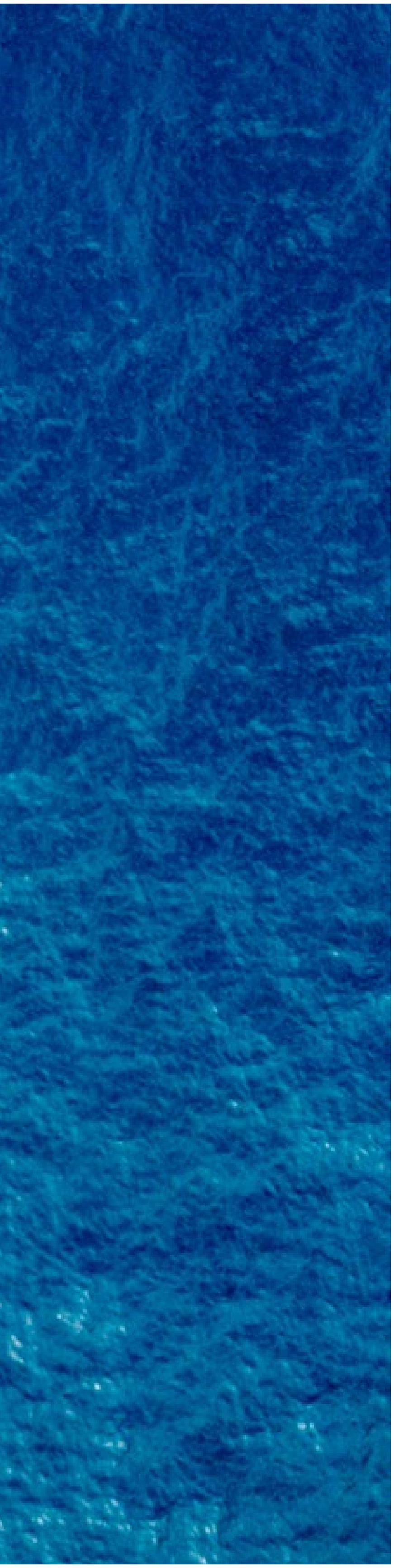
Focusing on fundamentals

A global trade leading practices briefing

2019

Building a better working world



Background

The Ernst & Young LLP (EY) 2019 Global Trade Focus Day, aptly titled "Focusing on Fundamentals," presented an opportunity for the EY Global Trade practice to assemble a group of distinguished and experienced global trade professionals to update a discussion on trade disruption that began in our 2018 symposium — "is trade the disruptor or the disrupted?" The 2018 symposium focused on disruptors — both in the US and abroad. Since then, significant trade disruption has continued. Examples include the new North American Free Trade Agreement (NAFTA), otherwise known as the United States-Mexico-Canada Agreement (USMCA); continued Brexit uncertainty; material sanctions on companies, countries and persons in Russia, China and Iran; and the imposition by the US of duties under Section 301 of the Trade Act of 1974 on Chinese-origin goods and related Chinese retaliatory duties. China and 301 dominated the conversation based on the level of tariff rates and the wide range of industries impacted.

As in past years, our global trade participants represented a variety of industries and brought differing perspectives. Our 2019 Global Trade Focus Day explored strategies to manage and perhaps benefit from disruption. A common theme that emerged among participants involved "getting back to basics." Global trade fundamentals have been an essential part of the global trade professional's toolkit over the last year.

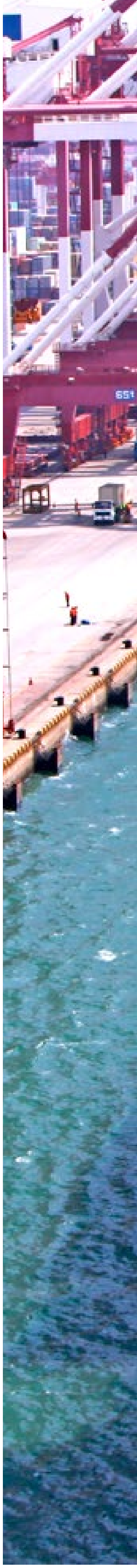
Each participant company has import and export operations in multiple jurisdictions. In a discussion facilitated by EY professionals, the global trade executives described how they have adjusted to cope and thrive in a time of disruption. This briefing focuses on major themes identified during the discussions and summarizes key takeaways to equip global trade professionals with benchmarks and leading practices to navigate through continued trade disruption.

J. Michael Heldebrand
EY Global Trade

Sharon A. Martin
EY Global Trade

Lynlee Brown
EY Global Trade

Introduction



Keep calm and trade on?

When we concluded our roundtable discussions last year, global trade disruption was beginning to take hold, and addressing disruption was quickly moving to the forefront of corporate priorities. Global trade executives were faced with the added pressures of being prepared to manage and respond to disruption while continuing to move goods cross-border in a compliant, efficient and cost-effective manner.

The 2019 Global Trade Focus Day revealed that the added pressures of disruption had not changed significantly since our 2018 symposium. But because of the continued release of new measures month by month, global trade professionals are convinced that trade disruption will not subside in the short run but are uncertain how long it will last. Global trade executives cited the 301 duties on Chinese-origin goods as the main driver of trade disruption.

In this environment, they continue to look for ways to balance "fighting fires" with executing strategic, value-added initiatives. While some global trade executives are taking the approach of "keeping calm but trading on," we found the overwhelming majority of participants embracing the disruption, and using the enhanced corporate visibility and attention as a platform to bolster the global trade function.

Back to basics

Given the high rates and the broad range of products affected by the 301 tariffs at the time of the symposium, global trade professionals were challenged by their executives to find ways to minimize the impact. In many instances, imports that were historically duty-free were subject to a duty of up to 25%, creating challenges for trade professionals who had never addressed or implemented duty-mitigation strategies. Other companies had not concentrated on verifying the accuracy of country assignments or analyzing country of origin in multi-country production scenarios since, historically, the results of such efforts yielded lesser impact. But our conversations revealed that now, more than ever, global trade executives are focusing on the essential fundamental global trade concepts of classification, country-of-origin and valuation. While classification and country-of-origin reviews have been the short-term mitigation strategies, valuation planning has been secondary because of complexity and the extended time to both implement change and realize benefits.

Global trade executives agreed that accurate classifications are imperative as a first step in battling the current state of disruption. Participants shared that initially they were focused on assessing the accuracy of classifications and then, if products were determined to be "on the 301 list," efforts were turned to evaluating ways to tariff-engineer to achieve more palatable duty rates. However, they agreed that tariff engineering is typically a longer-term solution given the level of analysis required and the fact that modifications to production or supply chain do not happen overnight.

Origin is something many global trade professionals had not historically dedicated significant time and attention to — particularly in the non-preferential origin space. However, when companies are faced with additional duties of up to 25%, the accuracy of origin has become critical. Global trade professionals agreed that origin determinations can be more complex than they appear at first glance since there is less guidance or precedent to directly apply to the analysis. Thus, the need to be thoughtful in analysis was emphasized.

Global trade executives further recognized the importance of planning options related to origin. For instance, companies can review multi-stepped manufacturing plans to identify whether the move of a key step in the process would result in a "substantial transformation" and therefore impact the resulting origin. Numerous participants noted that extensive internal discussions centered on shifting the supply

chain and supporting the business in analyzing various alternatives. But these decisions typically are longer-term and require well-thought-out cost and benefit analysis since moving production typically is not an "overnight" decision.

As for customs value, global trade executives are evaluating potential first sale for export scenarios. Other customs value reduction strategies — such as bifurcating rights granted in royalty agreements or revisiting transfer pricing strategies for customs purposes — remain in the background. The latter has gained some attention with a handful of global trade executives who note progress in relation to transfer pricing, in particular.

Whereas global trade executives previously found themselves as responders to transfer pricing initiatives, in the current environment they are driving the ideas and initial discussions – bringing planning strategies to tax and transfer pricing colleagues instead of the other way around. Some strategies involve reviewing costs included in transfer prices, as well as looking to bifurcate product and non-product costs for payments of intangibles. Trade executives see this change as a positive factor that elevates both their role and that of global trade within the company.

Global trade professionals agreed that diligence is warranted when making any direct change to mitigate duty impacts. While careful consideration of the rules and analysis is required, global trade executives also discussed the importance of examining potential remedial actions and evaluating impact on past transactions.

Some participants advocated reaching out for third-party assistance or advice, and in some cases, participants have turned to rulings or discussions with customs authorities for added certainty. With regard to the latter, participants cautioned that before meeting with customs authorities, companies must have a carefully planned strategy — one that is thoroughly researched and evaluated to explore all angles. In addition, the executives discussed the pros and cons of applying for rulings in times of disruption. In particular, they emphasized the importance of weighing the risk vs. reward that the certainty of a ruling can bring. In a landscape of 25% duty rates, an unfavorable ruling can significantly impact a company's bottom line. Participants also expressed frustration with the longer-than-normal wait times on receiving rulings.

Key trends in a world of continued disruption

Increased emphasis on collaboration with suppliers and customers

Global trade executives have found value in reexamining supplier and customer contracts. The objective is to determine the party liable for the additional duties and, if not to their favor, evaluate whether adjustments can be made. In recent years, leading-practice global trade organizations have been reporting that their teams have been successful in gaining a seat at the supplier and customer tables. However, in today's disruption, given the intensity and frequency, there is a call for creativity around such interactions — both with internal functions that drive and support such relationships, as well as externally with suppliers and customers.

For example, one global trade executive noted that in talking with customers to fully understand customer supply chains and distribution chains, they found that products shipped from China to the US ultimately ended up in Mexico. Thus, a simple conversation and a better understanding of customer supply chains assisted in planning and helped avoid the 10% additional tariffs to the extent that Chinese products were not ultimately destined for the US.

Another global trade participant discussed success with duty drawback by working with customers who ultimately export, increasing their understanding of the nuances of utilizing the US duty drawback regime and new regulatory provisions expanding its use. This collaboration enabled the company to rework contracts to obtain export documentation needed to recover import duties.

One global trade executive shared how revisiting customer contracts and then engaging in meetings with the supplier, importer and customer resulted in a three-way split of additional costs and contract renegotiations. Another executive noted that the strategy of sharing the costs with customers was not even an option with company executives — even if allowed by contract – for fear of damaging customer satisfaction and the relationship.

A few participants also expressed challenges with supply chain partners. This was especially true when supply chain partners advocated "changing the harmonized tariff schedule classification" to unlawfully circumvent Section 301 tariffs. A concern noted by many was an anticipated increased level of enforcement by U.S. Customs and Border Protection to crack down on significant duty avoidance.

Similarly, global trade executives cited frustrations upon hearing from customers about competitors importing the same products under a differing classification unaffected by 301 duties. In these situations, global trade executives found themselves again going back to the basics — increasing the understanding of business partners about the rules for determining classifications. These additional tasks left global trade professionals somewhat frustrated by the time required to manage such inconsistencies or unfamiliarity with rule sets.

Also, with respect to supplier and customer relationships, global trade executives discussed efforts to return to the basics of Incoterms. They found themselves increasingly spending time creating awareness within other functions in the company and external supply chain partners on the implications of certain Incoterms. Prime examples involve Delivered Duty Paid (DDP), where import clearance and import duties become the responsibility of the seller, and Ex Works (EXW), where export and import clearance and import duties fall on the buyer. With the prospect of a 25% duty rate applying, a misunderstanding of Incoterms can result in failed margins. Therefore, the education around Incoterms has become increasingly important.

Advocacy continues to provide measurable benefits

In the 2018 symposium, we highlighted the trend of advocacy and its benefits. In early 2019, global trade professionals continue to find that targeted, well-planned efforts in advocacy can provide benefits. Being that a stronger focus on advocacy is a newer trend, trade executives point to the time involved in educating and bringing internal advocacy representatives up to speed on global trade and all things import and export — but the consensus among participants was that this time is often well-spent and can result in benefits.

One global trade professional noted that through lobbying, the company was successful in a product's exclusion from an anti-dumping investigation. Other global trade executives had success in obtaining a 301 exclusion for their respective organizations, in part, through lobbying efforts or industry collaborations. But in the end, citing pressures on time and resources, global trade professionals emphasized the need to be very thoughtful when devoting time to advocacy efforts and stressed the importance of picking the topics and partners wisely.

Planning requires increased attention and creativity

Planning for increased duties is on the upswing. Information technology (IT) and telecommunications industries — which once benefited from either unconditionally duty-free products or conditionally duty-free products under deals, such as the Information Technology Agreement (ITA) — are being called upon to examine mechanisms for duty deferment and reduction. One global trade professional shared that it was not until the 301 tariffs took effect that anyone in the company acknowledged the existence of an inactive foreign trade zone (FTZ). Further, in this example, the company began feasibility assessments to potentially convert additional distribution centers into FTZs. Other global trade executives decided to conduct cost-benefit analyses weighing FTZs against duty drawback and bonded warehouses. But the consensus among participants was that C-level executives expected such analyses to be performed quickly and effectively and that in cases where products were faced with a 25% duty impact, the materiality threshold for savings was quickly achieved.

One area that trade executives continue to consider as underutilized is preferential claims under free trade agreements (FTAs). Global trade executives admit that, in many cases, the 80/20 rule for prioritizing efforts comes into play with FTA solicitation, analysis and certification. Global trade functions that are automated are more likely to break the 80/20 barrier, but those without automation continue to struggle with maximizing benefits. Regardless, global trade executives emphasized that successful automation of the FTA process (or any process) requires quality data. Finally, the solicitation process — in particular, the need to educate suppliers — is the other key hindrance to more fully utilizing FTAs to reduce duty bills.

Continued importance of data

Data is imperative, and effective data analysts are in high demand. The primary theme around data was "the need for speed." However, global trade executives cautioned weighing speed against accuracy. Phone calls to global trade practitioners from C-level executives have become the norm in the current climate of disruption. In fact, one global trade executive noted, "I am now on speed dial!" While global trade functions have progressed significantly in relation to the availability of data, there is still work to be done, particularly regarding the accuracy of data.

Other similar themes from previous symposiums persist when it comes to data. Decentralized companies cited challenges with accessing data from multiple enterprise resource planning (ERP) systems. Consistency of data when obtaining it from varied sources or globally is an issue, as is the level of detail of data, particularly when relying on third-party (e.g., customs broker) sources. One participant highlighted that for years, the struggle was to obtain data; now, the struggle is access to too much data. Global trade executives agree that a lot of the challenges in level of detail or consistency with data would be addressed to the extent that all governments made data available to importers and exporters. Global trade executives cited the convenience in obtaining data in the US through the Automated Commercial Environment (ACE), and in the UK's Management Support System (MSS) through Her Majesty's Revenue and Customs (HMRC). But at this point, global trade executives recognize global availability of data is a wish and not reality.

The other trend global trade executives recognized — and, in some cases, cautioned – is the rise in sophistication of government authorities' use of data. Participants discussed how customs authorities are ramping up resources in data analytics and the importance for importers and exporters to stay ahead of the curve and know their data. Participants also cited the more recent progression by government, particularly in Central and South American markets, such as Brazil, Chile and Mexico.

Global trade executives also pointed out that creativity in relation to data has resulted in some accomplishments. Specifically, the enhanced connectivity with supply chain partners, including suppliers and customers, has facilitated progression with access to data.

Finally, global trade executives agreed on the challenge of finding the right resources and talent in relation to data and technology. Global trade resources are particularly scarce in these times of disruption, but finding good "data scientists" and "data analysts" with global trade knowledge is even more challenging. Participants debated whether it's easier to hire a "tech person" and teach them trade or the reverse – no single conclusion was reached. However, global trade executives agreed on the need to enhance skills sets in this area.

Technology still not fully harnessed in global trade function

Technology is the area that global trade executives point to as suffering the most in the times of disruption. Getting budget for technology has traditionally proved challenging, but finding time and resources to devote to technology is proving even more challenging during this heightened period of trade-related disruption. While other areas of the business are making small steps ahead in relation to artificial intelligence and blockchain, global trade executives admitted having little time to get global trade functions a seat at the technology table. For example, one trade professional referenced logistics and finance departments as moving ahead in blockchain-related efforts while admitting global trade hasn't even been in the periphery of the discussions.

While it appears global trade professionals have some work to do to harness technology, it is encouraging that other areas of business with which global trade professionals routinely interact are moving forward with technology agendas. Perhaps next year we will hear a different story.

Talent availability challenges continue but disruption leads to career opportunity

Consistent with 2018 findings, the trend toward centers of excellence in both insourced and outsourced models continues. Global trade executives continue to rely on centers of excellence to allow the operational aspects of trade to run in the background, freeing up their time for value-add activities, including responding to disruption.

Most global trade executives indicated that while pressed for resources in the disruptive global trade atmosphere, the times have also allowed for opportunity within their organization. Global trade executives admitted that "priorities have changed, but in most cases, for the better" — a sign of the resilience of trade professionals and the ability of leading-practice teams to be agile. Specifically, global trade executives discussed the need to assign work to less-experienced team members out of necessity. For those who embrace the change, their experiences have broadened and made the team stronger and better adapted for the longer term. The takeaway: "Disruption invigorates the team."

In addition, team members are expressing satisfaction, and in many cases pride, as a result of the added attention and the elevation of the function's relevance. For example, when C-level executives refer to the department or team in "town hall"-style meetings — and particularly when executives can point to a success realized by the global trade team — team members feel a renewed sense of pride in work. Global trade executives, with smaller teams, also discussed the need to share some of the increased workload with other functions within the company and, in some cases, to suppliers or other supply chain partners. However, global trade executives also cautioned that disruption is creating additional strain on teams and recognized the need to devote more time to coaching and aiding in the development of soft and technical skills.

In terms of desired skills and experiences, the wish lists remained fairly consistent with earlier symposiums. Executives placed emphasis on smart, well-equipped, flexible, quick-learning individuals – and if they are trained in customs or export, all the better. Global trade executives continue to point out the need for better "data analysts" – people who are able to run data, analyze data, and compile data into user-friendly dashboards and management reports.

Enforcement not yet in focus

While global trade professionals agreed that the current priority is managing disruption and keeping internal stakeholders informed, they acknowledged that risk management and enforcement are topics that require attention today to prepare for tomorrow. Trade executives view risk management as a given in their global trade toolkit and a leading practice of any well-situated global trade function.

However, these professionals also acknowledged that enforcement is likely to increase as a result of the trade disruption and additional duties on Chinese-origin products, and therefore agree that some attention is required to bolster defense files. Specifically, additional diligence is a leading practice especially to the extent that changes to the basics of classification, origin and value have resulted. While global trade professionals have not experienced significant surges in post-filing requests from customs authorities or a notable increase in audits, plans are being made for this type of activity. In the end, the global trade executives did not seem to view their approach to risk management differently, but perhaps the tone of enforcement is less of an "if" than a "when" question, particularly for those companies that made impactful changes to mitigate disruption.

Finally, global trade executives recognize the surge in export compliance-related activity. Global trade executives expect this trend to continue and potentially increase, citing the added sanctions efforts and the rise in enforcement.

Concluding thoughts

In the year since our 2018 roundtable discussion, global trade executives of leading-practice functions have been able to rely on the strong foundation and the agility of their global trade teams and interconnectedness within the company to mitigate and, in some cases, overcome the trade disruption.

Since we began these symposiums, we have observed global trade executives work strategically over the last 15-plus years to create global trade functions that are both centralized and global; incorporate a risk-based approach to compliance and monitoring; and achieve efficiencies and cost savings through quality data, appropriate use of technology, and effective talent and resources. These efforts are paying off.

When additional 25% duties are incurred, global trade executives have been able to leverage their seat at the table with other functions within the company to more swiftly implement FTZ or bonded warehouse projects. Similarly, internal relationships with procurement, supply chain and customer service have enabled collaboration with third-party suppliers and customers to review contracts, better understand integrated supply chains and revisit Incoterms. In addition, global trade functions that have focused on data – its availability, consistency and quality – were much better equipped to analyze the impact of disruption in a timely manner, whether it be Brexit, USMCA, other new or revised FTAs, Section 232 or Section 301.

Further, access to data enabled global trade executives to respond to the multitude of requests from all areas within the company, including those of C-level executives, with a meaningful impact analysis and, in some cases, planning options.

However, global trade executives also acknowledged that the trade disruption has resulted in the need to return to the basic foundational skill sets of classification, origin and valuation. And it was in the return to these fundamental principles where global trade executives were able to again demonstrate the creativity and value of the function. Thus, they found results by devoting time, for example to:

- Reexamine the accuracy of classifications and working with third parties to demonstrate that a more favorable duty rate does not necessitate a change in the classification without support
- Demonstrate that a shift in supply chain could result in a different origin, or to lawfully exclude certain elements in the declared value could result in a lower dutiable value

Global trade executives responded to the call to "keep calm and trade on" while navigating the disruption. But they also leveraged the strong foundations they established in their global trade functions and revisited some of the basic skills — and in so doing, realized cost savings opportunities where possible and continued to add value to their organizations.

EY | Assurance | Tax | Transactions | Advisory

EYG no. 003272-19Gbl
CSG No. 1906-3178686
ED None

ey.com