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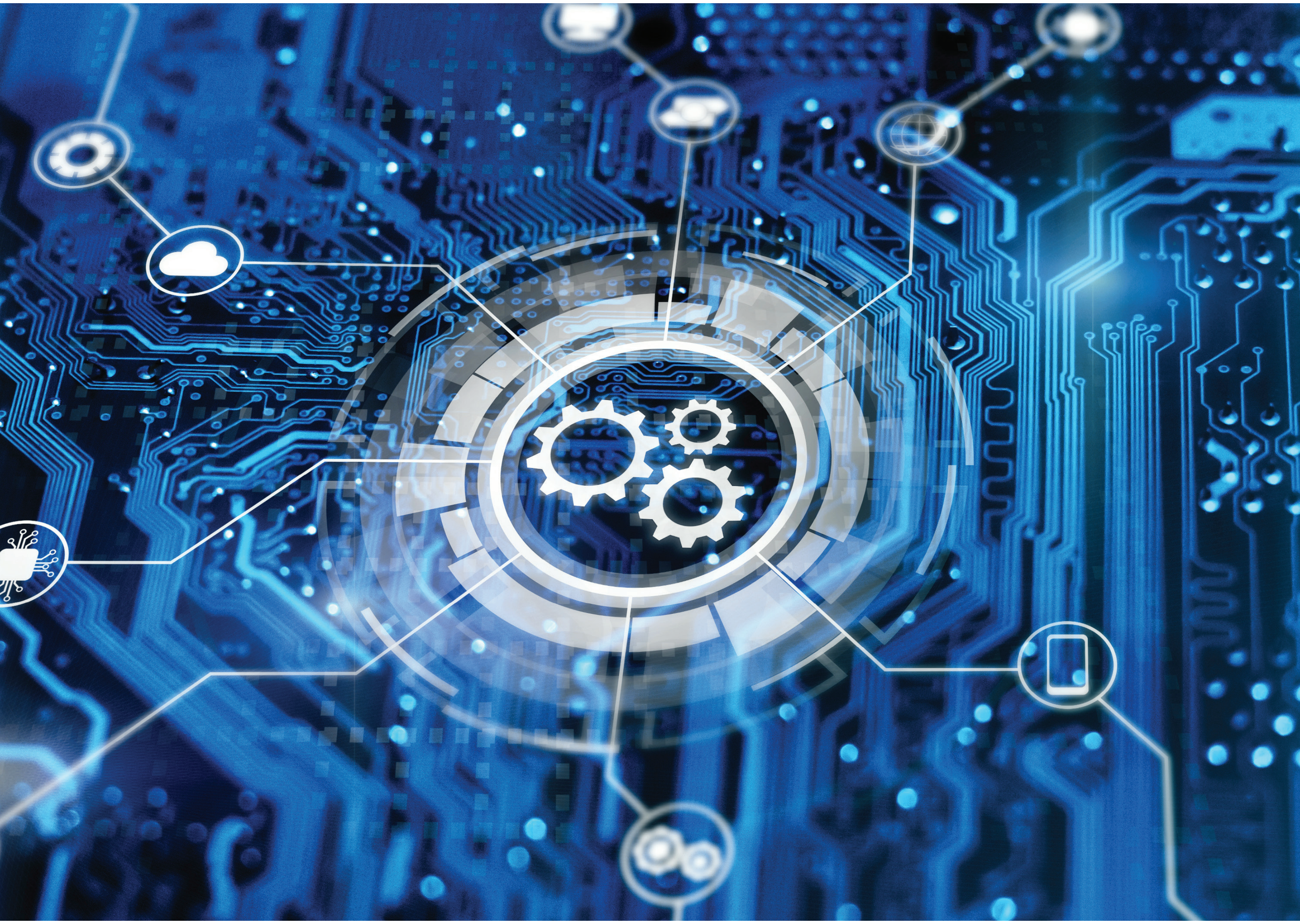

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CFOs are facing a perfect storm of increased price pressures, a challenging labor market, and sluggish revenue growth. Negative gross domestic product (GDP) growth is further dampening CFO optimism about the economy. CFOs on average expect a 1 percent drop in the growth of the real GDP1. Navigating this laundry list of high-stakes growth challenges won't be easy. But rethinking the way their business manages its accounts receivable (AR) processes can help.

As one of the largest assets on the balance sheet, AR can have a big impact on the financial performance of a business. That's especially true when it comes to researching and resolving customer deductions – when a payment is made on an amount less than the net invoice amount. Poor deductions management results in lost profits, high operational costs, wasted employee time, and frustrated customers and departmental stakeholders – all which chip away at corporate profitability.

The length of time to resolve deductions is a barrier to improving Day's Sales Outstanding (DSO), aging balances, and other key AR metrics. This paper details the three types of deductions, shows how manual approaches to deductions management increase the time, complexity, and cost of AR, describes an automated approach to deductions management, and details the benefits of automation.

On average, 2 percent of the total value of a company's invoices end up being disputed and dropped into a deductions operation if the process is manual[2].

The Situation

Whether you call them deductions, chargebacks, claims, disputes, or short payments, those instances where customers pay a business less than it expects can create a big operations and cash flow burden.

Deductions can be taken as a short pay on an invoice where the amount remitted against the invoice is less than the balance due, or when the items listed are debited on cash remittance details (which can be related to multiple invoices or related to a different agreement not tied to invoicing).

Deductions fall into three broad categories:

Deductions are the preferred method for paying promotional dollars in the consumer goods industry.

1. **Trade practices:** Trade practices are legitimate deductions that are a "cost of doing business." These deductions typically include promotional pricing, slotting fees, marketing and advertising bill-back allowances, rebates, mark-downs, the return of unsold seasonal or excess product, freight charges, bank fees, and price protection programs. In some industries, taking a deduction is an acceptable form of making a payment to a customer for pre-agreed upon terms such as a promotion or a rebate. In these industries, most deductions are valid. For instance, one major retailer instituted a program several years ago that allows it to deduct 3 percent from the cost of goods sold for suppliers who fail to deliver goods to its retail locations within a four-day window more than 90 percent of the time during a month.

Most mass market retailers short pay most of their invoices. Yet these deductions are valid, with corresponding credits sitting in an account or waiting for internal approvals.

2. **Preventable deductions:** Preventable deductions include poorly communicated pricing data, slow credit memo issuance, misinterpreted promotional programs, conflicting terms and conditions, processing errors in order entry, missed edits to orders, rush orders sent without shipping notifications, billing errors, incorrect taxes, compliance problems, and electronic data interchange issues. One common cause of preventable

1 The CFO Survey, June 2022

2 The Hackett Group, The Hackett Group Finance Benchmark, 2020

deductions is an incorrect invoice to a customer caused by mis-keyed line-item level information from a sales order. Complex promotional programs and pricing matrixes also can result in preventable deductions.

CFOs are demanding greater accountability and transparency over financial processes such as deductions management.

3. **Erroneous customer deductions:** These are unauthorized or excessive errors such as unearned or duplicate discounts, clerical errors, processing errors and misinterpreted pricing. Errors during account payable processing are a common cause of erroneous deductions.

28% of AR leaders say their organization has experienced more customer disputes since the start of the pandemic[3].

The Problem

Whether they are valid trade deductions or erroneous customer deductions, deductions take a heavy toll on billers. Deductions are:

1. **Time-consuming:** Inefficient and ineffective processes for resolving customer deductions waste a lot of staff time – time that could be better spend on core or value-added activities. What's more, the longer it takes to resolve a preventable or erroneous customer deduction, the greater the chance that the biller will not collect the full amount of the invoice.

24% of consumer-packaged goods (CPG) companies have not automated a single step in their deductions management process[4].

2. **Complex:** The array of departmental stakeholders (e.g. sales, marketing, finance, distribution and pricing), and information sources involved in preventable and erroneous customer deductions makes them complex to resolve. The vast number of departmental stakeholders involved in resolving deductions also makes it hard to track their cost to the business.

3. **Costly:** Customer deductions also chip away at net operating margins. It can take AR staff days to research and resolve an unauthorized customer deduction. And it's not uncommon for businesses to lose money to preventable and erroneous customer deductions. Businesses with complex supply chains or a heavy stream of promotions suffer the biggest losses due to preventable and erroneous customer deductions, industry studies show.

Suppliers must investigate all deductions to separate the valid and invalid ones.

The time, complexity and cost associated with preventable and erroneous customer deductions is a direct result of manual processes that most AR departments use to manage them.

56% of CPG brands take no proactive measures to minimize deductions[5].

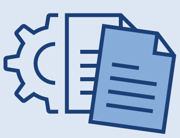
The first step in resolving a deduction is to assign it to someone for research and resolution (usually, an AR representative, analyst, or collector). The person responsible for managing the deduction starts by capturing the reason given by the customer for taking the deduction. In the case of a short payment, a biller may apply the paid amount and leave the invoice open with the remaining balance. For deductions taken on the receipt, billers may create a debit memo to record the deduction and a credit memo to pay the short pay and apply the payment receipts in full.

Deductions can be settled as a credit memo when they're valid.

3 Institute of Finance and Management (IOFM) Online Survey, 2021
4 Inmar Intelligence, 2022 Deductions Management Trends Report
5 Inmar Intelligence, 2022 Deductions Management Trends Report

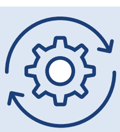
The person then must research the deduction for validity. The invoice is then reviewed for incorrect pricing, wrong terms and conditions, and other reasons for a valid deduction. Staff also might request clarifying information on the invoice from the customer, and/or stakeholders such as sales, marketing, or distribution. Notes on each activity performed to resolve a customer deduction also must be recorded. Based on the information uncovered by their research, staff then can determine how to proceed on the deduction, such as creating a chargeback invoice for the customer for the deduction amount, writing off the deduction amount, applying a credit memo to the deduction, treating the deduction as an unearned discount, or reversing the customer deduction.

All deductions must be accounted for in a biller's enterprise resource planning (ERP) platform.



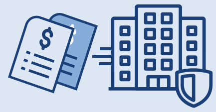
Despite the strides that businesses have made in automating their AR processes, the management of customer deductions remains a largely manual, paper-based affair.

Manual processes add to the time, complexity and cost of managing preventable and erroneous customer deductions. For starters, it is difficult to separate valid deductions from invalid ones. Manually matching customer deductions with customer claims to promotional plans and other terms and conditions is time-consuming and error-prone. It is even harder to research customer deductions when payments are made through a lockbox; billers may not have access to all the reasons and references provided by a customer. Additionally, creating credit and debit memos during cash application takes a lot of time, is error-prone, and often results in missing information.



Creating deductions workflows in most ERP platforms.

In a manual deduction environment, there also is no real way for AR staff to prioritize actions. Staff waste a lot of time determining who to call or e-mail and coordinating back-and-forth e-mails and/or phone calls between suppliers and departmental stakeholders such as marketing, sales or shipping. Communication breakdowns lead to bottlenecks that impact day-to-day efficiency. There also is increased likelihood of frustrated customers whose expectations aren't being met. The number of people involved in researching and resolving deductions also makes it hard to track costs. And since the information necessary to resolve deductions may reside as paper or electronic documents in multiple systems, processes are typically fragmented and non-standard, and information may be incomplete, inaccurate or not readily available to departmental stakeholders. For instance, researchers may not have access supporting documentation or line-item level detail and stakeholders don't have easy access to information on promotions and other trade practices.



The use of third-party sales partners such as brokers makes it more difficult to access the information necessary to resolve deductions, particularly in cases of complex deals.

The Solution

Automated deductions management solutions standardize resolution processes and provide a digital platform for researching claims, routing content and collaborating with stakeholders and customers.

Deductions are automatically assigned to an AR representative or other person.

Reason codes are automatically assigned to customer deductions during cash application based on references unique to each customer. Deduction reason codes are seamlessly fed into the biller's AR ledger, enabling staff to immediately begin following up on the deduction. Deductions that meet pre-set business rules (e.g. certain reason codes) are automatically written off.

In cases where trade discounts are referenced in the note field of an EDI transaction, automation can identify that the credit was taken as a trade discount and assign the necessary deduction reason code.

What's more, small, low-value deductions can be automatically grouped into a single deduction for posting to a customer's account, based on pre-configured rules for each customer. Bundling low-value deductions enables billers to recoup money that previously might have been fallen below pre-set deduction thresholds (e.g. $50). The technology keeps a history of all unbundled deductions.

For deductions that cannot be immediately resolved by the automated solution or an individual, workflows can be configured by customer and the reason given by the customer for the deduction.

World-class organizations reduce the time to resolve deductions by an average of 15 days[6].

An online portal provides AR staff with real-time insights such as:

- The status of deductions
- The latest conversations with customers
- AR aging
- Deduction Day's Outstanding (DDO) tracking
- Tasks to perform

This online portal also provides staff and stakeholders with instant access to the information related to a deduction, and facilitates collaboration between staff, departmental stakeholders and customers.

The Benefits

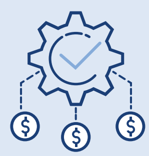
Automation reduces the time, complexity, and cost of researching and resolving deductions:

Embedded technology reduces the cost to manage non-trade deductions by 43 percent[7].

- **Time:** Automation significantly reduces the time required to research and resolve preventable and erroneous customer deductions. For instance, customizable workflows enable users to digitally route deductions for research, approval and resolution. An online portal facilitates collaboration between AR staff, departmental stakeholders and customers. And information regarding a deduction is instantly accessible for research and online collaboration. Some solutions can even settle deductions automatically by validating deductions against promotional programs or other pre-agreed upon terms and conditions. One benefit of faster deductions resolution cycles is reduced Days Deductions Outstanding (DDO). DDO is calculated by dividing the amount of a business' open deductions by the average value of deductions incurred over the last three months. If business' open deductions average $1 million each month and deductions total $2.5 million, the business would have 2.5 months or 75 days of deductions open. The lower a business' DDO, the better. Industry studies show that automating deductions research and resolution reduces DDO by 30 percent.

Almost half of CPG brands are unable to link deductions and trade promotions data for even half their deductions[8].

- **Complexity:** Automation eliminates the complexity of manually managing deductions by capturing the reasons provided by customers for taking a deduction, validating invoices against pre-agreed upon terms and conditions, flagging invalid deductions, and providing a clear audit trail of deduction settlements, including any subsequent payments.



Automation empowers businesses to identify and address the root cause of preventable and erroneous customer deductions.

- **Cost:** Managing deductions involves a tremendous amount of effort on the part of customer service, marketing, finance and accounting, distribution, and IT. The time spent resolving deductions takes staff away from core tasks and value-added activities. Businesses can calculate the cost of manually researching and resolving deductions by multiplying the average number of stakeholders involved in resolving a deduction by the average time each person spends and their average hourly compensation (including benefits) and adding any expenses associated with deductions management.

6 The Hackett Group, The Hackett Group Finance Benchmark, 2020
7 The Hackett Group, The Hackett Group Finance Benchmark, 2020
8 Inmar Intelligence, 2022 Deductions Management Trends Report

Automation also enables businesses to reduce the cost of write-offs and recover revenue normally lost to invalid deductions. For instance, automated solutions can create deductions for short-paid invoices, even if the deduction is not listed as a customer remittance. This provides billers with greater control over the process of managing short-paid invoices to help prevent profit leakage.

World-class organizations require 41 percent fewer full-time equivalents (FTEs) to manage deductions than their peers[9].

These are all compelling reasons for businesses of all sizes to automate deductions management.

Conclusion

Customer deductions involve a complex research and resolution process to assess the validity of a deduction against supporting back-up documentation which can come from multiple stakeholders and/or systems. Managing deductions requires collaboration across many departments, including sales, marketing, finance, distribution and more. Automating the research and resolution of customer deductions reduces the time, complexity, and cost of AR. It also frees employees to focus on core and value-added activities. For CFOs looking for ways to navigate economic uncertainty, streamlining deductions management with automation is an ideal solution.

About Esker

Esker is a global cloud platform built to unlock strategic value for finance and customer service professionals, and strengthen collaboration between companies by automating the cash conversion cycle. Esker's solutions incorporate Artificial Intelligence (AI) technology to drive increased productivity, enhanced visibility, reduced fraud risk, and improved collaboration with customers, suppliers and internally. Esker operates in North America, Latin America, Europe and Asia Pacific with global headquarters in Lyon, France, and US headquarters in Madison, Wisconsin. In 2020, Esker generated 112 million euros in total sales revenue. For more information, visit esker.com

9 The Hackett Group, The Hackett Group Finance Benchmark, 2020

About the Institute of Finance & Management

Accounting and finance professions have each undergone nothing short of a complete transformation since the Institute of Finance and Management (IOFM) was founded in 1982 and since then our mission has been, and continues to be, to align the resources, events, certifications, and networking opportunities we offer with what companies need from the accounting and finance functions to deliver market leadership. IOFM empowers accounting and finance professionals to maximize the strategic value they offer their employers.

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