WHITE PAPER

Leveraging Trade Agreements to Reduce Global Sourcing Costs

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Executive Summary

Manufacturers often spend 50% or more of revenue on direct materials. In light of this, it is not surprising that companies recognize the strategic importance of sourcing from low-cost countries to improve competitiveness, even during turbulent trade wars or other potential disruptions to distributed supply chains. However, direct materials are only one part of the cost of goods. Leading companies also leverage trade agreements to reduce landed costs by reducing duty obligations.

Special trade programs, including free trade agreements (FTAs), preferential trade programs and other duty reduction schemes, are a pact or program between two or more nations that have agreed to give preference by eliminating or reducing tariffs and quotas on certain goods and services traded between them. Trade agreements promote commerce between regions, increase labor and sourcing opportunities within those regions, and open foreign markets to exporters. Editors note: In this paper, we use the term FTA as the generic term for all trade agreements even though the type of agreement might be different.

Using trade agreements effectively requires deep compliance expertise. Using them efficiently requires a rich regulatory content database and connections to the rest of the supply chain, in addition to a technology platform with robust capabilities for global compliance execution.

This white paper presents five best practices for companies to leverage trade programs and gain the benefits. Many manufacturers produce their goods in a particular region or country yet source the components from other countries that participate in at least one trade agreement. These manufacturers can often significantly reduce their duty obligations — and thereby reduce the cost of goods sold — by aligning supply and manufacturing operations to the requirements of any applicable trade agreements. Annual savings can be substantial — potentially millions of dollars — but it is crucial for companies to properly navigate the complex processes to avoid fines and safeguard the benefits.

Deep Complexity for Manufacturers

Companies must navigate immense complexities and variable costs to capture the gains of trade agreement utilization. For instance, governments impose specific stipulations and require granular-level data to approve an FTA claim. Unfortunately, this data is typically decentralized in multiple systems and used by various functional teams across the organization, making it challenging for companies to understand, much less to document, their sourcing information.

To gather and deliver the information to the relevant agencies, companies must first accurately track key details about the parts, components and raw materials used to make finished goods. This tracking includes the country of origin and specific trade program indicators that identify classified products that qualify for any free trade or other duty savings agreements. This task can be a challenge because this essential information comes from the supplier base. With potentially thousands of suppliers and tens of thousands of components — each of which must be individually considered for each trade agreement — requesting the relevant data timely and organizing it for submission to trade agencies can quickly become unmanageable. This makes advanced collaboration tools crucial to any trade agreements program.

Companies must also be able to determine the amount of duty owed not just on imported materials and components but also on post-transformed goods — those that have been substantially modified by being assembled into a finished good or through some other means. In these cases, the importer must understand how each trade agreement's rule of origin applies to all components and subassemblies as well as the final, exported item.

Automating these complex processes requires a proven, robust global trade management (GTM) solution and is a key step to controlling the cost of goods by reducing duty obligations.

Five Best Practices for Successful Cost Savings

The five best practices below allow manufacturers to take full advantage of opportunities from special trade programs:

1. **Implementation of a supplier management program**
2. **Automatic collection of comprehensive sourcing data from every tier**
3. **Management of supplier solicitation and communications**
4. **Automation of the qualification process for multiple FTAs**
5. **Addition of new FTAs with less effort by building on the base portfolio**

Best Practice: 1

Implementation of a Supplier Management Program

To effectively administer trade agreements, the manufacturer needs to implement a trade agreement program and put processes in place to collaborate with suppliers and gather crucial data supporting all preferential status claims. However, manufacturers must take three important steps for the program to be scalable and efficient — important considerations in today's unpredictable trade environment.

First, they must establish systems and processes to efficiently request information and receive timely responses from suppliers. This is important because most FTAs require a certificate of origin and a trade program certificate from the supplier before the goods qualify. Most companies historically used email to collect this information. However, a consolidated platform is a better method for multiple reasons.

Most manufacturers have between 150 and 250 first-tier suppliers. However, when counting all tiers, that range can jump to a remarkable 7,000 to 18,000 suppliers. Managing communication with this many organizations requires automation and collaboration tools. Suppliers from all levels should have access to the platform and be trained on how to submit the information that will help in the process of qualifying an end product for an FTA. With a secure means of communication in place, suppliers and internal teams can confidently carry out their tasks.

Second, manufacturers should help suppliers understand the importance of knowing the country of origin for the parts or components they provide and the significance of qualifying products in this way. Suppliers that can demonstrate that their parts are qualified for preferential treatment in a trade agreement may see demand for those parts increase since the reduction in duty makes them less costly to procure. The investment to support a trade agreement becomes a win-win situation for manufacturers and suppliers alike. This will be discussed more in the next section.

Third, it is helpful for manufacturers to walk suppliers through the information-gathering process before actually beginning a supplier solicitation campaign. This step helps suppliers better prepare to deliver accurate information for each part and provide the necessary documentation. In particular, suppliers should know the format and specificity of the information they are to provide in advance because open-ended requests from manufacturers lead to frustration and low response rates.

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Best Practice: 2

Automated Collection of Comprehensive Sourcing Data From Every Tier

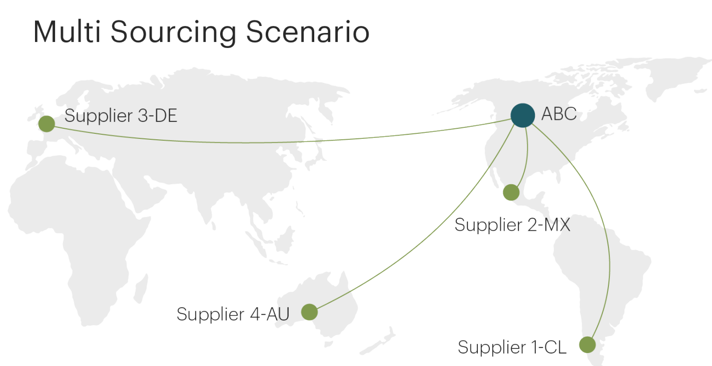
Supply chains are designed to run efficiently and provide various value streams such as optimized lead times, ideal safety stock levels and low-cost sourcing. As a result, a company could source a single product or component from many different countries to achieve varying degrees of each benefit. Where a product comes from — referred to as its country of origin (COO) — determines the trade preference programs for which it is eligible.

Manufacturers gain visibility into the country of origin through a digital library of detailed part and component data in a hierarchical format, including links to every finished product that uses that part from a given supplier. When importers source from multiple suppliers, parts and components often come from several countries of origin. It is feasible that a single part has elements sourced from many countries or that a finished product has parts sourced entirely from a single country. This diverse range of sourcing possibilities further complicates the situation for importers.

Figure 1 below illustrates a product with components from three suppliers in different regions. A manufacturer that seeks to qualify for trade programs could use multiple FTAs — but not all.

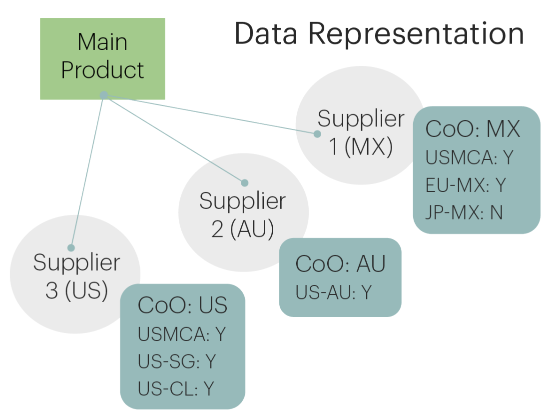
With well-defined origin information and a clear understanding of the relationships between parts, suppliers and finished goods, importers can make a determination regarding FTA eligibility. From that point, supplier solicitation campaigns and requests can be executed to collect certificates of origin to back up any preferential duty claims.

Figure #1 Sourcing Options



Challenges

- ☐ Identifying the parts' vendors
- ☐ Identifying the country of origin
- ☐ Identifying potential FTA opportunities
- ☐ Collecting certificates of origin
- ☐ Managing data entry and maintenance
- ☐ Continuing the process for new parts
- ☐ Continuing the process for parts with eligibility close to expiration



Best Practice: 3

Management of Supplier Solicitation and Communications

The key to managing a portfolio of trade agreements is to automate as many processes as possible, especially the complex and tedious work of soliciting suppliers for all required FTA documentation. A global trade management (GTM) solution with built-in campaign management features is the most effective means of gaining these key automation capabilities. Through a GTM solution, manufacturers can create mass solicitations to harvest origin certificates regularly. By utilizing automation, companies can solicit hundreds of suppliers within a few minutes, eliminate a large percentage of the solicitation effort and manage suppliers' responses, including a mechanism to address suppliers that have not responded.

Here are five proven processes that manufacturers can use to simplify campaign management:

Targeting the correct suppliers
It is important to target only those suppliers eligible to participate in the planned trade agreements. Soliciting a manufacturer based in Singapore for a US-Chile origin certificate will only lead to confusion. Instead, manufacturers can better target the correct suppliers by utilizing a GTM solution that can filter eligible suppliers based on their documented sourcing activities.

Setting a global standard that is adaptable
Communication with the supplier must be clear and instructional. Using standardized templates tailored to the supplier by country, language and cultural tone streamlines supplier collaboration and improves response rates. For example, content with a formal tone will be more effective when soliciting suppliers in Asia. The same content will not necessarily work well for all suppliers globally. A GTM solution should allow users to customize these messages as they see fit.

Only requesting what is relevant
It is important to remember that it will take time and effort for a supplier to respond. Not all parts may require documentation from suppliers. A GTM solution should enable solicitation based on a part's value, upcoming blanket expiration date, purchase order number and other relevant factors. Focused requests often drive faster responses from suppliers. Automated trade compliance software can add significant value to any solicitation process depending on the number of suppliers an importer has and the relative turnaround time of order cycles.

Using dashboards and alerts
When soliciting a large number of suppliers, it is important to be able to manage by exception. Leading GTM solutions provide dashboard analytics and metrics that help companies understand what percentage of suppliers have responded. Importantly, the manufacturer should stipulate a need-by date and focus any follow-up efforts on suppliers that do not respond within the requested window. Another essential feature is alert mechanisms to help manage by exception. For instance, these can help when a supplier needs clarification before responding and when a supplier has submitted documentation so the internal teams can review the submission. Leading solutions have built-in messaging tools to facilitate this process, allowing the compliance team to maintain a log of all discussions regarding a campaign or specific part. This information is useful in an audit to show due diligence in communicating with and providing guidance to suppliers.

Streamline the response process
Compliance professionals will ultimately be held responsible for the information they use to substantiate duty claims. Even though reviewing every supplier response can be tedious, it is necessary. Some suppliers will still respond incorrectly, no matter how much guidance importers provide. Look for a GTM solution that provides basic error-checking of supplier-provided information and an approval process for compliance teams to use when reviewing information. A digital audit trail of all communication, including supplier responses, will be the cornerstone of an effective audit defense strategy.

Figure #2 Example Costed BOM for Convertible Men's Pants

Item No.	Item Name	Material Type	Material Name	Supplier Name	COO	Consumption	Material Price Per UOM	UOM	Material Cost
TNF-194521	Convertible Men's Pants	Trim	Polyester Elastane	ABC Textiles	HONG KONG	0.34	12.45	Yards	4.74
TNF-194521	Convertible Men's Pants	Main Material	COTTON	Changzhou Huido...	CHINA	0.98	9.80	Yards	11.04
TNF-194521	Convertible Men's Pants	Trim	Zipper, Plastic, 24"	LC Limited	VIETNAM	2.00	0.36	EACH	0.72
TNF-194521	Convertible Men's Pants	Trim	Polyester mesh fa...	Changzhou Huido...	CHINA	0.12	5.54	Yards	0.73

Best Practice: 4

Automation of the Qualification Process for Multiple FTAs

Once all relevant certificates are collected, the final step is to systematically qualify items on the bills of materials (BOMs) using the appropriate rules of origin laid out in the stipulations of the trade agreement. This step will determine if the product qualifies for lower duties. To safeguard compliance, it is crucial to use the most current rules of origin for each trade agreement being considered.

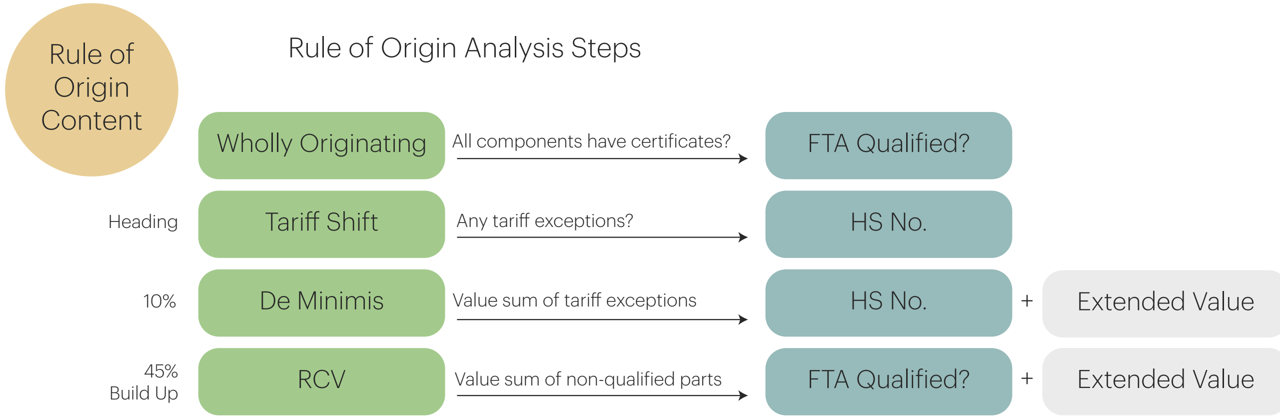
To get started with the qualification process — whether manually or using a GTM solution — importers will need the following information:

- Costed bill of materials (BOM)
- Detailed component information, including the Harmonized System (HS) number that provides the classification of the product, country of origin, and other data for the certificate
- Rule of origin content that outlines specific guidelines for any item to qualify for a duty savings

A BOM provides comprehensive details about the construction of a finished good, component or part. Usually, a BOM is costed, which means that it details the extended value of each component line item (See Figure 2 below). This is important because many FTAs mandate a specific regional value content (RVC) as part of the qualification rules. The parent component should also have a value or cost associated with it because, under some rules of origin, this information is also required for product qualification.

The BOM components are cross-referenced with the relevant ROO requirements to qualify an item for lower duties. Ultimately, each part and component must qualify before the finished product can be considered for lower duties. The criterion used for qualification is aligned with the rules buried in the legal language of the trade program. This is where automation is most time-saving and efficient.

Figure #3 Example of a typical US-bilateral rule of origin decision flow. Rules utilized in EU or ASEAN agreements can be slightly different.



To support high-volume trade scenarios, rule of origin requirements for each trade agreement in the portfolio must be tightly integrated with the GTM solution and easily maintained. Therefore, the qualification engine must support the universe of qualification methods for trade agreements, including tariff shift exceptions, de minimis claims below the threshold, and regional value content for components of minimal value. Then, the system should analyze the BOM against the rules of origin and available certificates to make a determination.

In Figure 3, a BOM is analyzed using rule of origin content. A qualification engine should check each section of the rule to analyze whether the bill of materials aligns with the criteria in the trade agreement. This procedure should be automated as much as possible so that the compliance manager only intervenes when data is missing.

For goods that do not qualify for the FTA, manufacturers should specifically identify where gaps exist so they can work to fill them. Filling the gap may be as simple as requesting a new supplier certificate or as complex as sourcing from another country or region. All qualifications should be logged and all certificates kept on file to support any audits needed later.

Best Practice: 5

Addition of New FTAs With Less Effort by Building on the Base Portfolio

Companies can rapidly support new trade agreements by building on the existing processes, framework and data of available trade agreements in the base portfolio. Often, the primary difference between agreements is the rule of origin content. Importers can often fully reuse the BOM integration and supporting business data.

Notably, the rules of origin used to qualify a product might be the same in many trade agreements, and data already captured from a supplier can be used again with less effort. For example, qualification status can be reused when the certificates of origin are already on file. HS classifications and material or component costs are also reusable. Still, different agreements use distinct criteria to determine if a BOM qualifies for the FTA. For companies that already use a trade agreement, the level of effort to implement a new agreement is minimal, especially if key processes are automated. Leading GTM solutions support multiple FTAs because they utilize a qualification engine that can be reused based on the rule of origin content parameters. With this capability, manufacturers can extend the reach of their FTA portfolio and see a declining cost of goods (and margin increase) for each agreement they leverage.

GTM solutions that can qualify a product for multiple trade agreements should provide an integrated rule of origin database or make external databases available as a plug-in for seamless execution. Plug-ins provide content that tells the engine how to analyze the BOM to determine if the goods qualify for a specific trade agreement, allowing companies greater flexibility to begin using trade agreements on a small scale and add other ones as market reach grows.

For companies that already use a trade agreement, the level of effort to implement a new agreement is minimal, especially if key processes are automated.

Conclusion

Capturing the full potential of trade agreements requires leading-edge technology and information services to identify the best sourcing strategies and synthesize the rules of origin. Based on the best practices presented in this white paper, companies should look for GTM automation solutions that can address all facets of multi-FTA cost savings initiatives, including:

- Establishing a supplier management program
- Maintaining accurate rules of origin for each FTA in the portfolio
- Using campaign management tools to organize and store information solicited from suppliers
- Automating the qualification process across multiple FTAs to ensure the maximum duty savings
- Successfully analyzing even the most complicated rules of origin against BOMs
- Providing suppliers tools to simplify submissions and collaborate

Equipped with the process and supporting technology, manufacturers can reach the next level of low-cost, multi-country sourcing with ease.

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