Hidden costs of compliance

Reducing transactional risk in your retail business

Chargebacks, accounts receivable and sales tax compliance: the Bermuda triangle of back-end business management where time and money seem to mysteriously vanish. At least it can seem this way to retailers who are being pulled off course to deal with complex compliance regulations. One wrong turn and you could be headed straight for disaster–be it an audit, a dispute resolution or even bankruptcy.

So how can you prevent your profits from disappearing into a black hole of fees and penalties? Start by understanding the three biggest transactional risks facing your business:

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Chargebacks

Credit cards have become nearly ubiquitous with sales, especially in the U.S. According to a recent survey by Community Merchants, two-thirds of all point-of-sales (POS) transactions are paid for with plastic.

Credit cards also brings added risk of financial fraud. Retailers lose 10 times more than banks and 20 times more than consumers each year from fraudulent card activity.[1] According to CyberSource, half of all retail fraud results from chargebacks, which are transactions disputes by cardholders.[2]

Chargebacks can occur for legitimate reasons (technical problems with a payment, duplicate or incorrect billing, refunds, quality claims) or not-so-legitimate ones (unauthorized purchase, identity theft). Regardless of the reason, chargebacks can be damaging to your business. Unauthorized transactions and chargeback fees have cost U.S. merchants $100 billion.[3]

Fees levied by the credit card provider or bank can run $30 to $100 per chargeback.[4] These fees must be paid by the merchant regardless of the outcome. Exceed 1% of monthly sales or 2.5% of total dollar volume in chargebacks labels your business high risk and could result in fees as high as $100,000 per month and even the loss of your credit card acceptance privileges.[5]

According to chargeback.com, retailers spend 1.8 hours, on average, resolving each individual chargeback. Even at the federal minimum wage, that's an additional $13 per transaction! The added costs of dealing with chargebacks can force merchants to adopt more restrictive terms of service and return policies, which could alienate customers and affect sales.

Other costs include the replacement of lost goods, shipping expenses, legal and administrative fees and dispute resolution. If you sell online, you face even higher risk due to card-not-present industry regulations that put the responsibility onto you, the merchant, to confirm identity and authorization. This higher rate of chargebacks costs online merchants more than 0.5% of their annual revenue, a ding to the bottom line that many can't afford. In fact, half of online business failures are a result of chargeback costs.[6]

To keep fraud losses to a minimum, it's critical that you manage disputed charges, returns and credits quickly. Not doing so can result in late-response fees or lost sales. Automating this process allows you to be more systematic, timely and

Chargeback Liability Example
(courtesy of The Fraud Practice)

Total Sale = $100.00
Margin (22%) = $22.00
Interchange Fee
& Acquirer MDR (3.5%) = $3.50

Net Profit = Margin – Fees
The merchant will make $18.50 from this sale.

Chargeback
Net Profit = $18.50
Consumer Refund = $100.00
Chargeback Fee = $25.00

Net Loss to Merchant = Net Profit – (Consumer Refund + Chargeback Fee)

The merchant will have lost $106.50 on this order and would have to sell 5 more orders at this amount to make up for this one loss.

This is without including additional merchant costs, such as overhead, shipping and processing fees and with a low chargeback fee.

[1] LexisNexis Risk Solutions
[2] CyberSource, 2014-2015 Online Fraud Benchmarking Study
[3] Merchant Lifeline
[4] Chargebacks911
[5] Chargeback.com
[6] Chargebacks911

accurate in verifying transactions, managing claims, resolving disputes and recouping payments, reducing both the cost and risk associated with chargebacks.

Receivables Management

How you handle receivables can also have a big impact on your bottom line. Carrying too many past due accounts on your balance sheet eats into cash flow. Long-term supply agreements with contract manufacturers or wholesalers can also increase risk, especially if prepayments have been made.

Receivables management is labor-intensive, often requiring multiple people to manage the process. A Lab42 study found that 74% of businesses have two or more full-time people engaged in receivables management and 41% had more than fi e people handling this task. More than half of the companies surveyed reported spending more than 40 hours a month on accounts receivables; nearly 20% said this activity took more than 160 hours a month! Virtually all the businesses surveyed said it took more than one ask to get an invoice paid.[7]

A Harvard Business Review study found that the cost of carrying accounts receivables on the books exponentially increased over time.

- 30 days - 1.82%
- 60 days – 10.29%
- 90 days - 19.74%
- 120 days – 30.71%

Source: National Association for Printing Leadership (NAPL)

Replacing manual accounts receivable management processes with automation software can alleviate many of these costs and resource constraints as well as improve cash flow and reduce days outstanding. One SAP study found that integrating receivables with billing systems resulted in 26% fewer overdue accounts and write-offs.

Sales Tax Compliance

Trying to navigate sales tax laws is highly challenging given how broadly the states differ in how they tax goods and services. In fact, a recent NSBA survey found that managing sales tax ranks in the top fi e for administrative burdens on a company. Chief concerns cited were complexity around varying state, county, city and municipality rules and regulations for online transactions as well as audit risk from potential tax liability or calculation errors.[8]

In addition to being tricky, managing sales tax is also time consuming. Relying on spreadsheets and rate tables subscriptions, looking up rates online, storing paper exemption certificates and filling out and filing complicated tax returns are laborious tasks. New Aberdeen Group research estimates that small to mid-size businesses spend upwards of 300 hours per year manually managing sales tax compliance at a cost of around $65,000.[9]

[7] *ZenCash*
[8] *NSBA, 2014 Small Business Taxation Survey*
[9] *Aberdeen Group, The Costs of Compliance: Best in Class Strategies for Automating Tax Management and Avoiding Hidden Costs, 2014*

Larger organizations also reported spending more time managing routine tax compliance and disputes–roughly 10% more time than previous years, according to the Ernst and Young 2014 Task Risk and Controversy Survey. And 8 in 10 of the U.S. businesses surveyed revealed that they don't have sufficient resources to deal with these tax activities.

Automating sales tax saved considerable time over manual processes. A recent survey of Avalara customers found that nearly 40% now spend less than one hour on sales tax related activities monthly since using AvaTax. Prior to automation, the majority (87%) of these same companies were spending twice to more than 20 times as much time preparing and filing tax returns. Customers also reported substantially reduced risk as a result of automation, with far fewer errors, rate or change oversights and audit penalties.

Get real (time) when it comes to risk

A disputed charge here or there and a late payment or two may not seem like a big deal, but they add up. Why risk it? New cloud-hosted software solutions have made managing transactional activities in your accounting, ERP or ecommerce system more accessible and affordable. Most integrations are simple and easy to set up and pricing is based on usage, so you can right-size the subscription to fit your needs.

Automation means less manual work and fewer chances of costly errors or oversights. The Hackett Group found that companies that used automated solutions have 47% lower finance costs as a percent of revenue; a similar SAP study found this to be closer to 57%. Companies that automate transactional activities also have little-to-no data duplication, fewer billing errors, and lower compliance costs.

More importantly, when you spend less time managing transactional risk, you can spend more time on activities that bring money in the door versus sending it out.

[10]*Ernst & Young, 2014 Task Risk and Controversy Survey*