Empowering Distributors to Maximize Margins through Effective SPA Management

SPA (Special Price Agreements) in Wholesale Distribution

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Across industries, manufacturers follow the common practice of offering special pricing agreements to distributors to win business and compete for market share. This often means that the distributor ends up selling inventory for less than they originally paid for it, and to recover margins, it is critical that they efficiently 'chargeback' that cost delta to the vendor. Managing the high volumes that run through these special pricing programs requires a solution that is tightly integrated with a company's existing systems, resulting in the visibility that is critical to obtaining maximized profitability.

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Executive Summary

Maintaining or increasing **product margin** is highly regarded as a method for profitable growth among distributors. Industry data confirms that roughly half of distributors' **profit is now based on vendor cost recovery programs** (SPA programs). Those programs must be well managed to be financially successful, especially when one considers the increased focus by regulators on SPA controls and reporting.

Even the best run distributors depend heavily on vendor cost recovery for success. For some distributors, their entire net profit results from these vendor payments. But these programs present distributors with a dilemma. How can they manage this increasingly important source of cost-of-goods-sold reduction, in a way that is not costly, time consuming and cumbersome?

It is a daunting task for distributors to keep track of the many SPA programs in place; validity dates, specific customers and SKUs, stand alone or only eligible in bundles, minimum & maximum quantity restrictions, etc. Calculation variables like List price, cost prices, purchase price makes it more complex. Considering all their permutations, SPA programs are a very complex method of shaping demand, providing incentives for sales and compensating distributors based on performance. Because of the potential to impact the company's bottom-line profitability, it is critical to be able to properly identify and resolve any SPA related issues.

Wholesale Industry is looking for an affordable, manageable and supportable enterprise solution for large organizations to ..

- Lower operating costs with efficient and streamlined management of vendor claims
- Reduce manual administrative work
- Reduce cost of dispute resolution
- Reduce vendor receivables days outstanding
- Increase Cash flows
- Reduce cost of goods sold

This white paper will illustrate today's chargeback process in detail, pinpoint areas where distributors can improve their chargeback process, and describe the benefits of an integrated enterprise chargeback solution.

Why do we need Vendor Chargeback System (SPA)?

On paper, the chargeback process is simple. A contract is negotiated between the distributor and the vendor or manufacturer, outlining the terms and conditions of a special pricing agreement. A customer places an order with the distributor that is eligible for the special price. The distributor submits a claim to the vendor or manufacturer for reimbursement of the special discount. The vendor processes the claim, and the distributor records the payment.

However, the process is not as simple as it seems. For many distributors, it is complicated, time-consuming, error-prone, and therefore costly. The complexities of changing agreements can result in claim disputes and delayed payments. Any leakage of these claimed chargeback amounts results in lost margin, and could mean the difference between a profit and a loss. Aging claims can also impact a distributor's financial performance.

The challenge for most companies is that they do not have clear visibility into all of the special pricing agreements that may be at play, and how they integrate into their purchasing and sales processes. It is difficult for them to challenge disputed chargeback claims because they struggle to uncover what caused the discrepancy. Did they apply an agreement to a sale that was not actually eligible? Did the vendor stipulate an exclusion or a rule that the distributor was not able to support, other than relying on manual intervention?

An inefficient chargeback process is bad enough, but an inaccurate one that ultimately results in lost margin is too costly for a distributor to accept. If they cannot analyze the profitability of each SPA, then they risk losing critical insight that gives them competitive advantage. Without an integrated, systematic, rules-driven approach, they face income leakage, painful write-offs, high reserves, and increased days chargeback outstanding.

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Key Business Needs

- *Flexibility:*
  SPA programs come in different shapes and sizes; sometimes simple, other times quite complex. Programs may apply to all customers and products during a promotional period, or they may only apply to certain customers, products, or even specific opportunities. Distributors must be able to adapt so that they can price accordingly, track the cost delta in the ledger, and claim/collect the money from the supplier.

- *Accuracy*
  A distributor must maintain their suppliers' confidence in data so that they are paid timely with minimal disputes. They must ensure that they do not apply SPA discounts to ineligible sales and comply with the suppliers' guidelines for each SPA program.

- *Ease of Use*
  Must be intuitive for the users who:
  - create SPA programs in the system with precise eligibility rules according to manufacturer guidelines
  - create sales quotes/orders, relying on comprehensive view of all eligible SPA programs for each sale, as well as the impact on pricing, margin, and commissions
  - analyze the financial impact and ledger postings related to SPA programs
  - process claims according to vendor requirements
  - apply reimbursement payments to SPA claims

Distributors want a solution that will reduce end-to-end processing time by being easier to use than excel spreadsheets not integrated with their core systems.

Various Wholesale Distribution Industry Requirements:

Claimable SPAs: When a supplier authorizes a SPA for product, the distributor often fulfills eligible orders from existing stock. Once eligible sales are made, the distributor is then required to file claims, or chargebacks, for the difference between the distributor's normal purchase price and the discounted SPA cost. Following is a brief description of various types of claimable SPAs.

Price Exception – a customer specific agreement, where the vendor has authorized a special price for certain items sold to that customer, typically only for a specific deal or end-user.

Partner Program – programs created by a vendor to classify resellers who purchase their products, and to provide additional discounts and other benefits for various levels of customers.

Promotion – specific items or groups of items are discounted for a promotional period, typically available to all customers.

Mix and Match – popular promotional SPA issued by manufacturer to sell products in numerous combinations (e.g. buy item A or B, receive item C free of charge).

Demo – an item is discounted and sold as a demo unit. There are often restrictions on how many demo units each reseller is authorized to purchase within a product family.

Non-Claimable SPAs: SPA transactions do not always result in claims being filed. Following are some examples of non-claimable SPAs:

Purchase Offset – A vendor may reimburse a distributor by authorizing a reduced price on an offsetting purchase order rather than requiring a claim. The distributor will offset the cost variance on any SPA sales to the cost variance on such PO's in order to be made whole.

Write-Down – product that is discounted for liquidation, funded by obsolescence reserve, for example.

Coop Marketing – A distributor may receive marketing funds to promote the manufacturer's product, received in the form of additional discount when product is purchased. A negative SPA can be used to maintain a higher selling cost and prevent this additional coop related discount from going to the street, since the vendor will require the distributor to verify proper marketing use if the funds.

Vendor rebate SPAs: Vendors typically offer distributors volume-based incentive rebates as a percentage of sales-out or purchase-in. It is advantageous for distributors to diligently monitor these opportunities in order to attain the required goals for payout.

Intercompany SPAs: For entities with a multi-company organizational structure, they may have the need to share inventory, and as a result, share SPAs also. Intercompany SPA allows that to happen, monitoring eligible sales and usage across companies, but consolidating the claiming process.