Overview

The following paper has been prepared by the LBMX Group Consultancy Practice, a division of LBMX focused on helping Purchasing Co-operatives, Buying Groups and Independent SME's (small medium enterprises) become more effective through strategic process improvement. This paper is part of a series of papers describing key business process improvement strategies for these kinds of organizations.

One of the decisions that organizations (groups) need to make very early in their development is the type of billing model they will employ. There are basically three options available. These are central bill, direct bill or central pay.

In a central bill model, the supplier sends the invoice to the group who will then (with or without adjustments) forward it to the member. The member then forwards payment to the group who facilitates payment to the supplier. In most cases the goods are shipped directly to the member.

In a direct bill model the supplier sends the invoice to the member directly and the member pays the supplier without involving the group. The only role the group plays is to negotiate and keep track of supplier rebates.

Finally in a central pay model, the supplier invoices the member directly, but the member pays the group who in turn pays the supplier. In all cases the order process used by the member is not affected by the billing model used.

Although each model has its place, the following document discusses the case for Central Billing. It describes the advantages to the group, the members, as well as to the suppliers. In addition, it reviews the main risks associated with Central Billing and how they can be minimized.

Benefits of Central Billing to the Group and Members

The following points describe the key benefits that the group and members can receive by moving to a Central Bill format. These include;

- The group will achieve greater leverage with suppliers. In many "direct bill" situations (where the supplier invoices the member directly), suppliers often feel that the group gets "in the way", between them and their customer. A Central Billing environment changes this, as it is the group that pays the bill and in effect becomes the customer.
- There can be real economic advantages for the group and members if they can participate in 'pooled' buys or 'event' buys. The nature of the Central Bill process makes these kinds of programs available and easy to implement.

- Central Billing of members generates line item purchase details from the invoices of all members and therefore allows the group to track member affinity to group programs.
- Since Central Billing ultimately reduces the credit risk for the supplier, the group and members achieve a Central Billing Allowance (CBA) and / or higher rebates. This financial gain can be used to enhance member credit security and / or provide a personal financial return to members for providing credit security.
- Central Billing provides a central point for dealing with member claims and disputes, providing value for both the member and the supplier.
- Credits for these claims and adjustments can be taken immediately (as opposed to a member having to wait until they can make more purchases to apply the credit against).
- There are significant operational efficiencies for members, since the group acts as one point of contact for all programs with ALL suppliers for ALL members of the group.
- Central Billing means that the associated EDI setup costs only require that members make one connection to the group, making the EDI technical requirements and costs far less than in a multiple supplier “direct bill” scenario.
- Likewise this same economy is created for suppliers and this benefit usually generates an additional EDI allowance / rebate.
- Central Billing reduces accounting / payables costs for members and the entire supply chain since there is only one payment to the group per period per Member and from the supplier’s credit management perspective, only one ROA (Receivable on Account / Accounts Receivable) for the entire group.
- Central Billing reduces the time per member in providing suppliers with credit information and credit checks since there would only be one credit check required from a complete group perspective.
- Central Billing means that the cost of servicing a large number of geographically dispersed members is absorbed by the group. This means the supplier’s servicing of these small independents becomes more cost competitive and in line with servicing the chains and big-box stores. As a result, this often leads to better supplier pricing, or additional rebates.
- Central Billing can often allow for inventive and comprehensive marketing initiatives to be launched in a way not possible if the members were less cohesive.

Benefits of Central Billing to Suppliers

The following points describe the key benefits that suppliers can receive by moving to a Central Bill format. These include;

- Central Billing provides a central point of contact to introduce and communicate all supplier product and marketing programs. This can allow for inventive and comprehensive marketing initiatives to be launched, which ultimately build member purchase volumes.
- Central Billing provides a central point of contact for dealing with member claims and disputes

- Central Billing creates a central point to assess and evaluate the performance of programs, create improvements / enhancements that can be rolled out to the members in a universal and timely fashion.
- Central Billing creates a central focal point to develop effective, consistent product brand recognition with the eventual end user, be it the member, the trades or the consumer.
- Central Billing provides an opportunity for suppliers to develop a greater understanding of what is needed to achieve marketing program penetration of certain types of members, by region or by business type within the group.
- The cost of servicing a large number of geographically dispersed members is virtually eliminated, making the Central Bill group with small independents more attractive to a supplier, as an alternative to a ”big-box” customer, because of the broad geographic penetration and lower risk of being de-listed as a preferred supplier.

Credit Risk

There are a number of options to reduce the credit risk that groups face when they consider a move to a Central Billing process. These include;

- In most cases the group is able to collect a Central Billing Allowance (CBA). This is because each supplier has a bad debt allowance in their pricing model and selling through a centrally billed, secure group, the risk has now been reduced. One option for groups to minimize their risk is to pay all or part of this allowance into a contingency fund for the day when a bad debt might be experienced through a member default.
- A percentage of rebates (CBA & EDI and others) could be held by the group to create a security fund as discussed above. Some of this fund could be an asset of the group itself, while a portion of it could be assigned to each member as they earn it through their own purchases. This contingency fund could be held on a 10 year rolling basis, whereby in year 11 all of the money held from year 1 is returned to each member, less any losses. Over time, the contingency fund should be built to a level equal to 3 months of purchases.
- The group could ask for guarantees from members, such as GSA – General Security Agreements or Irrevocable Letters of Credit (ILC). As the contingency fund discussed above becomes large enough, the requirements for guarantees are reduced proportionally and eventually eliminated.
- Another option is for groups to consider asking for an Irrevocable Letter of Credit, provided **personally from the owner** of the business, or perhaps from an **individual investor outside of the member company**. The low cost of providing this ILC will provide the investor with a higher than market rate of return from the revenue generated from the CBA fund.
- Prior to the contingency funds being large enough, groups could put an insurance policy in place with a 3rd party provider, which could be paid from rebates (for example a rate of around ¼ of 1% against all purchases) to cover the credit risk.
- Consider self-insuring all small members below a certain level of purchases and retain 100% of the CBA & EDI rebates earned on behalf of these smaller uninsured

members. Utilize 3rd party insurance to cover all other members' purchases above that level.

- The group has the ability to use technology to manage member purchases early in the order cycle. For example, the group can require the supplier to obtain an authorization number through a group web interface for all members, or specifically identified members, prior to shipment of all orders. The group will be able to automatically manage all outstanding orders with authorization numbers, against the credit limit in place for the member, or against the security held by the group.
- Consider technology to electronically route P.O. confirmation to the group for ALL purchases from ALL members before the order is shipped, regardless of how the supplier receives the P.O. Then track the P.O. confirmation values against a Credit Open to Buy Limit, by member, which is set by the group.
- Require all members to provide proper and regular financial reporting to the group to determine if more Credit Controls need to be put in place for any given member.
- Consider requiring all NEW members to provide 100% coverage, with the coverage being reduced over time by their portion of their individual contingency fund value.

About LBMX Inc.

LBMX is a leading provider of technology solutions for buying groups, purchasing co-operatives, independent members and their suppliers. These solutions comprise rebate and purchase analysis software, member electronic document delivery and complete EDI services to assist members and groups to connect to suppliers.

LBMX's close association with this specific supply chain model has allowed LBMX to develop a unique understanding of groups, their members and suppliers. This has resulted in the implementation of LBMX technology solutions that are a fit with both the strategic direction and operational priorities of their customers.

Based on LBMX's "many-to-many" technology, LBMX solutions are helping to connect suppliers, groups and independent member owners resulting in over 250,000 trading relationships. This has resulted in significant operational efficiencies for all members of the supply chain as well as providing groups with access to line item member purchase detail upon which better buying and rebate decisions can be made. LBMX has customers in Canada, United States, Australia and New Zealand.

LBMX
1402-148 Fullarton Street
London, Ontario, Canada N6A 5P3
877.429.5269 | 519.850.5269
info@LBMX.com www.LBMX.com