Why You Need Trade Visibility

A White-Paper by Sourcing Innovation

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A trade visibility solution is a key component of a supply chain visibility platform that allows a company to track its products from the time they leave a supplier's warehouse until the time they reach the end customer. Supply chain visibility is important not just because it helps a company understand the factors that impact costs, cycle times, and service levels, but also because it allows a company to identify minor issues as soon as they arise and correct them before they become major problems. For example, if a multi-stage shipment gets into port late, and the product is needed by a target delivery date, the buyer can take action and expedite the product mid-shipment if the buyer has the information before the product leaves port. Without visibility, the buyer wouldn't know the product is going to be late until the delivery date is missed.

More importantly, without trade visibility, a buyer might not know that a slight import or export coding misclassification is costing them millions of dollars in duty, that their trade cycle is 40% longer than it needs to be, that the frequency of customs inspections (and the corresponding cost) is many times higher than they thought it was, or that they might not be in compliance with the Mod Act (the Customs Modernization Act), the ISA (Importer Self Assessment), or the IEEPA (International Emergency Economic Powers Act). However, a company that has a full trade visibility solution will have more efficient processes, reduced cycle times, lower filing costs, and significantly higher compliance rates while identifying millions of dollars in duty savings. The reality is that without a trade visibility solution, an average company will lose millions (if not tens of millions or hundreds of millions) annually in lost opportunities, will have a significantly higher compliance risk, and will be unable to "close the loop" -- a critical requirement for true supply chain visibility.

This white-paper will explore the lost opportunities and compliance risks that result from not having a closed-loop trade visibility solution in an effort to help you understand why trade visibility is important and why you should include a trade visibility platform as a key part of your supply chain application suite.

Lost Opportunities

Without a trade visibility solution, a company will miss out on duty savings, process savings, lower filing costs, tracking cost reductions, error prevention, and C-TPAT savings opportunities. Moreover, it will not be able to automate best practices in global trade, which could increase its financial risk should it ever be found to be in non-compliance with trade regulations (as the United States Sentencing Guidelines Manual allows for reduced penalties for companies that adopt formal compliance programs under 8A1.2).

Duty Savings

Incorrect HTS classifications, ignorance of free trade treaties and free trade zones, and lack of visibility into the total cost of trade can all lead to significant losses that could be avoided with a trade visibility system that would immediately highlight (potential) misclassifications, associated free trade treaties, and the total duties and tariffs paid.

As described in a recent Aberdeen Insight on "*5 Ways to Increase the Business Value of Trade Compliance*" [Aberdeen1], many companies are paying too much duty due to misclassifications. A Global Data Mining study across 5 companies with between 3 Billion and 31 Billion in revenue found over 150 Million in potential duty savings in the existing supply bases just through better classification. For example, let's say you were importing silk yarn where some included silk waste and some did not and used HTS code 5005.00.00 for the entire shipment. This would cost you a duty rate of 50%. However, if you separated the shipment into silk yarn, 5004.00.00, and yarn spun from silk waste, you would only pay 40% duty on the former. This would likely never be noticed by customs, and you'd lose 10% of the total merchandise value. Moreover, the HTS system is littered with examples where a code for one product has a low duty rate while a code for an extremely similar, almost undifferentiable product has a high duty rate -- and you can bet that customs won't be looking for overpayments when you're selected for an audit and audits are on the rise. In 2007, U.S. Customs authorities conducted 66 audits just on textile importers, a 57% increase in activity over the previous year, and recommended additional revenue collection of 5.6 Million. In addition, they initiated 1,905 reviews of entry documents which resulted in 959 detained shipments and 314 seized shipments worth $48 Million as a result of violating China quota restraints. [CFO]

And consider the example from "*Creating a Competitive Advantage in Global Trade*" [GDM1] by Global data Mining that described how an importer who took advantage of a Free Trade Zone accumulated multiple shipments imported during a 7-day period and combined them into one weekly entry. This not only saved hundreds of thousands of dollars in broker's fees and merchandise processing fees, but also contributed to millions of dollars of cash-flow related savings as the inventory "pipeline" filled up with duty-free goods.

Now consider this example from a recent World Trade Magazine [WTM1] article about a company that had just designed a new innovative printer with eagerly awaited components. As a service-minded company, it decided to ship the printers with the cartridges already installed. This resulted in the company paying a 4.7% duty rate on a printer that would have been duty free if the cartridge was simply shipped separately. As a result, the company lost millions of dollars -- a loss that would have been avoided if the company had a trade visibility solution that highlighted the different duty rates available for printers.

Trade visibility solutions do work. Consider this quote from Greg Hines, Sr. Manager of Trade Compliance of Symbol Technologies who use third party software from Integration Point. "Part of the reason we went to the FTZ (Foreign Trade Zone) was to reduce the duties [we paid]. Implementing the supporting technology has helped us improve the visibility of all processes involved in FTZ management. Using FTZs has allowed us to effectively reduce duties and increase the turn-around speed of our supply chain ... this system interfaces with the customs systems to submit the required information to the government"

Process Savings

Without a modern trade visibility solution, a company will miss out on the productivity savings associated with an automated solution that allows it to automate standard and error-free transactions and only focus on exceptions. Consider the example of a multi-billion dollar company that sells in 200 countries that was described in Aberdeen's brief on "*New Strategies for Global Trade Management*". [Aberdeen2] The company adopted a global payment gateway with multi-currency support that allowed business customers to see total costs and make credit card payments in their local currency. The gateway saved 15 minutes in productivity per order, reduced accounts receivable from 45 days to 4, and reduced default rates. Then there's Eastern who said that "Prior to using the Integration Point Denied Trade Screening Solution, we estimated that it would take an employee 15 to 25 minutes to screen one of several hundred shipments. Now it only takes 1 minute per shipment, allowing our valuable employees to be available to handle customer service needs." That's a 93% to 96% savings in processing time. [IP1]

Filing Cost Savings

Manual filing costs can be quite high and cost hundreds of dollars per order or more. This might sound high until you realize that a typical international transaction requires 35 documents across 25 parties complying with over 600 regulations and more than 500 trade agreements. [SCD1] However, an automated system can reduce processing costs to pennies a transaction, essentially reducing the filing costs to the filing fees. Consider the example from a recent Logistics Magazine article [LM2] that described how Renault lowered broker documentation and processing costs from an average of $200 to as low as $20 per transaction in some cases by implementing a global trade management solution.

Furthermore, late filings, which often occur from the lack of automated systems to support the process, can be quite costly as well. As of 2006, the CBP was issuing approximately 3,000 liquidated damage claims each month just for late filings. [MSC1]

Error Prevention Savings

Manual and spreadsheet-based processes are error prone. Up to 90% of spreadsheets have non-trivial errors in them, as per a recent study from Oregon State University [ORE1]. Then there's the fact that there is a chance for error every time data is re-keyed. Even a simple error in data entry can cost a company millions. Consider the example of a large camera maker from "*Unraveling the Myths of Import Compliance*" [JPM1] by JP Morgan who had to pay a 20 Million penalty on a 60 Million import for something as seemingly benign as an incorrect country of origin labeling on camera equipment that was duty-free.

Tracking Cost Reduction

Without a trade visibility system, tracking your purchases can be time consuming, error prone, and extremely difficult. With a trade visibility system, tracking is easy, instantaneous, and error free. Consider the example provided by Levi Strauss & Co. from Aberdeen's "*Global Trade Management in 2007*" [Aberdeen3]. "The tool provides more complete and accurate data regarding finished goods destined for the United States, which has allowed us to better manage incoming products and proactively address issues by exception ... As a result, the cost of tracking inbound shipments has been reduced by 98%."

C-TPAT Enablement Savings

In order to qualify for C-TPAT enrollment, a company must have adequate supply chain security and visibility. A trade visibility system enables better security as it allows a company to always know where its products are and what levels of security are in place.

Even though there is a cost associated with C-TPAT, which has found to double supply chain security costs for an average company, there are also significant savings that result from fewer supply chain disruptions and a decreased number of Customs Border Protection inspections, as discussed in the 2007 Cost Benefit Survey. [C-TPAT1] In addition, The Manufacturing Institute and Stanford University found in its 2006 study that participating companies reported a number of improvements in their inventory management and visibility practices due to their security investments. For example, 75% of study participants reported a reduction in theft, loss, and pilferage and 38% of companies improved their on-time deliveries and reported cost savings from improved inventory management while 75% of companies reported cost savings and 100% of companies reported an improvement in the timeliness of shipping information. Although not all companies in the study could quantify the savings, those that could reported an average cost savings of 5% to 10%. [MIS1]

Consider the example of Hasbro which was C-TPAT certified in 2002. As highlighted in a CIO article [CIO1], its inspections dropped from 7.6% of containers coming into the US in 2001 to 0.66% in 2003. Given that the company imported about 8,000 containers in 2003 and that the average inspection cost was $1,000, Hasbro saved about $550,000 a year in inspection costs alone by enrolling in C-TPAT, which is a 5-to-1 return rate.

Cycle Time Savings

A supply chain study has estimated that the cost of each additional day 'in transit' is equal to 0.5% of the total value of the goods. [GDM2] Thus, any reduction in cycle time will result in savings, and if you can reduce your global trade cycle by an average of 10 days, cash flow will improve by at least 5%. A trade management system can easily shave 40% off of cycle time, as reported in a recent Logistics Magazine article [LM1]. In addition, Aberdeen has found that companies that have compliance automation software are 1.4 times as likely to have increased customs clearance speed. [Aberdeen4]

Then there's the example from Global Data Mining's white-paper on "*Creating a Competitive Advantage in Global Trade*" [GDM1] about on import professional who spent more than three years single-handedly developing a trade database for his company. Before the database existed, the average days of demurrage, or "spin time", of an entry to clear customs was six days. After the trade database was developed, the "spin time" was reduced to 1.45 days, an improvement of more than 300%. Fortunately, you don't have to wait three years. There are solutions on the market readily available that you can have up, running, and configured to your needs in a matter of weeks.

Total Opportunity Cost Savings

A trade management system that allows you to understand the total cost of a sourcing decision before it is made can save millions. Consider the example of a manufacturing company who imported over 300 Million of a new product from country B to country A that was given in Global Data Mining's white-paper on "*Creating a Competitive Advantage in Global Trade*". [GDM1] . The company chose to import the product in its raw unprocessed form. The plan was to leverage existing capabilities in country B to convert the product into its final form, and then package it for distribution. No one checked the Value-Added-Tax or VAT tables for the raw materials shipment versus a completely processed product shipment into country B. When the shipment arrived, there was an unexpected $70 million VAT on the imported raw material. If the company had shipped the product directly to country B in its final distribution form, it would have reduced the VAT by $50 million.

The reality is, as per Aberdeen's Research Brief on "*Global Trade Management Automation*" [Aberdeen4], that companies that have the tools in place to analyze supply chain network design are 1.9 times as likely to reduce total landed costs -- and a trade visibility tool is a key component of global supply chain network analysis.

Compliance Risks

Trade visibility is a key component of compliance risk management. With so many new acts and regulations to keep track of, including SOX (Sarbanes-Oxley Act), the Mod Act, 10+2, IEEPA, the ISA, FCPA (Foreign Corrupt Practices Act), NAFTA (North American Free Trade Act), denied party lists and export control acts, it's essentially impossible for a company of any size whatsoever to even hope to be compliant in global trade without an automated system. This is very problematic when you consider the penalties associated with some of these acts, which include automatic fines in the six and seven figure range, penalties that can equal the total value of the shipment, and even jail-time for the responsible parties.

For example, as highlighted in a recent article from International Business Training, recent amendments to the IEEPA increased the civil penalty for a "person to violate, attempt to violate, or cause a[n export] violation" to "an amount not to exceed the greater of (1) $250,000; or (2) an amount that is twice the amount of the transaction that is the basis of the violation." This means that a 10 Million dollar shipment found in violation can result in a 20 Million dollar fine. In addition, it also increased the criminal penalty for the party involved who "upon conviction, [can] be fined not more than $1,000,000, or if a natural person, may be imprisoned for not more than 20 years, or both". [IBT1] In addition, as highlighted in a recent Logistics Management article, under the new 10+2 regulations, importers can be charged with fines equal to the shipment value if they fail to file and face charges of $5,000 per transaction with missing or inaccurate data. [LM8]

As an example of how expensive an export violation can be, consider ITT Corporation and its night-vision goggle fiasco that resulted in an initial fine of 20 Million by the Department of State and that might ultimately cost it 100 Million for sharing the technology with unauthorized parties. [LM3] Fines under NAFTA can also be quite high as well. The first prosecution in Southern California involving violations of the North America Free Trade Agreement in 2005 resulted in a 5 Million Fine and the possibility of jail sentences for three executives. [GDM3]

In addition to insuring that you are in import, export, and customs compliance, a trade visibility solution can also help you insure that your employees are not violating operational acts such as SOX or the Foreign Corrupt Practices Act (FCPA) by allowing you to monitor all supply chain related activity. Violations of the FCPA will cost you millions of dollars, as it did InVision who was charged with bribing foreign government officials to buy its machines and had to pay a 1.1 Million civil fine and an additional 800,000 civil penalty. [Ferret1]

When you consider that U.S. Customs has historically collected $7 for every $1 spent conducting an audit when prior disclosures, underpaid duties, liquidated damages, and penalties are summed up, that these figures do not include the importer's operational costs for record collection and audit assistance, and that U.S. Customs can conduct an audit with 30 days notice at any time, can you really afford not to be compliant? [GDM3] And can you really afford not to have a trade visibility system when a recent Aberdeen Study [Aberdeen5] found that 71% of all companies surveyed complain that internal stakeholders outside of the compliance department do not understand the impact of their actions on trade compliance and the risks associated with non-compliance? It's something to think about.

The Closed Loop

As detailed in the Global Trade wiki-paper [GTW], the global trade cycle is a very involved multi-step cycle that has to be executed flawlessly if a company wants to realize the savings that it negotiates in its strategic sourcing events. However, this rarely happens, as emphasized by a recent study by Global Data Mining that surveyed 7,000 suppliers across 5 well-known retailers and found that the average perfect order index was a dismal 22.9%, which meant that 77.1% of all orders took longer and cost more than they should. Much more, despite the fact that AMR Research has found that an increase of 10% in the perfect order index correlates to an earnings per share (EPS) improvement of 50 cents and that an average company can increase their perfect order index by 70% with an appropriately implemented trade visibility system. [GDM4] It's something to think about.

Global trade is a very complex process, and the savings only materialize if the loop that connects the supplier to the shipper to the broker to customs to the buyer is unbroken. Otherwise, steps get missed and savings get lost. When you factor in the shipment delays, increased inventory costs, penalties and fines, lost-sales, and claim write-offs that result from missed steps that would not be overlooked in a closed loop process, costs add up quickly, and it ends up costing the global economy over 420 Billion annually, according to a United Nations Study that found that the inefficient administration of customs processes accounts for 7% of the cost of international trade. [SIIA1] Fortunately, many of these costs can be reduced, and even eliminated, by a trade visibility solution.

In addition, the full audit trails provided by such a system insures that any errors that arise in the trade cycle will be discovered quickly. This is important because the importer is held responsible regardless of who made the error. In other words, supplier, shipper, and broker errors are your liability. Consider the case of Cadbury who eventually discovered a problem but neglected to act timely. As a result of the delay, Cadbury incurred 3 Million in fines. [LM6]

That's why you have to implement a trade visibility solution. Without a trade visibility solution, you can't close the loop, and if you can't close the loop, you miss out on savings opportunities and increase your compliance risks across the board.

Conclusion

You could choose to keep doing business as usual and not include a modern trade visibility system as part of you global trade solution platform, but such a choice would likely lead to a significant amount of lost savings, high compliance risks, and unnecessary losses from higher inventory times and custom delays. In today's dynamic economy where just a few margin points often mean the difference between unbridled success and bankruptcy, can you really afford to take the risk?

About Sourcing Innovation

Sourcing Innovation, which started in June of 2006, is a resource for sourcing, procurement, and supply chain professionals who are interested in improving themselves and the overall performance of their organizations. Sourcing Innovation is education about, and in-depth analysis of, technologies and approaches that can have a profound impact on the way you do business. More information about Sourcing Innovation can be found on the blog itself, at http://blog.sourcinginnovation.com/.

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