THE CASE FOR AN INTEGRATED TRADE COMPLIANCE STRATEGY

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WHY TRADE COMPLIANCE MATTERS TO DIRECTORS AND EXECUTIVE OFFICERS

(Matthew Gersper, Randell Carr, Creating a Competitive Advantage in Global Trade, Global Data Mining, 2006)

"*Trade regulation and compliance has become sobering business. The events of September 11, 2001 and the corporate corruption scandals of Enron and Worldcom changed forever the world of international trade. The U.S. government has responded aggressively by adding more complexity and more scrutiny to international trading standards and programs. It is also developing technology solutions and a National Targeting Center to increase its oversight and enforcement capability. In addition, the Sarbanes-Oxley Act of 2002 impose strict requirements on executives, has potent enforcement powers and a strong emphasis on internal controls.*"

Directors and executive officers are ultimately responsible for corporate compliance with national and international regulators encountered in the course of their global sourcing and marketing endeavors.

Most companies tend to compartmentalize their trade activities into import and export functions, with separate groups working independently with outsourced providers of financial, legal, trade, and customs services.

This can create a "silo" affect that, while effective for the day-to-day execution of trade- related activities, reduces or even eliminates visibility to the areas of the enterprise impacted upstream or downstream. There can be significant consequences that will inevitably find their way into the corporate boardroom and executive offices.

Our intention is to build the case for why an integrated global trade strategy makes commercial sense, and is an essential component of a solid corporate approach to minimizing regulatory risks that may threaten the enterprise, and maximizing opportunities that may benefit it.

Effective management of international trade will only increase in importance as Canadian and US companies refocus their efforts on growth and expansion to take advantage of global opportunities.

Our underlying rationale for this perspective is based on 6 tenets:

1. Supply chains are more internationally integrated and diverse than ever before, creating a complex new mix of origins, currencies, manufacturing locations, and markets.

2. Regulators in the US, Canada, and globally are harmonizing their efforts to enforce international trade rules in pursuit of revenue, and to suppress terrorist threats, therefore increasing the risk of detection.

3. It is the regulator's responsibility to write the rules of trade, communicate expectations and consequences clearly to the trading community, and enforce compliance with those rules.

4. It is the corporation's legal responsibility to be informed, compliant with the regulations, and prepared for the inevitability of verification audits or enforcement actions.

5. Directors, executives, and senior managers need to be discerning, and match their Investment in risk mitigation to the potential magnitude of severity and commercial impact to the enterprise.

6. An intelligent trade risk mitigation strategy identifies desired outcomes, and proactively anticipates regulatory intersections at each stage of the business cycle from product development to contract fulfillment.

In a nutshell, rapid globalization, supply chain complexity, and intensifying regulatory vigilance translates into escalating trade compliance risk for internationally active corporations and their leadership teams at the Director and Executive levels.

RISKY BUSINESS – THE PROBLEM WITH "SILOS"

(Henry Keizer, Global Head of Audit-KPMG International, 03/2010)

"*The stakes associated with increasing government compliance requirements have risen. Foreign regimes have become mature in their strategies around monitoring and policing economic activities within and through their countries as they seek to recoup revenues lost to the financial crisis. In addition to financial penalties, compliance failures damage hard-won reputations, impact customer loyalty, and threaten regional or global plans.*"

Figure 1 illustrates a typical corporation that is involved in global sourcing and marketing. Note that the two worlds are distinct and separate from one another, appearing to be independent or unrelated in any meaningful way. To understand why this occurs we have to observe how most companies are constructed and governed.

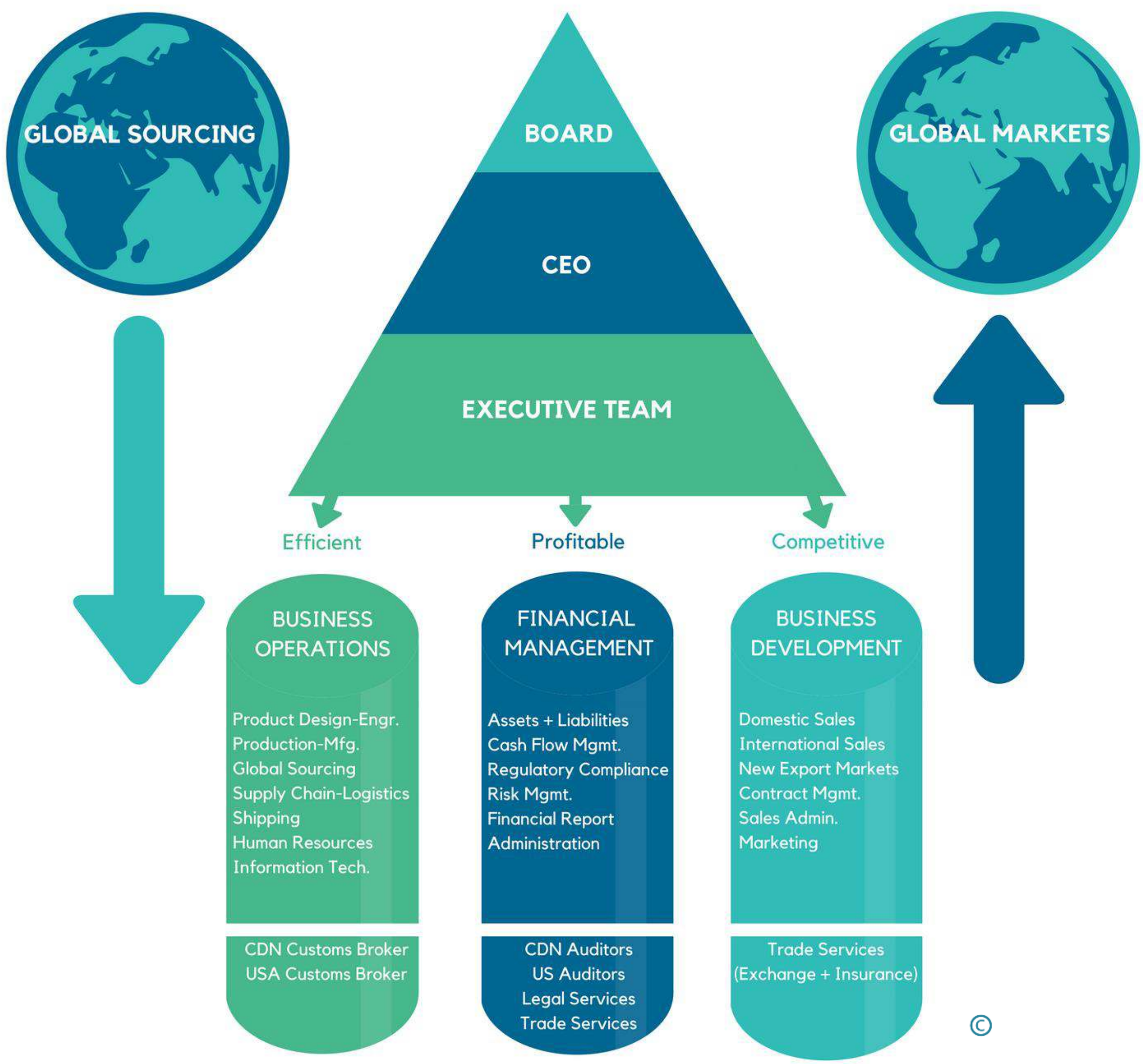

Figure 1: "Silos" compartmentalize international sourcing and marketing functions.

Medium and large enterprises are generally structured along vertical lines of accountability for pragmatic reasons, to divide up responsibility and leverage the collective energy of the parts for the benefit of the whole.

A Board of Directors oversees the direction of the enterprise, with a focus on financial performance, risk management, and future casting.

Medium and large enterprises are generally structured along vertical lines of accountability

The Chief Executive Officer reports to the board, and acts as the conduit for translating the direction of the board into a strategic plan for execution by the Executive Team.

The President leads the Executive Team of Vice Presidents or Senior Managers, who have functional responsibility over the primary areas of:

- Business Operations (efficiency and production);
- Finance & Administration (fiscal reporting, cash flow, risk management);
- Business Development (client relationships, marketing, growth).

CASE IN POINT

A "virtual" apparel manufacturer with globally subcontracted operations inadvertently failed to accurately declare the correct identity and origin of the finished product upon importation into the US. This oversight ultimately resulted in a demand for duties several months later by Customs of over $70,000, plus penalties and interest. The additional costs imposed were written off as unrecoverable, negating a significant share of the profits earned for the contract in question.

Global Sourcing and the related supply chain functions are managed by the Business Operations group, either via an in-house Customs and trade department, or in collaboration with outsourced service providers in transportation, logistics, and customs representation. Import-related outcomes and performance metrics are generally related to hard costs or productivity, and viewed as manufacturing inputs accounted for under "cost of sales."

Beyond general reporting and accounts payable functions, Finance and Administration is passive to this area of corporate activity on a daily basis aside from cash flow management. But they often become involved after the fact with taxation and legal obligations imposed by domestic and international regulators.

CASE IN POINT

Two of the world's leading organizations in oil and gas equipment services incurred penalties of $610,000 and $800,000 in 2009 due to a licensing and classification violation. Both of the companies exported and re-exported various valve types and spare parts to a wide range of countries without the required licenses.

Global Sales and the related supply chain functions are, generally managed by the Business Development group. Support is marshaled from the Business Operations group for transportation, logistics, and customs representation, and from the Finance and Administration Group for international collections.

So, why does this model expose the company to the risk of an unwanted compliance-related intervention; furthermore, why does it set up the enterprise to miss opportunities to reduce costs or harvest competitive advantage?

Regulatory intersections – and risks – occur at virtually every stage of the business cycle from product design and development, through sourcing and manufacturing, past the sales and fulfillment phases, and through to the audit parameters of the regulators, which run anywhere from four to seven years retroactively.

Most companies tend to compartmentalize their trade activities into import and export functions, with separate groups working independently with outsourced providers of financial, legal, trade, and customs services.

CASE IN POINT

A multi-national vehicle manufacturer, serving markets in Europe and North America, failed to accurately classify a major component imported by one of the their Canadian divisions, resulting in overpayment of duties by $250,000 annually. It is estimated that the impact of this omission after production burden costs and overheads were applied, was double that amount at the point of sale, resulting in margin erosion.

If not anticipated and compensated for, failure to anticipate and build in allowances or checks and balances can at best result in ineffective product costing leading to margin erosion. At worst, the outcome can be loss of market share and customer base, or financial distress imposed by regulators for contraventions by way of fines, penalties, loss of privileges, and unrecoverable retroactive assessments – long after the sale is complete.

WHY AN INTEGRATED GLOBAL TRADE STRATEGY IS NOT AN OPTION

((Beth Enslow, Senior Vice President, Enterprise Research, Aberdeen Group)

"Without cross-functional oversight and implementation capabilities, it is nearly impossible for trade compliance professionals to induce their operations counterparts to take action on trade compliance savings opportunities. Alignment among product design, manufacturing, sourcing, logistics, and finance is required."

Figure 2 illustrates an integrated approach to a global trade strategy. There is a horizontal channel of accountability between the Business Operation, Finance and Administration, and Business Development areas; and a vertical link to the service providers, Executive Team, CEO, and Board of Directors.

The benefit of a fully integrated international trade strategy is increased predictability and visibility of regulatory consequences and opportunities to the Board of Directors, CEO, and Executive team.

Note that the fundamental structure of the company remains intact. There is no major rework of the reporting structure, or the core functional role of each of the primary components of the enterprise.

The Global Sourcing and Global Markets components have been annexed onto the business as core pieces to be managed in a cohesive and coherent way, with the goal of minimizing risk, and maximizing opportunity.

All stakeholders have a role to play in the effective execution of the integrated strategy, beginning with the Board of Directors who set the risk appetite, and place a priority on legislating that checks and balances are in place at all levels, with appropriate accountabilities and audit trails.

The CEO and Executive Team take ownership for creating the framework, and identifying the owners and points of intersection between the functional areas. They develop the audit trails and visibility mechanisms to ensure that the right parties are working together on the important issues at the right time, with visibility to upstream and downstream stakeholders.

The Business Operations, Finance and Administration, and Business Development areas are engaged in the areas that they directly oversee, in addition to being accountable to their counterparts where there is a shared consequence to be anticipated or avoided.

CASE IN POINT

A leading manufacturer of household accessories was able to save over $6,000,000 annually in duty by designing and implementing an effective NAFTA management strategy. They invested in a compliance champion to track and log the flow of imported inputs through all the stages of the manufacturing process. By doing so, they were able to benefit from multiple duty reduction programs, saving costs and gaining competitive advantage.

CASE IN POINT

A leading US distributor of metal and plastic products, with clients worldwide, lacked a system to track country specific duties or anti-dumping levies. To remedy this, a comprehensive database of all products was built, and then cross-referenced with the regulatory elements of each market. As a result, the company was able to minimize trade related costs, and exposure to fines and penalties in this highly regulated industry sector.

Service providers in the areas of legal representation, finance, trade consulting, and customs brokerage are collaborative in working together on supply chain and compliance-related priorities that require cooperation and visibility. They are responsible to the Finance and Administration Executive for accountability, as this area is the common denominator that connects the components together horizontally and vertically.

Regulatory intersections and risks occur at virtually every stage of the business cycle.

The result of a fully integrated international trade strategy is increased predictability and visibility of regulatory consequences and opportunities. A compliant profile reduces and eliminates the negative consequences of a regulatory intervention. A robust, sustainable framework ensures future viability and succession planning should individuals within the enterprise move on, or service providers be replaced.

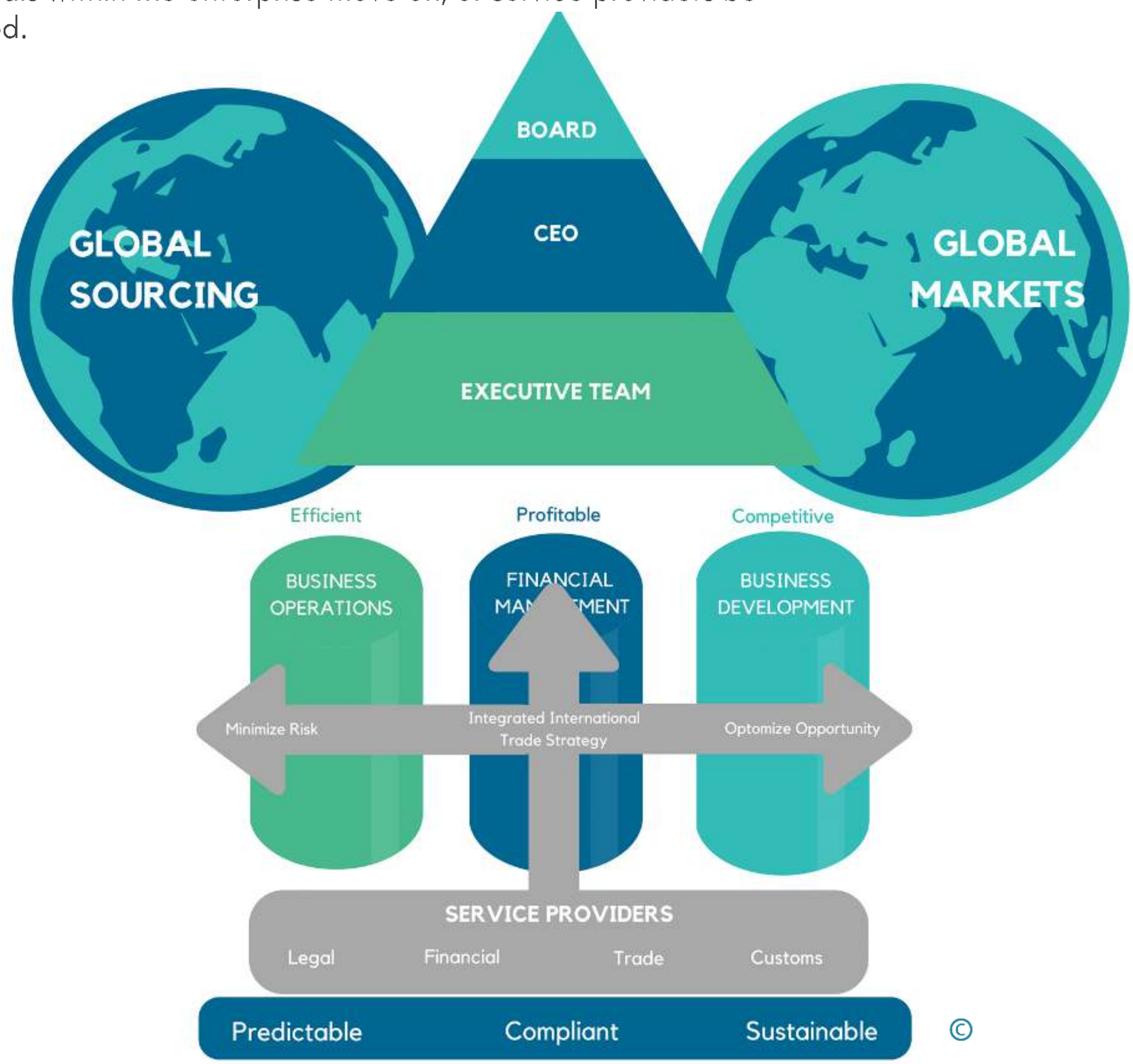

Figure 2: An integrated model connects all parties horizontally and vertically.

If the negative consequences of a silo-based approach, as outlined in Figure 1, are risks at virtually every stage of the business cycle from cradle to grave, the benefits of an integrated strategy and cohesive approach are just the opposite; that is:

- Visibility to board of directors and executives to risks and opportunities;
- Shared ownership and accountability that aligns with roles and responsibilities;
- A compliant profile that reduces and eliminates negative consequences of a regulatory intervention;
- A sustainable framework to ensure future viability and succession planning, should individuals within the enterprise move on, or service providers be replaced.

CASE IN POINT

A large Canadian manufacturer was forced to comply with complex, new US regulations with potentially dire consequences. The company designed an integrated information management system to track trade-related information throughout the sourcing, production, and export stages. They were able to successfully avoid costly penalties or potential forfeiture of merchandise, resulting in cost certainty, and uninterrupted service to their US clients.

MAKING IT HAPPEN – A CALL TO ACTION

It is clear that effective management of international trade will only increase in importance as Canadian and US companies refocus their efforts on growth and expansion in the wake of global opportunities.

We believe that companies who invest in international trade compliance and a strategic approach as outlined in this white paper, will have a much higher probability of success than those who take a reactive posture that only addresses risks as they become a reality.

Companies that integrate effective and commercially proportionate compliance remediation mechanisms into their processes of governance, risk management, business operations, and global sourcing and sales, will experience additional opportunities beyond basic conformity with the regulatory letter of the law.

The trade-offs in transparency and predictability more than offset the costs of designing, implementing, and maintaining a plan that anticipates outcomes and addresses them proactively, for the benefit of all stakeholders.

ABOUT THE AUTHOR

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, Managing Partner, and President and co-founder of the firm's US subsidiary, GHY USA Inc.

He is the architect of GHY's thought leadership platform; author of the firm's published white papers, and a regular speaker at national trade conferences.

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), World Trade Centre Winnipeg, and a past directorship with 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 was recognized in 2015 with Platinum status by Canada's 50 Best Managed Companies program, in addition to proudly maintaining recognition as one of Canada's 50 Best Managed Companies from 2008 - 2017. Furthermore, GHY International was named a Top 100 Small & Medium Employer in Canada for the years of 2016-2017.