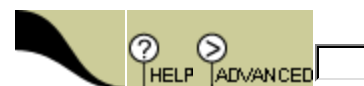




May 16th, 2003

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Tug of War

MAY 01, 2003 – The chargeback bug is slowly infesting the athletics space. One of the more contentious aspects of any retailer/vendor relationship, chargebacks are penalties retailers "charge back" to vendors for shipping mistakes or, in some cases, to support markdowns or advertising. They've been around since the first supplier short-shipped a retailer and was asked for a discount on the next order. However, they've accelerated since the late '80s at department stores and national chains due to consolidation of the retail marketplace, greater automation of logistical processes, and heightened competition. Now, albeit to a lesser extent, regional sporting goods and athletic footwear retailers are increasingly taking up the practice, especially as former department store merchants take slots at those chains.

Although chargebacks tied to markdowns are a burden for some (especially department store vendors), the bigger angst for sporting goods suppliers is chargebacks tied to logistical compliance. These chargebacks, which can cost up to 10 percent of sales, are more common on items such as apparel, which often requires additional handling, labels, tags and hangers.

The harshest accusation is that some retailers use chargebacks as a profit center. However, most chargebacks appear to be levied for legitimate reasons, such as early/late deliveries, missing items, or applying an improper Advanced Shipping Notice (ASN). After investing millions creating highly automated systems for tracking and moving inventory, retailers are increasingly using chargebacks to penalize vendors who cause those systems to malfunction.

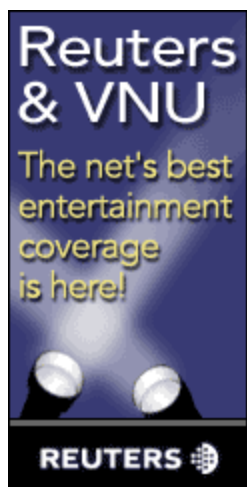
Still, many vendors are frustrated because the shipping guidelines are tough to follow, with each retailer establishing its own rules and changing them often. Some vendors feel the demands placed by a few retailers are nearly impossible to meet. "They ask you to do some things that you are incapable of doing," says Eric McCrite, at sporting goods wholesaler McCrite and Associates, who believes an industry standard should be established for logistics.

Other complaints include exorbitant charges for minor infractions, such as a label on the wrong side of a box. Chargebacks often involve hard-to-prove disputes, such as missing items, and a few retailers seem to be

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applying them in an arbitrary and malicious manner.

"There are good retailers and bad ones," says Jeff Goschen, IT Director, Hi-Tec Sports USA. "Some are more sophisticated, but that doesn't make them bad. It's the ones that try to charge you back for nonsense items or send you a chargeback 120 days after something happens. Some carry it to a ridiculous point."

For many, the frustration over chargebacks masks an outrage over retailers continually passing chores, such as ticketing and inventory handling, back to vendors. As they've grown, many retailers are using their leverage to demand better shipping, amenities such as custom hangers and labels, and markdown support from vendors. George Horowitz, chairman, CEO and president of Everlast Worldwide, believes many chains are struggling to make profits and this is the way business is evolving. However, he says sales terms have to be reasonable. "It has to be an opportunity where both sides can make money," explains Horowitz. "It has to be a partnership."

James Chick, president of Chick's Sporting Goods, believes it's a matter of extremes, with some retailers excessively charging back vendors, and some vendors constantly shipping poorly. "You have to penalize the bad ones or else they don't change their behavior," says Chick.

"We look at being in a partnership with our vendors," adds Gary Smith, VP and CFO at Hibbett Sporting Goods. "We try to help them through the EDI process and meeting our shipping requirements. We certainly don't look at it as a revenue source. We just hope to break even."

Ideally, full compliance enables retailers and vendors to reach shared goals of moving product to the selling floor as fast as possible, leading to quicker sell-throughs and a higher likelihood of full-price sales.

"It can be beneficial to us if it points out a flaw in our delivery system and then we can implement a change to move faster or provide product more efficiently," says Fran Allen, New Balance's VP of sales for North America.

Adds Chris Elkins, Columbia Sportswear's senior customer operations manager, "There are several cases where chargebacks have forced us to look at some of our processes and make some changes that could very well improve our overall performance down the road. In those cases though, customers either reversed chargebacks when improvement was shown, or gave a waiver period while we were working together to make improvements."

Moreover, many vendors are substantially reducing chargebacks by setting up strong logistical systems and fighting questionable chargebacks when they occur. "If you deal with your retailers on a professional basis and always respond back to them in a timely manner, this can be proactively handled," says Hi-Tec's Goschen. Toward this end, Hi-Tec installed a software package from Footworks Information System to better handle the varying packaging, shipping, labeling and billing

requirements of each retailer.

Ultimately, vendors walk away from an account if excessive chargebacks make it unprofitable to work with that retailer. Tipton Clark, marketing coordinator at Footworks, says vendors should measure the cost of giving into chargebacks versus the cost of fighting the ones that are unjustified. "This tells you the cost of doing business with the various accounts," he notes.

K-Swiss doesn't do business with chains that rely on chargebacks or markdown allowances. "We price our shoes fairly and we deliver them fairly so [chargebacks] are really out of sync with our business philosophy," says K-Swiss chairman and president Steven Nichols. "Every once in a while we take a little nibble and attempt to do biz with one of them, but eventually it starts to sour because we play it straight and sometimes they don't."



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