



Free-Trade Pacts Create Challenges and Opportunities for Importers

BY JEAN V. MURPHY

Regional and bilateral free-trade agreements offer big potential savings to companies that are able to manage them effectively. Having the right technology is a critical key to success.

A proliferation of bilateral and regional trade agreements in recent years has made it more difficult than ever for companies to understand the many duty-avoidance options they might leverage to lower the total landed cost of imported goods.

The World Trade Organization estimates that by 2010 there will be around 400 such agreements. While these go against the WTO's support of broad, multilateral trade pacts, the slow pace of the current Doha round of multilateral negotiations has made the relatively rapid time-to-benefit of bilateral agreements an attractive option. Many WTO members already are party to 10 or more such agreements, WTO Director-General Pascal Lamy said in a recent speech. He warned that the rules of origin that typically are a keystone of these pacts complicate both the production process of businesses

that have to comply and the lives of customs officials who have to monitor and enforce them. Moreover, he added, they compromise "the transparency of the trading regime."

Nevertheless, preferential agreements offer significant savings opportunities to companies that are able to manage them effectively. Most enterprises, however, fail to tap the "huge opportunity" available and leave "millions of dollars of potential financial improvement" on the table, according to a 2007 benchmarking survey of hundreds of corporations by the Aberdeen Group, Boston. With the help of Global Data Mining LLC, a trade data analysis specialist, Aberdeen more specifically quantified potential savings among five enterprises from various industries using actual trade activity. These companies, which had revenue ranging from \$3bn to \$31bn, were collectively found to have \$261.2m in

untapped savings opportunities. That is over and above \$100m that the five companies already had saved since 2001 by leveraging trade agreements and other duty-reduction programs. Most of the untapped savings could be realized by focusing just on the top 10 percent to 20 percent of opportunities, the report said.

One reason that companies are not doing a better job in this area is because "they are significantly under-invested in technology for global trade management," says Beth Enslow, senior vice president for supply chain risk management at Marsh, New York. "This is ironic because global trade is the fastest-growing area for many companies and it still is largely being managed with sweat and spreadsheets," she says. Another issue is that companies have not raised trade compliance to a strategic level and often treat trade compliance people "like administrative clerks," says Enslow.

“Compliance definitely needs to be elevated within the corporation,” says Clay Perry, vice president of global markets at Integration Point, a provider of global trade management solutions based in Charlotte, N.C. “We think the compliance function should be centralized and as close to the CEO as possible.”

Melissa Irmen, vice president of products and strategy at Integration Point, stresses this point. “If the compliance department doesn’t have the ear of upper management, it is hard for them to get the resources they need to acquire technology. And if you don’t have technology in place, it can be a really daunting task to manage these programs.”

Without technology “companies simply lack the information they need to really get their arms around the potential savings that are available under these agreements,” says Bernie Hart, global product executive at JPMorgan Global Trade Services, New

York. Trade Planner, to help them figure out where the critical components of an end product should be sourced so that overall landed cost is lower. It is no longer just about going to China. You could have a slightly higher invoice from another country but if there is a preferential agreement in place, you could end up with a lower landed cost because of duty savings.”

Trade Planner compares different sourcing or distribution strategies using trade content data from 120 countries, he says. “Companies can use Trade Planner to look at the impact of sourcing from multiple countries and do a side-by-side comparison of duty rates, transportation, insurance and other costs. They can compare apples to apples to see what is the best strategy.”

With ‘what if’ scenarios, users can “change the country of origin for various parts, change product values, change transportation costs and also change exchange rates,” says Anne van de Heetkamp, director

ing on the size of the company—that account for the most duty paid and/or that have the highest added value, says Hart. “You always want to know where these are being sourced and where they are crossing borders, so you can have a heightened sense of urgency and a disciplined process for performing an opportunity analysis to see if you are getting the most duty minimization possible.”

This type of opportunity analysis is one of the services that JPMorgan provides clients, he says. “If we see a lot of products coming in from Mexico without using NAFTA, for example, we do an opportunity analysis and then sit down with the client to talk about what needs to be done to get those parts qualified so they can get rid of the duty payment.”

JPMorgan Chase’s compliance solutions also enable “what if” scenarios. “Say a company has a source of supply in Mexico that qualifies for NAFTA, but it then finds a

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York. However, companies are beginning to awaken to these opportunities and the need to have the technology to take advantage of them, says Nathan Pieri, senior vice president of marketing and product management at Management Dynamics, a global trade management vendor based in Rutherford, N.J. “I think we are seeing the beginning of the next level of low-cost country sourcing,” he says. “The first level was all about where to get the cheapest product. The next level is about taking a hard look at where components are manufactured and how to leverage preferential agreements to minimize total landed costs.”

Management Dynamics has a number of customers that are starting down that path, importing under five to 25 different trade agreements and starting to plan their global supply chain with duty savings in mind, he says. “We have a number of tools, including

of global trade compliance at TradeBeam, a global trade management software and services company based in San Mateo, Calif. “They can test all of the things that might impact their decision about where to source or manufacture.”

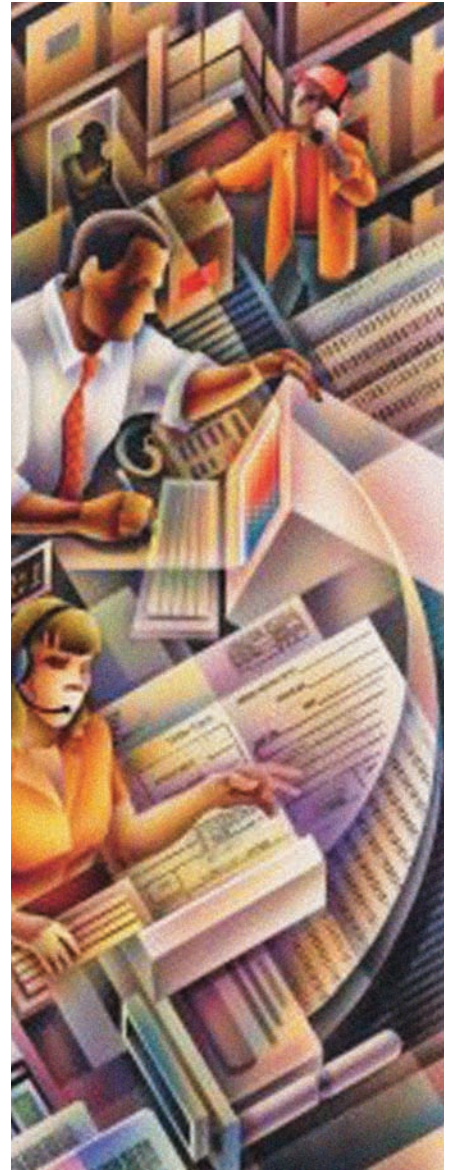
It’s important to use these capabilities early in the design process of a product, she notes. “Say you are building a car and the engine will be sourced from Japan. No matter where you assemble your car, the engine will be such a high percentage of the value that you are likely not going to qualify for duty reduction. But if you identify that early, you may have time to change your sourcing structure and find an engine supplier in a country that would be eligible for preferential treatment.”

JPMorgan Chase recommends that companies always have a handle on the top 10 part numbers—or the top 100 depend-

cheaper price for one component in the U.S.,” he says. “We can analyze how this change would affect its eligibility for NAFTA overall. A company can keep submitting these different scenarios to find out how its duty payments will be affected under different conditions.”

One JPMorgan client, Black & Decker, has increased its NAFTA savings by 240 percent, from \$3m to \$7m annually, since turning this function over to JPMorgan on a managed-services basis in 2003. “More than 95 percent of Black & Decker products that are eligible are taking advantage of NAFTA today, whereas before that level was significantly lower,” Hart says.

Integration Point’s specific solution for free-trade agreements “has both a rules engine that does the opportunity analysis as well as a content library, where we can load all the different trade agreement rules from



around the world,” says Clay. “Essentially, if a new trade agreement comes up next week, it’s just a matter of loading the rules content into the engine and it can analyze that trade agreement for you.

“The key thing our software gives clients is confidence,” Clay says. “From U.S. Customs’s standpoint, it is the responsibility of the importer to make sure that their claim for preferential treatment is valid. A lot of companies don’t have the confidence in their data to make this claim and so they let it pass. Our system gives them the confidence to make those claims, knowing they have the data to support them.”

Now, You Execute

Once savings opportunities have been identified, the next step is to document a product’s qualification for that duty savings. This is done through a solicitation process, explains van de Heetkamp. “You go to your suppliers and solicit from them a statement

as to the origin of the products you are buying from them. They provide you a proof-of-origin certificate that you can use to substantiate your claim in an audit.” Compliance solutions like TradeBeam’s can automate this exchange of documentation, she notes.

Once the origins of all components and assemblies are entered into the system, “the software application takes the bill of materials and calculates what percent of an end product originated in the country from which you are importing and will compare that to the rules of origin to see if the product qualifies for preferential treatment,” says Pieri. Usually the threshold is 60 percent to 70 percent or more. “If you meet the requirements, your duty rate will be reduced, in many cases to zero,” he says. The trouble comes when a company does not have enough originating content in the product to qualify, but takes the duty savings anyway. “If that is discovered in an

audit, penalties will be imposed that are much higher than the original duty rate,” says Pieri.

If an analysis shows that an end product is short of meeting the requirements, a company might engage in tariff engineering, says Enslow. “This again involves using simulation capabilities to see how a product might be altered to change its treatment under a free-trade agreement,” she explains.

Barry Prevor, who along with Steve Shore is the co-CEO of Steve & Barry’s University Sportswear, explained in an interview with U.S. News & World Report that changes such as mixing more cotton than polyester in a garment or fashioning a garment to be waterproof, which would change the tariff code, might enable his company to take advantage of more economical duty classifications. This kind of engineering is “part of our ability to bring low-cost products” to market, he said.

“Companies with a many-to-many supply chain environment that are manufacturing or distributing or selling in multiple countries regard tariff engineering as a big opportunity to take better advantage of trade agreements and significantly lower costs,” says Enslow.

Another way to get the desired result may be to change suppliers, says Hart. “Say we run a bill of materials from a client through our qualification engine and it comes back that two of the components are at 49 percent when they need to be at 51 percent. A company might want to consider re-sourcing these two components. With the information we provide, they can go back to their purchasing organization and give them a clear picture of what they need.”

With an appropriate analysis companies might also find that their best option is to separate combined products for importation. “We recently worked with a food company that was importing olives in vinegar,” says Enslow. “The company found that it could have saved 17 percent if it had imported these separately and packaged them in Canada.”

While there clearly are many savings opportunities, sometimes compliance costs or risks don’t justify trying to take advantage of them.

The decision to whether to take advantage of specific agreements is analogous to deciding whether to take advantage of a tax loophole, says Marshall Gordon, senior vice president of worldwide sales and marketing, a global trade management vendor based in New York. “If you and I were to maximize the intended purpose of the IRS tax code, using every possible deduction we could take, we may end up having at some point a cost of accountants that exceeded the benefits of the savings,” says Gordon. Sometimes compliance has such a significant impact on overhead in the office of the buyer or importer that it exceeds any savings opportunity, he says. “There are overhead costs associated with documentation, inspection and the compliance process as well as the cost of risk mitigation associated with complying properly,” he says.

One way of reducing compliance costs is through automation with solutions like TradeCard, he says. “When many activities are automated, overhead costs do not increase proportionately to the amount of sourcing going through a preference

program,” he says. “Automation also minimizes the risk of incurring fines or penalties at a later date and minimizes the risk that a company might lose its import privileges or be viewed by Customs as suspicious, which can result in transit delays.”

TradeCard’s automation software is not so much decision support as process discipline, Gordon says. “Some of our clients call us the process police. Instead of having people chasing things down, we collect, catalog and flow the right documents to the right place so the whole process is far less cumbersome and in compliance. And all those people are able

managing documentation to prove qualification under rules of origin, you had better know that it is worth it at the end of the day.”

Aberdeen’s analysis supports this warning. It identified shipments where trade agreements probably should not have been taken. “For instance,” asks the report, “should an organization really bear the additional risk burden of using a trade agreement for a \$33 shipment?”

Automation also is critical to communicating and monitoring compliance throughout the organization, says Irmén. “One of the things we help companies

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to spend their time doing real value-added work.”

At the same time, Gordon says, automation is driving companies to look deeper for low-hanging fruit. “One of the things we are seeing, even among clients that are relatively automated, is the realization that they can take advantage of small unit savings that would not have been possible with manual systems. Perhaps they can save three cents on a unit. If they have two million units, it is worth the \$1,000 it would cost to set that up because it can run in perpetuity. So, along with a flight to automation, we do see customers trying to maximize the value of a lot of these programs.”

Van de Heetkamp also emphasizes the importance of understanding the costs of compliance with preferential agreements “If the duty rate difference is 8 percent and your cost of compliance is 9 percent, you clearly shouldn’t bother, even though, on its face, the 8 percent may seem substantial,” she says. “The goal is to make sure your return on investment is there. With the money you have to put into systems and compliance people and

deal with is in monitoring all of the transactions that happen in an organization, because if a decision is made to start buying parts from a different location and your compliance manager doesn’t get informed of that, there’s going to be problems.” Since the part number may not change, “the only way a company can know this has happened is if it has a system that knows what to look for and monitors every receipt transaction in the system. That can only be done with automation.” ○

Resource Links

Aberdeen Group, www.aberdeen.com

Marsh Inc., www.marsh.com

TradeBeam, www.tradebeam.com

Management Dynamics,
www.managementdynamics.com

JPMorgan Chase,
www.jpmorganchase.com

TradeCard, www.tradecard.com

Integration Point,
www.integrationpoint.net