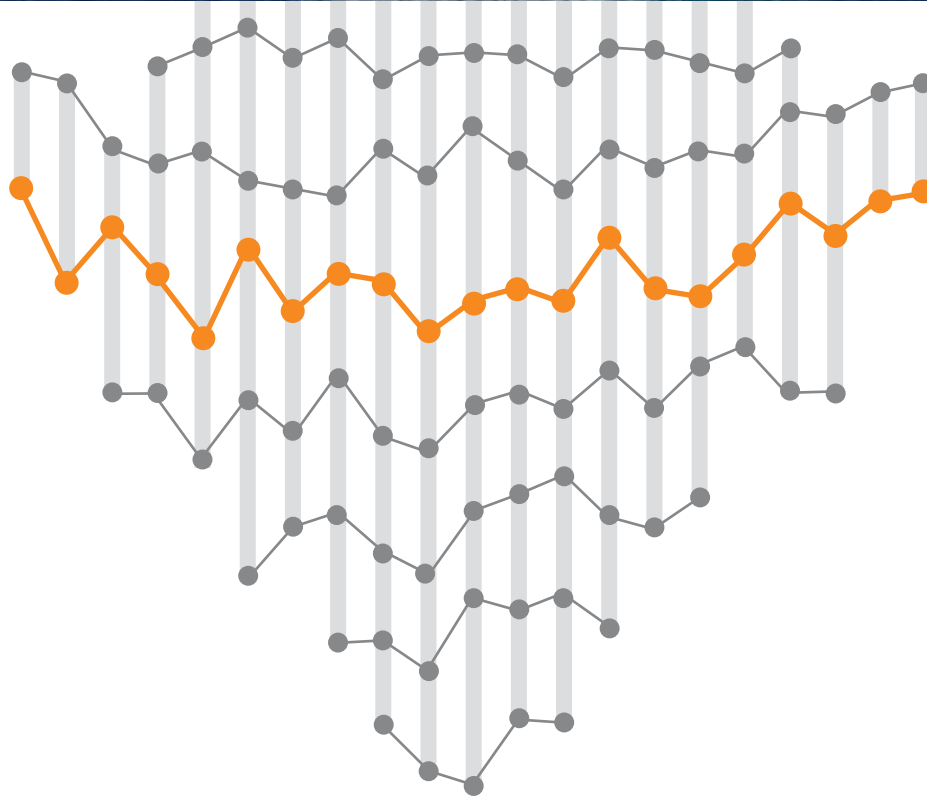


# Managing Global Trade: A Look Beyond the Surface

A qualitative analysis of global trade operations by Thomson Reuters ONESOURCE and KPMG International



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# Managing Global Trade: A Look Beyond the Surface

During the recent years, global trade regulations went from a sleepy niche to a major driver of mainstream news. In 2016, one major world power signaled their intention to leave the European Union and in 2017 another withdrew from a historic trade pact. Figures in many countries used protectionist rhetoric to obtain power. The possibility of sanctions, “trade wars” and other deployments of soft power increasingly replaced calls for military might.

In monitoring these events, we are watching history unfold in real time. What trade teams are struggling to do, how they expect their roles to evolve during the near term and what changes they can make to set their organizations up for success over the long term are topics that matter greatly.

We conducted our annual Global Trade Survey in 2015, 2016 and most recently in 2017. This latest edition seeks to highlight the realities of global trade in 2017 and beyond, and to better understand how trade professionals are handling these macro events and evolving the trade function. Our report features in-depth interviews with more than 30 leading trade practitioners who have substantial operational influence on global trade operations within their organizations. These individuals represent the top trade operations and compliance officials at very large multinational companies. Many of these organizations feature complex supply chains, regulation across many jurisdictions, significant tax burdens and constant changes that trade faces.

From this exercise, we constructed a rigorous and candid narrative of the risks and opportunities they see looming in their industry. Our annual Global Trade Survey, which we conducted jointly in 2015 and 2016, was the basis for these discussions. In these previous surveys, the research consisted primarily of data we collected from a statistically significant sample of global trade operators. Our current report put our conclusions to the test by talking them through, in a qualitative setting, with professionals who are in charge of their trade-related activities and teams.

What we found is that trade practitioners understand that a sophisticated trade compliance function adds enormous value to the business and helps inform strategic decisions. They are doing a lot of things well – they innovate constantly, execute methodically and plan for the future strategically. Perhaps most importantly, they are mindful of how the global trade function can be improved and accepting of new ideas to address historic challenges.



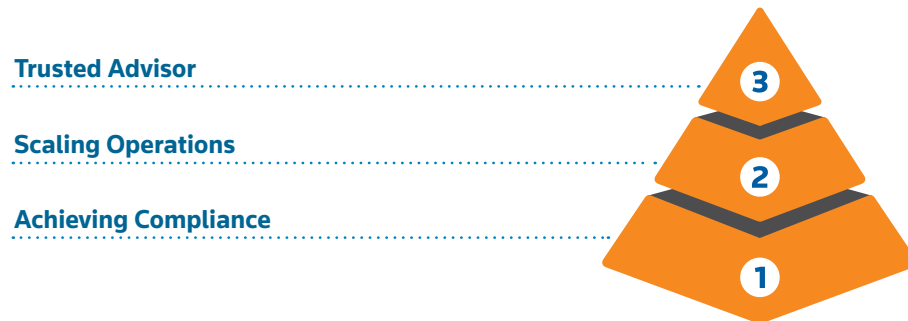
## How trade practitioners lead

1. **By having a vision:** Motivate colleagues and make a strong case for trade to management and other departments.
2. **With knowledge:** Explain the mission and value of their team clearly and powerfully.
3. **By delivering value:** Articulate the impact of trade’s work clearly and objectively. Set tangible goals and meet them.

*Leading trade executives gain support for impactful trade programs, and then build and sustain them.*

# The Global Trade Pyramid of Value

An important and consistent pattern emerged from our conversations. We found that the ideal trade function for large, global companies is a pyramid-shaped hierarchy of needs: achieving compliance, scaling operations and becoming a trusted advisor.



## What operations are like in...



### 1. The Bottom Tier: Achieving Compliance

- Lack of consistent processes and technology across units and countries
- Reactive approach to fixing problems after they are exposed through audits, repeated customs holdups and regulatory enforcement
- Direct and costly consequences of not being prepared and forward-thinking: staff burnout, poor morale and tedious day-to-day workflow

*We can't excel because we merely have to survive.*



### 2. The Middle Tier: Scale Operations

- An individual or small team takes responsibility for trade compliance activities and for controlling a largely centralized process.
- Centralizing data and supporting the trade activity in more intelligent, less manual ways and begins to take pressure off the trade team and makes the work less tedious.
- It's easier to get work done and the combination of better technology and improved processes gives trade teams more confidence that mistakes are not lingering. They can pay mind to preventing future challenges rather than fixing current problems.
- Still, there are challenges. Meeting the governance, scale and automation needs can be ideally accomplished in that order, but this can be difficult to do in practice.

*Improvements are delivering value. Now we're cooking with fire!*



### 3. The Top Tier: Trusted Advisor

- Trade becomes a trusted advisor and true partner to the company's executive management by delivering value above and beyond cost-cutting and compliance.
- Trade practitioners have a seat at the table where business decisions are made.
- There is a dependence on trade among executive management and department heads that did not exist previously.

*We've used a combination of modern technology and leading practices to embed trade strategy into the DNA of the organization. The company is truly empowered by our knowledge, expertise and abilities.*



The outcome at the top of the pyramid is the corporation becoming truly empowered through trade for crucial business intelligence that management uses to make strategic decisions, and eventually an autonomous trade department that has trade professionals focused entirely on strategy.

Our 2017 analysis explores the macro themes that, according to our conversations, truly matter to trade practitioners. It explores the specifics of three areas of trade operation — the centralization of processes, the utilization of free trade agreements and the classification of goods — that, for a variety of reasons, tend to be on the agenda of trade executives, and which were featured prominently in the 2016 survey results.

Throughout this analysis, we will return to the notion that leading practices of global trade can be thought of as a pyramid-shaped hierarchy and explore how this way of prioritizing needs can help keep teams on the right track.





## Our Findings: Centralization

### What we knew



*The centralization of trade processes had a slight edge over non-centralization, **53 percent to 47 percent** (2016 survey).*

Many trade teams don't operate with centralized processes, and there is no one decisive factor that dictates whether a trade team is centralized or decentralized. It's usually an evolution.

### What we found



While centralization produces net benefits and is a leading practice for trade, the importance of local knowledge for some aspects of trade is crucial and prevents complete centralization from being realistic.

Furthermore, efforts to centralize the trade management process usually arise from a specific event or challenge. The centralization of trade is usually perceived as either a necessity or a strategic goal for management.

Our interview subjects universally agreed that the governance element of global trade can and should be centralized. Centralizing governance is an example of a good starting point for centralization. Once they make the shift in one area, companies tend to centralize more trade processes than they initially thought they could.

Centralization is an imprecise term. Trade management centralization is best thought of as concentrating under a single authority the people, the processes and the data that drive trade with the objectives of creating efficiencies, reducing risk and achieving scale.

At leading-practice companies, the appetite to centralize processes tends to occur after the need for consistent, recurrent compliance has been met. Our conversations showed that centralization is thought of as a means of scaling trade, particularly either governance requirements or the operational aspects of trade management.

The reporting relationship between heads of trade and upper management at a company impacts the objectives of trade and therefore its overall approach to matters like centralization. When trade compliance reports to a chief financial officer, for instance, the objective is to control costs. When it reports to a general counsel, the objective is to mitigate risk. When it reports to a chief operating officer, the objective is to be as efficient as possible. Heads of trade compliance must therefore make a business case for centralization in the context of the applicable objective.

We found that the decision to centralize trade is either a long-term strategic aim or a response to a triggering event. It can either be proactive or reactive.

- Long-term objective (proactive): Management turnover, a trade team's natural evolution
- Triggering event (reactive): A merger, an episode of regulatory enforcement or a change in trade policy

Management turnover can create new strategic aims and therefore lead to relatively immediate efforts to centralize trade management practices, while a trade team's natural evolution over time can more methodically make the case for centralization.

Isolated corporate events, regulatory actions and political risk, on the other hand, can force the issue.





*“The instinct of leading trade professionals will usually be to centralize, and to keep centralizing until there’s an obvious reason not to. Being able to rigorously monitor and steer the function through KPIs and other measurements, therefore, becomes an important part of the centralization discussion.”*



Our respondents frequently acknowledged the value that regional expertise provided. They know not everything can be centralized. We observed import documentation, clearance-related activity and country-specific program compliance as functions that tend to stay local among leading-practice trade teams because local knowledge is essential. A common way to manage this is for regional experts to report up to a centralized headquarters but retain some level of autonomy.

Finally, we expected to see a correlation between who trade practitioners reported to and how they behaved, particularly on issues such as centralization. We found that trade practitioners have a wide variety of reporting relationships, but these relationships do not affect behavior in any consistent way.

Respondents cited classification, broker management and supplier management as functions that benefit from centralization. They cited cost, process consistency, creating a global view of trade compliance and improved auditing processes among the desirable outcomes. Centers of excellence and shared service centers for trade compliance are common methods of centralizing to ascend to the middle tier of the Pyramid of Value.

However, greater accountability, a sustained focus on tasks rather than on strategy and losing touch with local operations are potential pitfalls of centralization of the global trade function. Integrating systems, reducing the number of ERPs and properly structuring data are common barriers for centralization. Generally, the shift is only feasible with a strong commitment from a company’s information technology department.

#### **New takeaways:**

1. While it is possible to centralize governance functions without automating them, it is not feasible to centralize the operational side of trade management without using automation as an aid to create efficiencies, reduce risk and achieve scale.
2. There was more of a tendency to centralize export activity than import activity among the trade professionals we interviewed.
3. There is a point at which centralization becomes impractical. Localized knowledge and relationships remain essential elements of a diligent approach to trade, and centralization should not blunt the value that local experts can bring to the process.

## Our Findings: Free Trade Agreements

### What we knew



*Just **23 percent** of respondents said their company used all applicable free trade agreements (FTAs) (2016 survey).*

While trade practitioners understand that using free trade agreements may yield duty savings, FTAs are perpetually under-used among trade teams. Complex rules or origin, challenges in gathering required documentation and a lack of internal expertise are commonly cited reasons why.

### What we found



Very large, very complex enterprises are substantially more sophisticated in how they use FTAs than their competitors. At these companies, the C Suite has visibility into FTAs.

These enterprises tend to handle FTA administration and compliance at the local or regional level. These companies are closely monitoring the return on FTAs, with many being able to say what they save on the agreements per year, right down to the dollar.

However, many companies represented in our discussions don't place a great deal of trust in the consistency and reliability of the origin determinations and declarations their suppliers make.

The largest of the large multinational corporations are capturing value from the assortment of FTAs that are available to importers and exporters. Their smaller, but equally as global, competitors are missing out on some of the upside.

Our interview subjects are tracking investments in FTAs with impressive granularity, able to show net duty savings. The same cannot be said for multinationals as a whole. In our 2016 trade survey, which examined this subject quantitatively, just 23% of respondents said their company was using all the FTAs available to it.

Although the emphasis for ROI calculations seems to be duty savings, most companies represented in our discussions indicated that managing certificates of origin documentation is a significant burden for FTA compliance. On the risk side, several respondents expressed concern about relying on manual calculations for complex origin determination requirements. Global trade management (GTM) solutions address both of these matters.

We expected very large companies to have formulaic, top-down processes and strong centralized controls for the management of FTA compliance, but this was not the case. We expected to hear that FTAs impact where companies build facilities, but again, this was not the case. Instead, our conversations revealed that very large multinationals trust local or regional teams with FTA compliance, and that a country's workforce and infrastructure influence construction decisions far more than trade linkages do.

Furthermore, supplier risk was a constant theme in our discussions with sources. We went into these discussions believing that companies are at times too quick to reflexively trust their suppliers, and this expectation was validated. While the FTA utilization rate is high, leading trade professionals acknowledge to us the risks that their lack of visibility into the business of their suppliers is creating.





Globalized, standardized processes for identifying and complying with FTAs are rare, with very large companies seeming to achieve high FTA utilization through manual processes. These companies have the resources to dedicate time and effort to FTAs, but they're generally using primitive tools and manual processes to keep track of the return.

These teams generally report to management significant cost savings borne from high FTA utilization. This can create a false sense of security by failing to acknowledge the risks created. The primary need of a global trade team is to avoid risk by using a mix of processes and tools to achieve legal and regulatory compliance, and it appears that need remains unmet at very large multinationals when it comes to FTA utilization. The risk doesn't get pushed up to the supplier. The company that makes the claim takes the risk.

Generally, companies have for many years absorbed risks associated with FTAs. The case for mitigating it can be difficult to make unless there is a negative compliance event because management has usually already discounted the cost savings FTAs generate.

Broadly, FTA compliance is a scale-sensitive endeavor. The very large companies we interviewed often have enough scale on their largest trade routes to invest in FTA compliance programs, and therefore have high FTA utilization rates. But smaller companies — say, below the Global 2000 — often have smaller trade volumes on any given route, which can quickly drop below the level at which FTA savings cover the compliance costs.

For these companies, lowering the cost of FTA compliance — even modestly — through automation or a shared services approach can create a net cost reduction for all of the trade subject to FTAs.

#### **New takeaways:**

1. Very large companies have become comfortable in the manual processes they use to leverage FTAs. These are sophisticated companies that are identifying and complying with FTAs in an unsophisticated way.
2. New companies, or those that are only recently able to claim FTA benefits, can skip the manual processes very large companies are stuck on. They are well-positioned to use FTAs more effectively.
3. There is a high degree of confidence that the trade agreements that liberalize trade today will continue to be available in the future, regardless of the political winds.



*"If you're just starting out with FTAs now, you'd be crazy not to automate it. But if you're at a very large company that's been using them for decades, there's less of an incentive to push for automation because management has seen the endgame of the process. But they aren't seeing the risks, like those created when there's limited visibility into a supplier's operations, that automation can fix."*

## Our Findings: Classification

### What we knew



**91 percent** of respondents reported having a challenge with product classification (2016 survey).

Trade professionals almost universally cite classification as one of their greatest challenges. Multinational companies are beginning to use shared service centers or centers of excellence to support the classification process.

### What we found



The classification process is centralized but highly manual. Our interview subjects almost universally centralize classification and most could easily and clearly articulate why.

Companies have robust review and exception-testing protocols for centralization, but stand-alone consultant audits are not commonplace.

These findings line up well with what we expected.

Because classification is a manual process even among very large global companies, it is a constant source of risk and complexity for trade teams. These teams need to ensure, for instance, that regulatory changes are made to spreadsheets in a timely manner, and that they maintain version control for the documentation that brokers receive. Dealing with multiple countries and thousands of SKUs intensifies the complexity and manual burden.

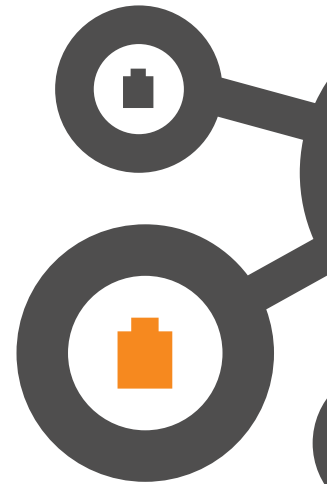
A familiar, manual process to classify applicable goods and materials satisfies a trade team's base need to achieve compliance. Classification seems to exist at the bottom tier of the pyramid. But changes could dramatically improve the classification process at many global companies and climb higher up the Pyramid of Value.

First, we found that, while there are robust review and exception-testing protocols in place among the very large companies represented in our discussions, few had standalone audits of classification after it has been assigned. This is likely because those companies are confident that the correct determinations are made initially.

Furthermore, none of our sources articulated a process for addressing regulatory changes beyond having the trade team's staff deal with them manually. One global retailer has 80 people who work largely on product classification. It can be intensely time-consuming and a source of great risk.

Our discussions indicated that trade teams are also not frequently outsourcing classification. Although some sources did mention an occasional reliance on an outsourced service provider for classification, they know it is expensive and does not materially reduce their risk.

Instead, leading-practice companies tend to follow a common course of action: bring classification in-house and centralize the function.





*"It's important for companies to centralize classification before they try to automate any elements of it. If you automate before you centralize, you're automating an inefficient process and actually elevating the risk profile."*

Centralization helps bring trade teams towards a single source of truth for classification. Having strong processes in place, such as internal approvals, checks and balances, education on product description accuracy and distinct lines of communication, to support the classification process is crucial, and automation presents an obvious upside for reducing the costs and risks associated with these processes.

A leading practice for most any company with a substantial trade footprint involves automated classification and a classification shared service center. Obstacles that can get in the way of this include multiple systems that store product-related information; inconsistencies in product descriptions and identifiers across locations; and a lack of data standardization.

Whether through more-robust tree-based classification methodologies or on-demand solutions that are always updated with the right content, or a combination of these tools, there is potential for trade teams to improve their operational efficiency by updating the classification process.

#### **New takeaways:**

1. Very large companies are engaging in risky manual work and, despite having large labor forces working on classification, they are not running internal classification audits to catch mistakes.
2. There is a high awareness of the benefits of centralizing classification, but there are some clear obstacles.
3. Trade teams at very large companies have managed classification the same way without major consequences for years. Their success makes it challenging to compel their companies to invest in new processes and automation to enhance an area that appears to be meeting its regulatory obligations. Accordingly, most enhancements in the classification process are incremental and focused on workflow, documentation and audit trail.







## Conclusion

There is currently a once-in-a-generation level of uncertainty in the global trade space. At the same time, trade is a greater priority among corporations than it has ever been.

These two trends have conspired to create a uniquely complex environment for global trade operators: trade leaders are constantly diffusing this complexity with technology and leading practices while simultaneously searching for new ways to become yet more efficient, deliver yet more value, and have their people spend yet more time on strategy.

Every company has different needs when it comes to trade, and there is no one solution that works for every trade team. The right approach usually involves a balanced combination of updated processes and new technology.

Visionary, effective trade leaders realize their companies need guidance and leadership from trade now, and are able to consistently climb the Global Trade Pyramid of Value. They put forward clear objectives, leading practices and visions for all of trade's collaborators to follow. They don't buy software or hire stand-alone consultants. They partner with technologists and service providers to implement customized solutions that fit their company's unique needs.

Thomson Reuters ONESOURCE™ and KPMG collaborate to offer a leading-practice set of technology and services to support the needs of global trade teams. We can help trade teams make a compelling business case for an appropriate allocation of resources for the trade function.

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