Integrated Trade Compliance Strategies: The Role of Corporate Leadership ©

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BACKGROUND

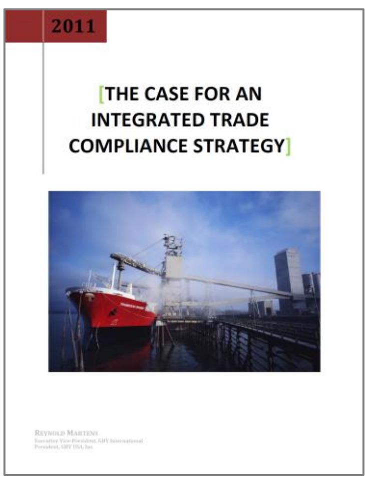
In previous white papers, we explained how in today's increasingly global economy, trade compliance matters more than ever before.

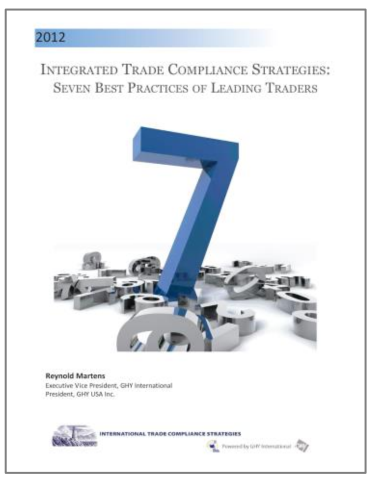
In "The Case For An Integrated Trade Compliance Strategy," we outlined the key reasons why companies need to adopt a holistic approach when it comes to dealing more effectively with this highly complex and rapidly evolving issue.

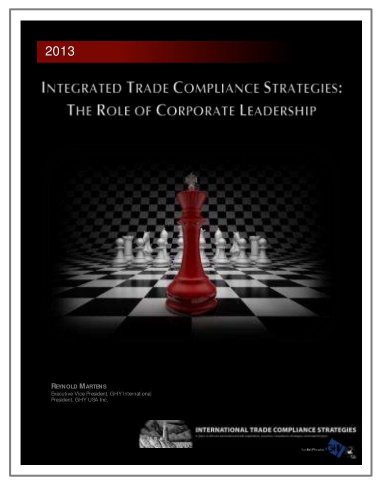
Our second white paper, "Integrated Trade Compliance Strategies: 7 Best Practices of Compliant Traders," described several of the best business practices we observed being utilized by a number of proactive companies to facilitate the successful implementation of what we describe as an "integrated trade compliance strategy."

Foremost among the "best practices" of the various companies we previously surveyed was the indispensable role of corporate leadership in making international trade compliance a vitally critical issue throughout their organizations.

The intent of this document is to examine in more depth various aspects of this core business leadership element as it relates to achieving compliance success in a global business environment.







EXECUTIVE SUMMARY

The board of directors is a key component of corporate leadership with a fiduciary responsibility to protect the long-term interests of shareholders by providing sound governance, strategic business advice, and vigilant oversight to ensure management policies are consistent with the company's strategy and risk appetite.

Boards also have an important role to play as guardians of the firm's brand integrity, a factor of increasing importance in a dynamic online environment where business reputations can be surprisingly vulnerable.

Added to these responsibilities, the hyper-competitive nature of global trade demands that boards expand the scope of their traditional risk management capabilities and become adept at "risk-intelligence" – a discipline that goes beyond merely assessing and mitigating potential risks to discovering unexpected opportunities in sometimes chaotic circumstances.

Trade compliance may seem to be something of an afterthought in this tall order of existing board responsibilities, but nothing could be further from the truth. In a globalized business environment, compliance has become an integral risk management component that needs to be matched commensurately to each company's level of international trade investment.

Companies that source products from abroad rely on complex global supply chains involving multiple modes of transport for basic inputs or finished goods. Global exporters – whether they are active across the Canada-US border or throughout the world – know that trade compliance issues can have a significant impact on strategic direction, and should therefore be front and center in the minds of board and other corporate leaders.

In this document we describe the traditional role fulfilled by the board of directors, and illustrate how these familiar priorities intersect with trade compliance in today's globalized business environment.

We also provide case studies of how "best practices" trade compliance measures have been successfully enabled by the boards of differing companies.

Finally, we set out five core principles for boards to consider when addressing the shifting demands of globalization, and six questions that can be used to roughly benchmark your own organization's performance.

An extensive resource guide and bibliography are included for further research and study.

WHAT IS THE BOARD OF DIRECTORS' ROLE?

OVERVIEW

The destiny of any organization is guided by many different factors, but ultimate responsibility rests with its senior leadership. The buck stops here, as the old expression goes – both in terms of positive results and negative repercussions.

A company's corporate ethos and core values are reflected through its board. Ideally, it should represent an appropriate mix of experience, industry knowledge and specialized expertise, enabling it to bring practical wisdom, and mature judgment to bear when considering the long-term interests of shareholders.

The board of directors is a major component of senior leadership with responsibility and oversight comprising four critical areas:

1. Corporate governance;
2. Business strategy;
3. Risk intelligence; and
4. Organizational/reputational integrity.

CORPORATE GOVERNANCE

Corporate governance is legally vested in a board of directors who have a fiduciary duty to serve the interests of the corporation's shareholders rather than their own interests, or those of the firm's management. As such, the board bears ultimate responsibility for overall enterprise performance, and must hold the CEO and management team accountable for their actions.

The Chartered Accountants of Canada (CICA), defines the role of the board as follows:

"They will oversee the processes that management has in place to identify business opportunities and risks. They will consider the extent and types of risk that it is acceptable for the company to bear. They will monitor management's systems and processes for managing the broad range of business risk. And most important, on an ongoing basis, they will review with management how the strategic environment is changing, what key business risks and opportunities are appearing, how they are being managed and what, if any, modifications in strategic direction should be adopted."

In its *Framework for Board Oversight of Enterprise Risk,* the CICA goes on to describe the board's role in the oversight of risk as being akin to that of an audit committee which doesn't prepare financial statements or maintain the system of internal control, but bears responsibility for overseeing the reporting and control processes. "Similarly, boards of directors are not expected to unilaterally identify, analyze, mitigate and monitor enterprise risk, " it states. "Rather boards must oversee the risk management systems and processes as well as continuously review the outcomes and planning associated with such processes."

Business Strategy

The board of directors plays an important role in the strategic management process. The board oversees the framework of controls designed to identify, manage and mitigate strategic risks. Boards also commonly audit various components of an organization's strategic management process in order to make it more effective and efficient.

For example, the board can demand re-examination of the company's mission, its long-term goals, its corporate strategy, and its approach to the competition.

To quote Harvard scholar and "father of corporate strategy", Kenneth Andrews: "A responsible and effective board should require of its management a unique and durable corporate strategy, review it periodically for its validity, and use it as the reference point for all other board decisions." (Directors' Responsibilities for Strategy, Harvard Business Review, Nov-Dec 1980)

Boards that diligently integrate risk management with development of the company's strategic direction and business plan can contribute immensely to the likelihood of success by identifying (and then mitigating) potential risk exposure that might otherwise detract from the achievement of strategic objectives.

Risk Intelligence

The ability of businesses to survive and thrive often requires unconventional thinking and calculated risk taking. The key is to make the right decisions – even under the most risky, uncertain, and turbulent conditions.

Boards today are not only key players when it comes to protecting their firm's assets through conventional approaches to risk management (i.e., assessing current major risk factors and reviewing available options for their mitigation), but are increasingly involved with an upgraded form of "risk intelligence." In short, finding opportunities amid ambiguity, information overload, and often-chaotic circumstances.

As noted in a 2010 Deloitte whitepaper based on concepts in the book *Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise* by business consultants Frederick Funston and Stephen Wagner, "Organizations that prepare ahead of time to take advantage of shifts in the environment are far more likely to be able to move in time to seize competitive advantage than those who do not. "

Boards are ideally positioned to take a longer-term perspective that can aid in identifying the potential unintended consequences of short-term decisions, and to anticipate potential causes of failure, thereby increasing chances of survival and success through improved preparedness.

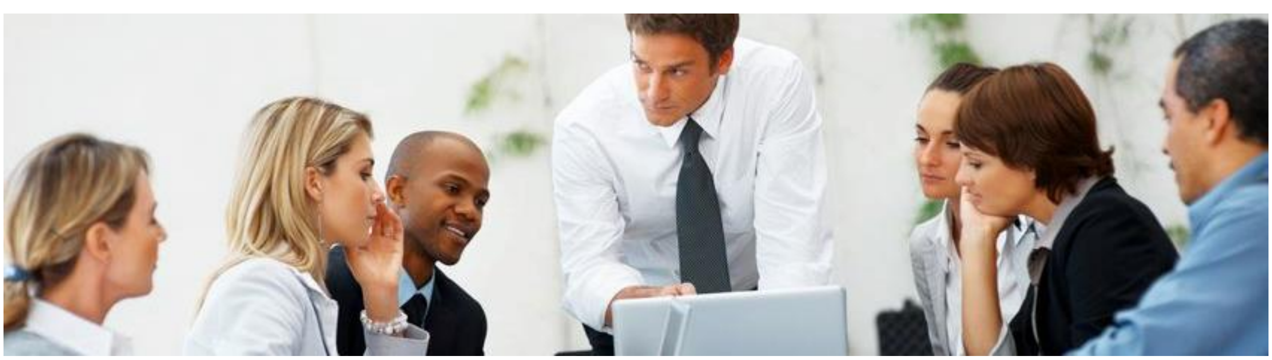
REPUTATION/BRAND INTEGRITY

Managing brand reputation is essential to any organization. Keeping and delivering brand promises are crucial elements in building strong customer-brand relationships. Reputation (aka "integrity") is one of the most important ingredients to ensure the long-term success of a brand.

If trust, respect, and loyalty cannot be established by an organization's brand, it will not be able to withstand today's highly competitive global market.

Boards are now more than ever keenly aware of their accountability for the company's reputation growth or deterioration. In its most recent annual *Board of Directors Survey*, U.S. accounting firm Eisner Amper found that amongst respondents, reputational risk has now overtaken regulatory compliance risk as their primary concern. "Directors identified the various risks that were most important to their boards with 69 percent identifying reputational risk as the most important. This percentage skyrockets with the addition of their concerns about the elements of reputational risk including IT risk, product risk, outsourcing risk, privacy and data security, and risk due to fraud."

A primary catalyst for this change is the increasing prominence of the Internet. As consumers have been afforded greater access to information they have become empowered (better informed) to decide how and where they spend their money. This empowerment has resulted in creating greater accountability on the part of businesses and organizations alike.



LEADERSHIP PRIORITIES

How Does Globalization Intersect With Leadership Priorities?

Corporations have a legal responsibility to be informed, compliant with government regulations, and adequately prepared for the likely possibility of verification audits or enforcement actions.

Accordingly, companies need to appropriately match their investment in risk mitigation to the scope of their commitment to international sourcing and export market development initiatives, with a view to minimizing any potential commercial repercussions of non-compliance.

Today, internationally active companies and their leadership teams at the board and executive levels must come to terms with 4 major trends of significant impact.

1. The escalating degree of trade compliance risk in a globalized business environment that is characterized by rapid change,

2. Proliferation of bilateral and multilateral free trade agreements,

3. Growing supply chain complexity,

4. Intensifying regulatory vigilance by governments around the world.

An intelligent risk mitigation strategy, therefore, should proactively anticipate potential trade compliance implications applicable to each stage of product lifecycle management, from conception all the way through to delivery and contract fulfillment.

As noted by KPMG LLP, the audit, tax and advisory firm, in its 2009 paper *Customs Compliance: Strategic Planning for Global Growth*, “Companies of all sizes are feeling the effects of globalization and increased shareholder interest in managing global risks…” It went on to observe that “trade is being transformed from an operational function on the sidelines of corporate awareness to an evolving function that helps mitigate organizational risks and strategically drives value.”

The rising bar now facing boards with regards to managing global trade risk was also highlighted by Deloitte in its *Director’s Alert: Issues for 2011* publication:

"Boards need to ensure they fully understand the global regulatory environment in which they operate as well as the interplay of regulations from one jurisdiction to another. This creates challenges for organizations that operate globally since operating in some countries may be subject to different rules than those in other countries, while the operations of one subsidiary can affect the solvency and reputation of the entire organization."

While potential risks are significantly compounded by the global trade environment, so too are the opportunities for driving profitability and shareholder value.

Expanding into new markets, effectively leveraging international supply chains, and diversifying both supplier and customer relationships, are now crucial factors to future growth for many companies.

Viewed as integral components of the company's strategic direction and plan, boards must be keenly aware of the manifold exposure to new risk posed by global trade, but likewise appreciative of the various ways in which the complex array of challenges it presents has the potential to create distinct competitive advantage.

Balancing emerging risks and opportunities demands an ongoing assessment of the business and regulatory environment by boards to ensure a proper alignment between the company's growth targets and appetite for risk.

Of equal importance is the need for oversight in light of a rapidly evolving framework of regulatory compliance, in order to prevent strategic objectives from being unnecessarily compromised.

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THE NEED FOR INFORMED VIGILANCE

"As company operations and holdings continue to expand into all corners of the globe, decision makers too often pay too little attention to specific country risks and other matters of critical importance. Boards of directors are particularly vulnerable to this glaring oversight due mainly to a lack of direct insight into a particular country – which leads to an inability to discern fact from fiction – and not knowing the right questions to ask of corporate management."

– Daniel Wagner, CEO of Country Risk Solutions, a cross-border risk consulting firm based in Connecticut, Huffington Post columnist, and author of the new book *Managing Country Risk*.

The consequences of global trade risks are often taken as simply consisting of monetary fines, penalties, or sanctions assessed by foreign governments, and it is true that these are the most immediate and directly punitive results of infractions associated with international trade.

In reality however, the range of possible risks and consequences involved is much broader, and may have a more profound effect that impacts both commercial operations and overall financial performance.

Boards have a duty of care and face personal consequences for commercial or regulatory oversights. In cases where there is an egregious breach of fiduciary responsibility for lack of due diligence, board members may even be held financially responsible for any resulting loss to the corporate shareholders or other principals, owing to their negligence.

A company's brand and reputation have an intangible but significantly real value based on performance; i.e., the ability to reliably and consistently deliver on its promises. Public companies are routinely subject to detailed examination in the course of their periodic financial disclosures to regulators, but privately held firms are by no means exempt from critical scrutiny.

In the case of both public and private companies, at any time their reputations can be subjected to trial in the court of public opinion should things happen to go awry, whether that involves being pilloried in the mainstream press, or arguably worse these days, mercilessly excoriated on social media platforms.

Consider 6 case studies that illustrate the diverse array of variables that must be considered by boards and executives in contemplating international operations or expansion:

Shifting production from North America to an overseas facility may be economically attractive and make commercial sense from a standard "due diligence" perspective, but what if the operation is suddenly rendered useless by a natural disaster, and there is no contingency plan in place? That may well seem like a far-fetched "black swan" scenario, but consider what happened in 2011 to the international supply chains of companies that were disrupted for several months by the unforeseen tsunami/nuclear meltdown in Japan, or completely devastated by widespread flooding in Thailand.

A joint-venture or subsidiary in a foreign country involving inter-company transfers of financial resources and production inputs, or the co-mingling of supply chains or inventory, can present unanticipated complications. If taxation and customs valuation implications are not comprehensively assessed before business is consummated, the enterprise could be unintentionally exposed to extensive transfer pricing violations, possibly resulting in significant retroactive adjustments and damaging penalties.

Expansion offshore for contract manufacturing could expose multi-national Canadian or U.S. companies to unanticipated duty assessments and penalties. If it is subsequently determined that the required transformation of materials, and/or specific value-added requirements needed to qualify the finished goods for free trade eligibility were not properly adhered to, there can be significant financial consequences long after sales contracts are executed.

Intellectual property and patent protection is an emerging area of risk for North American firms contracting out manufacturing or partnering with foreign companies. But liability can cut both ways – both to protect the Canadian or U.S. firm from illicit use of their intellectual property by unauthorized parties, or by exposing the firms to foreign regulators enforcing domestic patents that may not be recognized in North America.

Emerging markets often present unique challenges for Western companies that may naively assume a comparative level of ethical integrity exists, but soon discover a "pay to play" culture of corruption involving bribes or "special payments" to interested parties is involved in any deal-making. While expedient and perhaps even necessary to concluding domestic business arrangements in these countries, engaging in such behaviour runs afoul of stringent anti-corruption legislation in most Western countries. The board and senior executives are ultimately responsible for any financial exposure that results, not to mention the costly harm that may be caused to the company's reputation should public charges of corrupt business practices surface.

Global expansion can expose companies to "cultural risk" if the particular sensitivities of the country or region are not properly researched and factored into strategic plans. Tales of hapless cross-cultural insensitivity are legion. For instance, a successful U.S. manufacturer of golf balls looking to expand internationally was puzzled by unusually low sales of its product in the Japanese market until it was eventually discovered that the problem derived from selling the balls in packs of four. It turned out that in Japan the number four traditionally holds the meaning of death. Hardly a stellar way to build brand integrity or reputation.

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GLOBALIZATION AND INFORMED VIGILANCE

AN ACTION PLAN FOR BOARDS: THE 5-A'S

A recent Harvard Business Review Analytic Services study of companies with more than 10,000 employees found that only 1 in 10 respondents said their executive management was "highly effective" at creating a "strong risk-aware culture." Barely one-third of all respondents felt they were doing well at any of the key risk management capabilities most often cited as critical to organizational performance, such as linking risk information to strategic decision making, driving risk mitigation activities, proactively identifying current and emerging risks, and so on.

In follow-up interviews with executives, the Harvard researchers nevertheless found broad agreement concerning the important benefits of enterprise risk management (ERM) and the various "lessons" companies must take on board in this regard:

- Risk management needs to have a clear "owner" to be effective.
- Risk management and corporate goals need to be integrated.
- Companies must manage risk proactively.
- Companies must look deeper and wider to determine what their most serious risks will be in the long run.
- Companies must break down silos and bottlenecks.

Aggregating these ERM "lessons" with the concept of an Integrated Trade Compliance Strategy, we suggest five core principles for boards to consider when addressing the increased demands of globalization: Awareness; Alignment; Accountability; Assessment; and Adaptability.

1) AWARENESS

Asking the right questions to arrive at the correct answers involves understanding what the board believes it knows about global risk, but even more importantly, what it does *not* know.

The foundation of risk awareness is a clear articulation of the organization's risk appetite generally, and more specifically in the context of this paper, its risk tolerance with regards to global trade and expansion.

Some basic questions to consider should include:

- Which factors will be included?
- How will various risks be graded and compared to risk appetite?
- What preventative measures are in place to avoid a breach of risk appetite?
- How will risks be mapped to strategic objectives?
- What forward-looking "key risk indicators" will be most useful in decision-making?

(Reference: Christopher Eaton, Conference Board of Canada, "What Does Risk Integration Look Like Really?")

2) Accountability

The board of directors ultimately bears responsibility for global risks undertaken by the organization, whether it is aware of the risks or not. Accordingly, the board must take a leadership role in overseeing – although not actually managing – the various risk factors involved. As outlined by Deloitte in its *Risk Intelligent Governance* guidebook:

"…the board should establish and reinforce executive accountability for risk management. One way to do this is to expect full disclosure by management of the risks associated with each aspect of the strategy. Give management ongoing feedback about your satisfaction with their level of disclosure and the quality of risk-reward analyses. You might also consider a formal evaluation process, led by the board chairman, lead director or governance committee, for specific executives."

3) Alignment

Although the highest-ranking executive is usually appointed to be the "quarterback" responsible for managing the practical elements of risk management within an organization, as the analogy would suggest, in fact, a team effort is required to make things work effectively.

"Risk management theory and practice have evolved considerably in recent years and continue to do so. One of the biggest changes has been the development by larger organizations of a coordinated or integrated approach to risk management often described as "Enterprise Risk Management" (ERM). The basis of ERM is that every part of an organization is responsible for managing risks in its own area of business activity using processes and guidance provided by a centralized risk management coordinator. Some larger organizations appoint a Chief Risk Officer or other senior executive. Others have risk management committees or other coordinating mechanisms."

– Hugh Lindsay, *20 Questions Directors Should Ask About Risk*

The salient point is that every division or department within an organization should be responsible under the leadership of the risk management "quarterback" for the global trade risks that arise out of the activities they directly oversee.

4) Assessment

While the foregoing elements of Awareness, Accountability, and Alignment together create a solid foundation for an effective global trade risk management strategy, another vital principle must be added to the mix in order to prevent complacency from taking hold.

The enemy of vigilance, complacency, often sets in not through deliberate effort, but because of a genuine belief that all is well and as it should be. "We have this all figured out and rely on the system in place to identify and mitigate risks to our business" is an expression of conceit one can easily imagine having been confidently made by corporate executives immediately prior to the occurrence of any number of unforeseen calamities.

"Complacency results from the abandonment of critical thought. Sticking to the status quo and refusing to challenge assumptions may appear to reduce conflict, but at what cost? Critical thought is the flashlight that exposes the cockroaches hidden in the corners. Potentially disastrous flaws in strategies and activities are missed when we choose to remain in the dark and limit the participants in the debate."

– Cathy Taylor, *Conference Board of Canada: Risk Watch – September 2010*

To avoid being lulled into complacency and a false sense of security, constant assessment and intelligent probing of the status quo by the board will ensure that the "risk intelligent" organization is going "beyond compliance." It is imperative that the board is also properly exercising the due diligence demanded of it with respect to exactly how the organization's strategic plan is being implemented, on both a short and long-term basis.

5) Adaptability

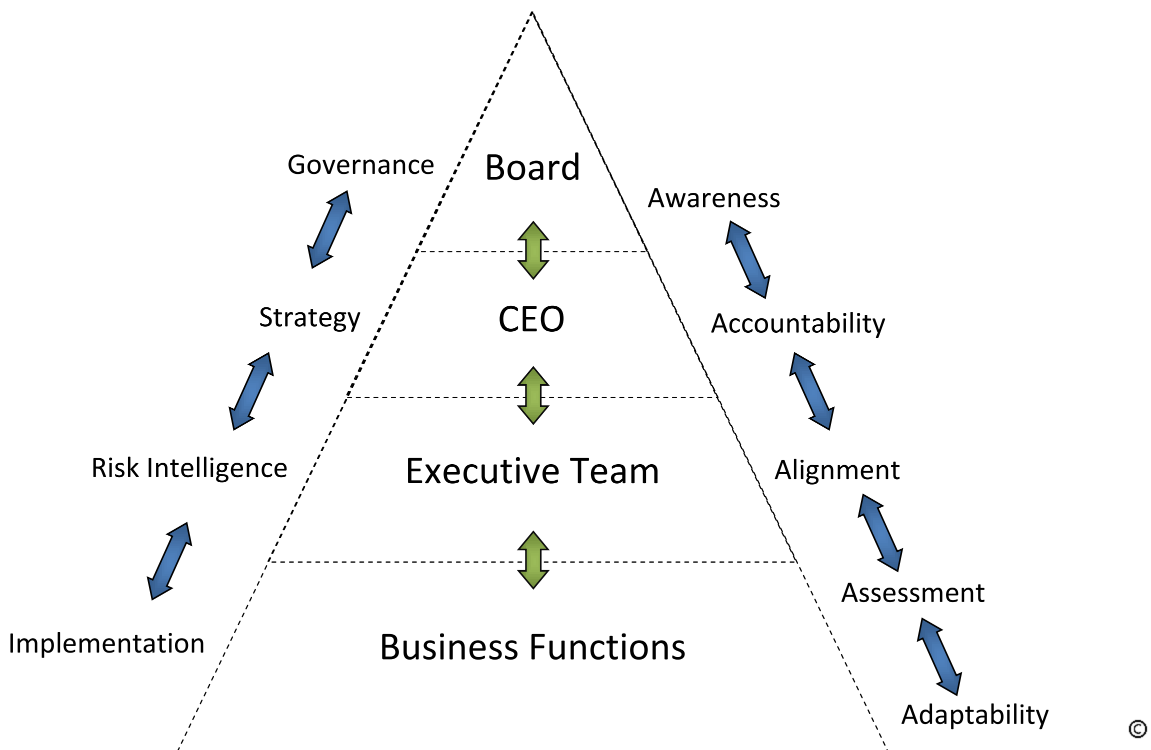
As companies engaged in international trade aggressively pursue new global markets and innovative supply chain options, the need to respond intelligently to emerging risks presented to the organization is paramount. Each new region and set of players involved present unique challenges and opportunities that need to be fully unpacked and understood prior to critical decisions or financial commitments being made.

"…The most important thing the board can do in overseeing risk in emerging markets is to continually exercise skepticism regarding the company's plan. Growth prospects in emerging markets are so seductive that many management teams formulate plans too hastily, without paying sufficient attention to the new customers, competitors and regulators in those markets."

– Ernst & Young, *Risk Oversight in Emerging Markets*

Boards should challenge management to consider all of the relevant stakeholders involved as it develops the organization's global expansion plan. Companies need to familiarize themselves with the competitive landscape, be prepared to adjust their marketing techniques as required, and possibly even recalibrate their risk-return equation in order to adapt to the specific needs of the target market.

THE 5-A METHOD:



MAKING IT HAPPEN: CASE STUDIES

The following real-world examples illustrate how internationally active companies of all sizes have been empowered by their boards to put "best practice" global trade risk management strategies to work.

LARGE CORPORATION

A privately held multinational corporation based in the USA is involved in trading, purchasing and distributing grain and other agricultural commodities in addition to trading in energy, steel and transport; the manufacture of livestock and feed; and producing food ingredients for application in processed foods and industrial use. Trade compliance in the organization is handled centrally by a global trade compliance officer, under the auspices of a global CFO reporting to the worldwide president and COO, who oversees a multinational team of management professionals. Import, export, and inter-company trade is closely monitored and reported to corporate HQ by domestic compliance specialists in each country. Communication takes place between global members of the compliance team on an ongoing basis, punctuated by in-person meetings at regularly scheduled intervals. Potential compliance risks are identified and analyzed in detail prior to moving ahead with critical decisions. Global trade compliance is regarded by the organization as a critical component of due diligence, commercial success/profitability, and brand reputation.

MID-SIZED INTERNATIONAL COMPANY

The president and executive team of this North American distributor of specialty chemicals and allied products has appointed a dedicated manager to oversee all compliance-related aspects of the company's global trade activity throughout the organization's supply chain – from point of origin with numerous manufacturing partners around the world to the secure delivery of products to its customers. Key risk elements at all stages of the process are continuously tracked and reported on to executive management with a focus on strict compliance with all regulatory impacts, which are of critical importance given the frequently hazardous nature of the commodities involved. Compliance is viewed by the organization as being more than an obligatory duty, but as absolutely essential to the protection its brand's most valuable strategic assets – reliability and reputation.

SME

A Canadian company with worldwide sales specializing in the manufacture of insulated outerwear. Garments are produced in the company's own factories in Canada and in Southeast Asia. The company president is directly involved in all global sourcing, manufacturing, and sales activities. He is also primarily responsible for managing overall financial risks of the organization, supported by close-knit operations team and an in-house "champion" with trade compliance expertise. All regulatory impacts are tracked and monitored with a direct link to the president concerning any cost or financial risk implications. Although the team is relatively small and operates on a somewhat informal basis, it is nonetheless highly effective at achieving its goal of rigorously controlling both risk and cost in a highly competitive market.

SUMMARY

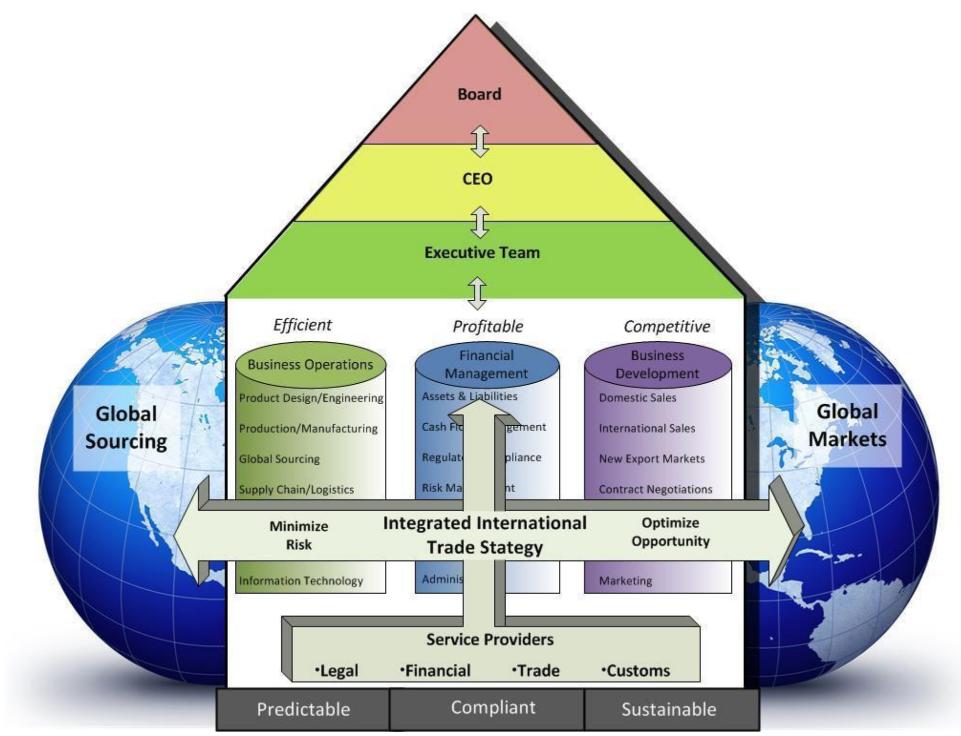
As we discovered when researching a previous white paper about "best practices" in trade compliance, corporate leadership plays a key role in driving the successful implementation of compliance-related priorities throughout the organization. This reflects a sentiment shared by many experts in the field of corporate governance that there should be a strong "tone at the top" from the board and senior management emphasizing that non-compliance will not be tolerated.

"Through its oversight role, the board can send a message to the company's management and employees that corporate risk management is not an impediment to the conduct of business nor a mere supplement to a firm's overall compliance program, but is instead an integral component of the firm's corporate culture and value generation process. "

– Wachtell, Lipton, Rosen & Katz: *Risk Management and the Board of Directors*

While senior executives and boards are not necessarily expected to be involved in the detailed implementation or day-to-day operational administration of compliance functions within their organizations, they nevertheless have ultimate responsibility for the oversight function in this regard.

In the course of protecting the shareholders' best long-term interests, ensuring overall enterprise performance, and safeguarding the organization's brand integrity, the board must therefore constantly assess possible risks, review options for their mitigation, and ensure adequate processes are in place for maintaining regulatory compliance.



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SIX BENCHMARKING QUESTIONS

1. Is global trade compliance currently a significant priority for your board?
2. Is your board aware of the implications of its international trade activities at all levels?
3. Do your strategic plans routinely incorporate the various risks and opportunities associated with globalization?
4. Has a qualified individual or dedicated team been charged with overseeing trade risk assessment with respect to your organization's international sourcing, export market development, and/or global supply chain activity?
5. Are procedures in place to track, monitor, and report international trade compliance risk variables at the board level?
6. Is there a process in place to analyze new growth strategies in emerging markets and assess potential international trade risks prior to business decisions being made?

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Reynold Martens graduated from the University of Winnipeg with a degree in history in 1979. He has been involved in the trade services industry since 1985 and in leadership at GHY international since 1991, where he holds the positions of Board Secretary, Executive Vice President, and President and co-founder of the firm's US subsidiary, GHY USA Inc.

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Reynold is active in various industry and community leadership roles, including involvement in the Institute of Corporate Directors, and national board directorships with the Canadian Manufacturers and Exporters Association (CME), and the Canadian Association of Importers and Exporters (IE Canada).

Founded in 1901, GHY International is one of the oldest customs brokerage houses in North America, and has been recognized in 2008, 2009, 2010, and 2011 as one of Canada's 50 Best Managed Companies.