

5. Develop a better audit process. Clearly document the specific requirements of each retail customer and do a QC check on a percent of outbound shipments. The documentation process is easy. Most large retailers have vendor websites where they post and update routing guides. The audits themselves typically involve checking that:

- The correct label has been applied to the correct carton or pallet
- Labels have been placed in the right location

- The correct packing lists have been attached
- Pallet instructions have been followed (e.g. correct pallet type used, proper pallet height and configuration built, use of shrink-wrap)

If you use a 3PL for distribution, ask to see their written audit procedure and their internal scorecards against these audits.

Compliance: What Part Can Third Party Logistics Companies Play?

Third party logistics providers (3PLs) who manage distribution for consumer product companies play a critical role in ensuring compliance. In fact, consumer goods companies with limited resources to invest in a compliance program can lean on a 3PL to take on much of this burden.

Weber Logistics is a 3PL that has made vendor compliance a strategic priority. Here are some of the steps Weber has taken to reduce the impact of chargebacks on its customers' profitability.

- **An intranet website on vendor compliance.** The site includes all major routing, shipping and labeling requirements for each retailer.
- **Detailed process documentation.** SOPs for all packing and shipping processes are written to incorporate compliance requirements.
- **Fool-proof label placement guidelines.** Weber's IT department programmed its WMS system to output an actual diagram of proper label placement at the same time shipping labels are printed.

According to Mimi Ma, Weber's director of quality and vendor compliance, "We're not waiting for customers to tell us what to do in the area of compliance. We view ourselves as part of our customer's organization, so it's our job to stay informed about retailers' changing compliance requirements."



Getting Chargebacks Reverse Pleading Your Case to Retailer

Here are several examples where large chargeback fines were reversed:

- A CPG company was hit with a \$15,000 chargeback when products arrived on a used pallet instead of the new pallet the retailer had specified. Turns out the product left the DC on the correct pallet but an LTL carrier switched the pallet in transit. Luckily, the company's 3PL had photographs of the shipment leaving the loading dock on the correct pallet and the charge was overturned.
- A toy manufacturer just signed on as a supplier to a national retailer but was soon hit with a \$30,000 charge for improper EDI transfer. The supplier was told by the retailer they had a short grace period to do EDI testing. With the help of its 3PL, the company met with the retailer and shared a detailed timeline of EDI testing and the charge was waived. Sometimes your evidence can be nothing more than documenting a good faith effort.
- A truckload of apparel products that was shipped to a national retailer resulted in a \$12,000 chargeback due to bad labels. The manufacturer asked to see a sample of the labels in question. When the retailer was not able to furnish the sample, they agreed to reverse the charge.



6. Challenge chargebacks. Vendors can successfully challenge a portion of chargebacks, but it takes time and effort. Your starting point is documentation. You'll need evidence that the shipment in question was compliant. It's like getting a traffic ticket. You can ask the judge to waive the fine, but without documented evidence you'll likely be writing a check. Determine for yourself the best way to document compliance before the fact. For label-related issues, photograph a portion of your shipments before they are loaded on a truck. For delivery time issues, have drivers sign in and out noting the time they arrived and left. You're likely to learn of a chargeback months after the infraction, so you'll need historical logs you can refer back to. (See sidebar: *Getting Chargebacks Reversed*)

7. Build relationships with key retailer contacts. Chargebacks are certainly a contentious issue. But the bottom line is retailers want you to succeed. They document their requirements in painstaking detail, host workshops to review routing guide changes, and invest in dedicated resources to work with suppliers on compliance issues. The key for suppliers is to take advantage of opportunities to collaborate with retailers. Visit the retailer's DC to understand their receiving process, conduct quarterly conference calls and scorecard reviews, cultivate a personal relationship with the retailer's compliance team. As complex as compliance can be, personal relationships can be the most powerful part of your compliance program.

Compliance = Profit

Non-compliant shipments impact profit in a big way, for both retailers and suppliers. So chargebacks will remain a necessary reality. Retailers have developed a large-scale, automated system for compliance enforcement. Their much smaller suppliers also have built compliance capabilities, but at a slower pace due to resource limitations. Some have leveraged 3PLs to kick-start efforts to become "Walmart compliant" or "Target compliant." Whichever route you take, the key is to get started. Mastering the compliance game drives dollars direct to your profit line and boosts revenue by improving your reputation with retail customers.

Founded in 1924, Weber Logistics is a third-party logistics company that provides warehousing, transportation, and port logistics services on the West Coast. With distribution centers throughout California and a fleet of trucks for dry and temperature-controlled deliveries, Weber gives growing companies flexible, scalable distribution solutions for their West region customers.

