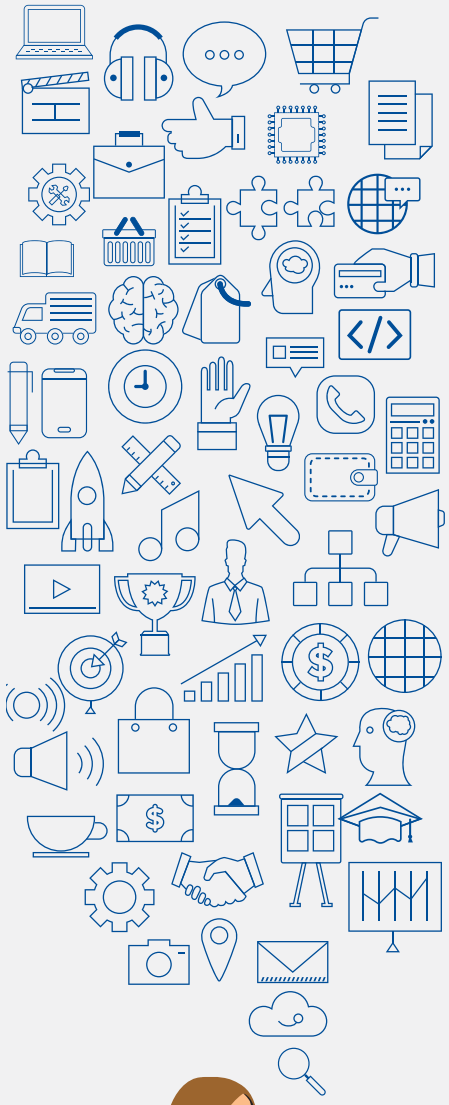
Sales and distribution spends: are these vulnerable to leakages?



Over the past few years, there has been a steady increase in demand for goods and services owing to increase in disposable income, growth in rural markets and middle class population, change in demographic profile (by 2030, approximately 77 per cent of India's population will comprise millennials and generation Z[1]) and change in consumer tastes and preferences (shift towards branded products). However, the COVID-19 pandemic has disrupted human lives and business operations across the globe. Consequently, organisations have been witnessing unprecedented changes within a short span of time. Consumer behaviour has changed as the focus has shifted towards safety and hygiene. Due to the COVID-19 scenario and social distancing requirements, digital transactions have increased considerably and consumers prefer the e-commerce channels for purchasing various products.

Organisations have a vast supply chain network of channel partners to help them cater to customers' needs across geographies and at the same time, minimise their investment and credit risks. This network of channel partners needs to be provided with sales led incentives to operate in the market in order to augment the sales of organisation's products.

Organisations spend substantially on marketing and distribution activities to enhance their sales and create brand awareness for their products. Organisations consider this as cost of customer acquisition and it generally amounts to 7-15 per cent of the total sales.

The 'high rewards' offered to sustain growth and increase sales often come with 'high risks', which need to be monitored on an ongoing basis. Such risks usually lead to malpractices causing financial losses, as well as reputational damage to organisations. It is pertinent for organisations to take necessary steps to minimise leakages in their systems caused due to such risks, as these significantly impact the working capital and result in operational and reputational issues for organisations.

1. Future of Consumption in Fast-Growth Consumer Markets: INDIA by World Economic Forum, January 2019

Marketing activities are typically divided into three segments based on the market penetration targeted by organisations – Above the Line (ATL), Through the Line (TTL) and Below the Line (BTL) Marketing

Above the Line (ATL)

- **Mass penetration**
- **Less number of transactions**
- **High value transactions**
- **Well governed**
- **Easy to monitor**

Examples: **Television, radio and print advertisements**

Through the Line (TTL)

- **Addresses ATL as well as BTL marketing**
- **Technology-driven**
- **Tracking and governance is comparatively easy to monitor**

Examples: **online campaigns, web based promotions, online advertisements**

Below the Line (BTL)

- **Specific market penetration**
- **High number of transactions**
- **Low value per transactions**
- **Difficult to monitor**
- **Multiple third parties involved**

Examples: **Trade schemes, branding and merchandising, trade fair, exhibitions, in-store marketing among others**

Out of the three categories of marketing spends – ATL, TTL and BTL, BTL spends are potentially most prone to leakages, given the high count of transactions and low value per transaction. These BTL spends are relatively less supervised and are prone to wrongdoings committed by channel partners and employees of an organisation, with or without the help of third parties. Although the value of individual instances of BTL leakages may not be relatively high, these could lead to substantial financial losses to organisations on a consolidated basis. This point of view document focuses primarily on the vulnerabilities in the BTL spends, which typically include the below mentioned activities:

1. Secondary sales schemes – includes volume discounts, white goods, trips, gift vouchers, among others based on the sales value.
2. Loyalty programs
3. Trade meetings of channel partners and outlets
4. Reimbursement of field force salaries to channel partners
5. Incentives to the channel partners and field sales force
6. Subsidies to channel partners
7. Point of sale material (i.e. standees, shelf edging and dummy packs among others)
8. Visibility/display activities (i.e. window spaces)
9. Signboards installed at outlets
10. In-store promotion activities (i.e. brand promoters and kiosks among others)
11. Liquidation schemes to sell products nearing expiry dates
12. Reimbursement to channel partners for damaged and expired stocks

Vulnerabilities in BTL activities leading to value leakages for organisations

Issues	Vulnerabilities leading to leakages
Fictitious outlets	Creation and maintenance of fictitious outlets in the Distribution Management System (DMS) in order to show a wider reach by channel partners and field sales force.
Fictitious secondary sales	Recording of fictitious sales in DMS in order to obtain undue scheme benefits by channel partners.
Miscommunication/ manipulation of sales discounts and schemes	Miscommunication of schemes and manipulation of sales, discounts, schemes leading to benefits either not passed or partly passed to the eligible recipients by the channel partners.
Manipulation of sales data	Manipulation of sales targets by the field sales force and alteration of the actual sales data to demonstrate achievement of eligibility criteria for earning sales incentives.
Channel stuffing	Channel stuffing towards the end of the sales cycle in order to obtain undue benefits of channel and loyalty programme, loyalty program eligible for outlets and return of this material in the subsequent months.
Falsified documents	Submission of falsified documents, acknowledgements as evidence for distribution of scheme benefits that were not passed to the eligible recipients by the channel partners.
White goods	White goods to be distributed as part of the secondary sales schemes were either not purchased or purchased from related vendors at an inflated value by the channel partners/ field sales force. This results in fictitious vendor invoices being submitted with the claims and the value of these white goods being siphoned either by the channel partners and/or field sales force.

Vulnerabilities in BTL activities leading to value leakages for organisations

Issues	Vulnerabilities leading to leakages
Morphed photographs	Morphed photographs or same photographs being submitted with multiple claims by the channel partners for visibility or display activities not executed by them, to obtain undue benefit of the visibility or display amounts reimbursed by the organisation.
Inflated or fictitious invoices	Inflated or fictitious invoices were submitted by the channel partners for advertising and marketing campaigns. Value of these invoices were siphoned either by the channel partners and/or field sales force.
Slow moving inventories	Slow moving inventories were classified as damaged goods by the channel partners in order to avail of undue benefits by transferring such slow-moving inventories back to the organisation, instead of pushing the same in the market.
Sale of expired products	Expired inventories sent for destruction were not destroyed. These inventories were tampered by changing the printed manufacturing date and wrongly sold as fresh inventories again, jeopardising the reputation of the organisation and also impacting its sales.
Diversion of products	Inventories meant for domestic sale or sale through a specific channel were diverted to another channel or exported outside the country due to price arbitrage between two channels or countries.
Subsidies wrongly claimed	Manipulation of financials by channel partners to demonstrate their eligibility for subsidies and obtain undue benefit of subsidies from the organisation.
Point of Sale Material (POSM)	Misutilisation of the Point of Sale Material (POSM) provided by the organisation to the channel partners. POSMs not distributed to the outlets were either sold in the market or sold as scrap by the channel partners.

Digital transformation in sales and distribution

With the operational challenges and remote working in the current COVID-19 scenario, it is essential for the management of organisations to adopt new technologies and undertake digital transformation of their processes. This would reduce human efforts through automation of certain processes, resulting in better cost optimisation, as well as enhancing the effectiveness of internal controls. Over the past few years, most organisations have either implemented or are in the process of implementing the Distribution Management System (DMS), Sales Force Automation (SFA) solution and merchandising portal to control and monitor their secondary sales and distribution activities.

Control gaps or underutilisation of the existing digital tools implemented by organisations

Implementation of tools and solutions viz. DMS, SFA, merchandising portal has multiple advantages, which enables effective management of sales, and operation of marketing and distribution initiatives. However, certain vulnerabilities are prevalent due to inadequate monitoring of data or lack of enhancement in the existing framework. Instances of such irregularities observed are as below:

Distributor Management System (DMS)

- The details of the outlets that are required to be captured in the DMS were not mandatory. This led to creation of duplicate or fictitious outlets in the DMS.
- Due to absence of maker-checker control mechanism, sales promotional schemes that were not stipulated by the organisation's management, were manually created or amended in the DMS. This resulted in undue benefits to the channel partners and field sales force.
- Manual application of promotional schemes at the time of invoicing in DMS resulted in channel partners not applying the scheme at the time of invoice generation. Subsequently, such invoices were amended to apply the schemes and falsely indicate that benefits of the schemes were passed-on to the outlets. This amount was wrongly claimed by the channel partners from the organisation.
- Reversals of secondary scheme on sales returns from outlets were not recorded by the channel partners, due to which the scheme benefits were claimed multiple times on the same inventories sold by them.
- Secondary sales invoices were backdated and printed in the DMS to indicate achievement of sales targets for the respective sale cycle.
- Secondary sales and schemes data from DMS were not synchronised with the organisation's server on a regular basis by the channel partners, which led to manipulation of secondary sales and schemes operated in the market.
- Inventories in the DMS were manually inflated by the channel partners using the stock-in option without actual receipt of goods. Fictitious secondary sales were recorded against these inventories in the DMS. Application of secondary schemes on such

sales led to the channel partners claiming fictitious secondary schemes from the organisation not passed on to the outlets.

Sales Force Automation (SFA)

- All the required details of the outlets were not captured in the SFA by the field sales force and outlets were created with invalid photographs and fictitious geographical locations (geo-location), which led to creation of duplicate or fictitious outlets in the SFA.
- Field sales force splits a sales order received from a outlet and records it as multiple sales orders received from multiple outlets in order to achieve sales incentives parameters based on number of invoices in a day.
- Manipulation of the geographical location (geo-location) of a outlet by sales executives to show coverage of the market route assigned to them, even though such visits were not actually done. The geo-location can be manipulated by using applications which help record/register a fictitious geographical location at the time of recording sales order in SFA.
- Sales executives may not synchronise the sales orders recorded in SFA on a real time basis with the organisation's server; thereby, manipulating the sales and schemes operated in the market.

Merchandising Portal

- Same photographs were uploaded by the merchandiser every day without visiting the store for verification of either display window space or installation of signboards.
- Same photographs were uploaded for multiple stores; thereby, wrongly claiming the amount of display window space or installation of signboards from the organisation.
- Photographs captured by the merchandiser did not display products of the organisation and the amount was wrongly claimed for display window space not provided by the outlet.
- Photographs were tampered to change the date of the photograph to wrongly claim display window space or installation of signboard benefits reimbursed by the organisation.
- Merchandising agency appointed by the organisation wrongly claiming reimbursement of expenses of merchandisers by submitting fictitious supporting documents.

What can you do to protect yourself?

Preventive measures

Amidst increasing vulnerabilities in the businesses today, the importance of vulnerability risk assessment to address the control gaps cannot be understated. Fraudsters (internal or external) take advantage of these vulnerabilities in the system to commit wrongdoings, adversely impacting the organisation. The ever-increasing adverse effects of COVID-19 could open more avenues for organised criminals to defraud susceptible organisations and its consumers. The use of robust technology to bridge the control gaps is essential for setting up early warning signals of potential wrongdoings and better governance of secondary sales operations, as well as management of sales led initiatives.

As control gaps are constantly evolving in today's dynamic work environment, the effectiveness of the controls and the output of technology tools needs to be regularly monitored and tested. Identifying such gaps in the implemented tools and its seamless integration with other applications used by the organisation at an early stage will assist the organisation in identifying and addressing the gaps proactively.

Proactive assessment of the processes assists the organisation to avoid losses due to wrongdoings and helps optimise its costs, which is paramount for organisations facing profitability and cash flow challenges in the current scenario. The organisation can either optimise its sales and distribution expenses (if the sales cannot be increased) or grow its sales by incurring same quantum of sales and distribution expenses. Further, it also helps build the reputation of being a brand that believes in proactive approach to identify and eliminate the loopholes/gaps in the implemented processes and tools and prevent leakages.

Detective measures

It is paramount to undertake detailed reviews into any indications/complaints/ suspicions pertaining to potential wrongdoings to determine the root cause, modus operandi of the said wrongdoings and the persons involved. This activity will also help the organisation take timely corrective action to prevent further losses, if any, and to prevent occurrence of such wrongdoings in the future.

Awareness

The investment in optimal utilisation of technology in sales and distribution becomes an imperative step towards a digitised future. We believe that keeping pace with emerging technologies while building a brand should be treated as a capital investment on which an organisation can build an edifice of a stronger tomorrow.

Post implementation of the appropriate digital platforms and tools, it is imperative to create sufficient awareness amongst the sales force, channel partners, claim processing team, among others to ensure optimum utilisation of the available resources.

Additionally, workshops and trainings can be undertaken to prevent, detect and minimise the occurrences of wrongdoings and to protect the organisation from unforeseen losses.

Glossary

Channel stuffing

Channel stuffing is a deceptive business practice used by an organisation to inflate its sales and earnings figures by deliberately forcing more products through a distribution channel than the channel is capable of selling.

Distribution Management System (DMS)

DMS is a software provided by the organisation to track its secondary sales business on a real-time basis; process channel partner claims in a disciplined manner; improves scheme management for the channel partners of benefits given to the outlets, among others.

Sales Force Automation (SFA)

SFA is a handheld based application provided by an organisation to record sales orders sourced from the outlets by field sales force. It is directly integrated with DMS for faster processing of sales orders, assistance in customer tracking, for secondary sales monitoring and sales force route management on a continuous basis.

Stock-in

An option available in the DMS to record the inventories manually for the products purportedly received by the channel partners from the organisation.

Outlets

Retailers, dealers, wholesalers and modern trade chains to whom products are supplied by channel partners.

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