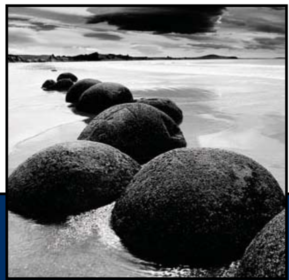
Benchmark Report

Trade Agreement Management:

Survey Results and Best Practice Research



One Meadowlands Plaza
East Rutherford, NJ 07073
(201) 935-8588
Solutions@ManagementDynamics.com
www.ManagementDynamics.com

Management Dynamics Inc.
POWERING GLOBAL TRADE®

Braumiller Schulz LLP

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Free Trade Agreements (or Preference Programs) are becoming increasingly popular among global companies searching for ways to reduce costs and remain competitive. Starting with the U.S.-Israel Free Trade Agreement, implemented in 1985, and then the North American Free Trade Agreement (NAFTA), signed in 1994, companies operating in the United States and North America began experiencing trade metrics the likes of which had never been seen before. Consequently, the benefits companies realized encouraged more companies to take advantage of NAFTA, as well as other agreements signed between governments in more recent years.

Today many executives view free trade agreements (FTAs) as imperative if they want their companies to keep profits margins as high as possible and stay competitive globally. They understand that if their company's participation in FTAs is not exercised regularly and effectively, it could result in money "left on the table." Therefore, to be successful, it is critical for companies to engrain FTA management in their corporate supply chain model.

But the intricacies of FTAs can be complicated. And NAFTA, which became the model for most future trade agreements and is one of the most widely used FTAs today, is highly complex. On top of that, to be successful and benefit from the full potential FTAs offer, companies must use multiple trade agreements signed between countries around the globe.

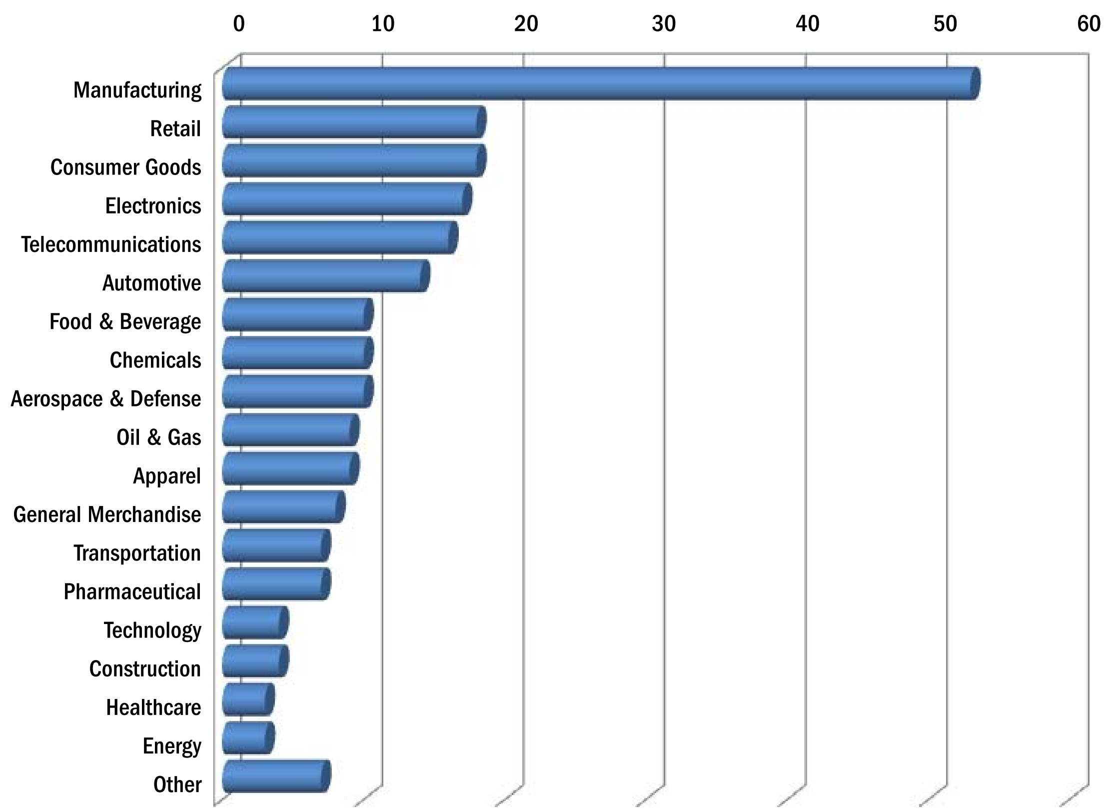
Expanding the use of FTAs can be a challenge for many compliance teams and many companies will turn to an outsourced partner to help. Another alternative is to use Global Trade Management (GTM) software to automate the solicitation and qualification processes and extend this implementation to each required trade agreement. This can be a particular benefit to companies that are just now trying to determine the best approach to increasing their use of FTA programs, especially in this economic environment where many are searching for ways to reduce costs.

This white paper outlines how and why companies can implement and benefit from building a portfolio of FTAs. Its findings are the result of a survey of over 300 respondents across many different industry verticals and revenue size. In addition, the report uncovers many known characteristics of free trade agreements, and divulges key insider information related to program management challenges, monetary savings and benefits, legal awareness and responsibilities, and strategies to help your firm initiate and sustain an effective program.

The objective of this white paper is to profile how companies use FTAs. By surveying over 300 respondents with 28 questions directly related to FTAs, this paper seeks to determine the key challenges in managing a trade program and how software is used in the process. The survey was distributed by World Trade Magazine, the ICPA Association, Braumiller Schulz, Management Dynamics, and other trade industry networks.

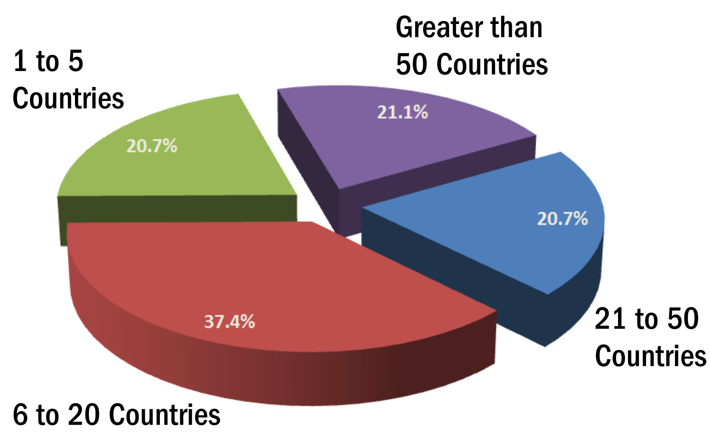
In conducting the survey, industries were broken down into key industrial groups. By doing this, survey results determined that 40% of respondents using FTAs operate in manufacturing, retail and consumer goods – key industries involved in global trade, particularly in the United States. The survey also determined that between 5 and 10% of respondents operate in other key industries such as aerospace and defense, automotive, and pharmaceuticals.

Breakdown of Respondents by Industry



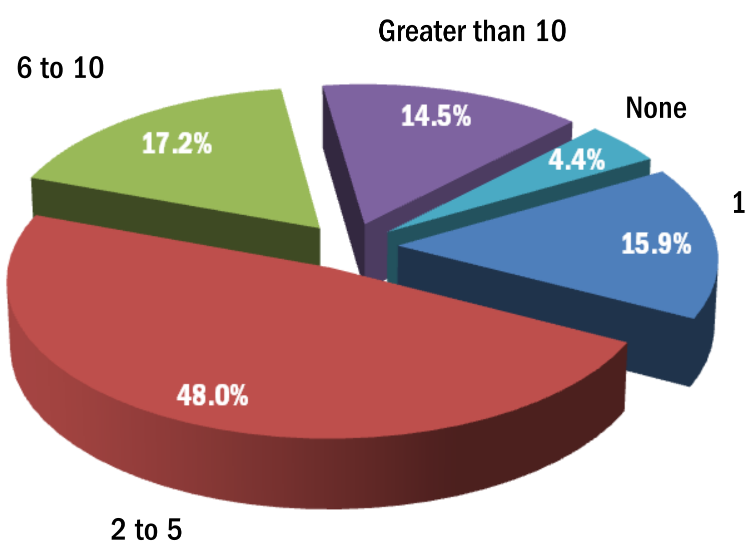
The survey determined that 42% of respondents operate in more than 20 countries worldwide. This is not surprising since many large, multi-national companies will operate in over 50 countries worldwide. In addition, the survey found that 20% of respondents also operate in five or fewer than five countries. This proves that many small and medium-sized enterprises are now expanding their global reach and see trade agreements and programs as an opportunity to better manage their supply chain.

A key issue facing companies when looking to build a comprehensive FTA program is size of team and availability of resources to take on the task. According to survey results, 48% of respondents have a team comprised of two to five compliance resources, while 20% have very small or non-existent compliance teams.



The survey found that compliance teams, particularly those employed by small to medium-sized companies, operate fairly lean.

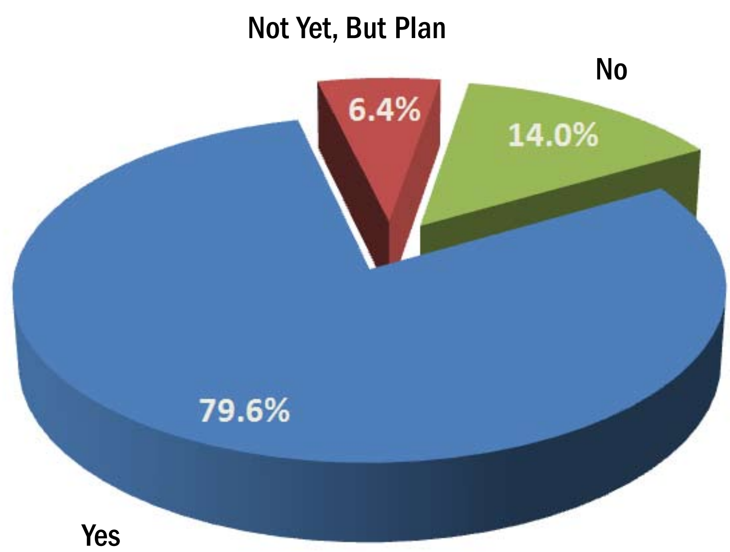
Larger companies tend to have larger compliance teams (greater than 10 full time equivalents) to support much higher trade volumes, maintain compliance with across export, import, and trade agreement programs, and mitigate risk when changes in governmental changes occur.

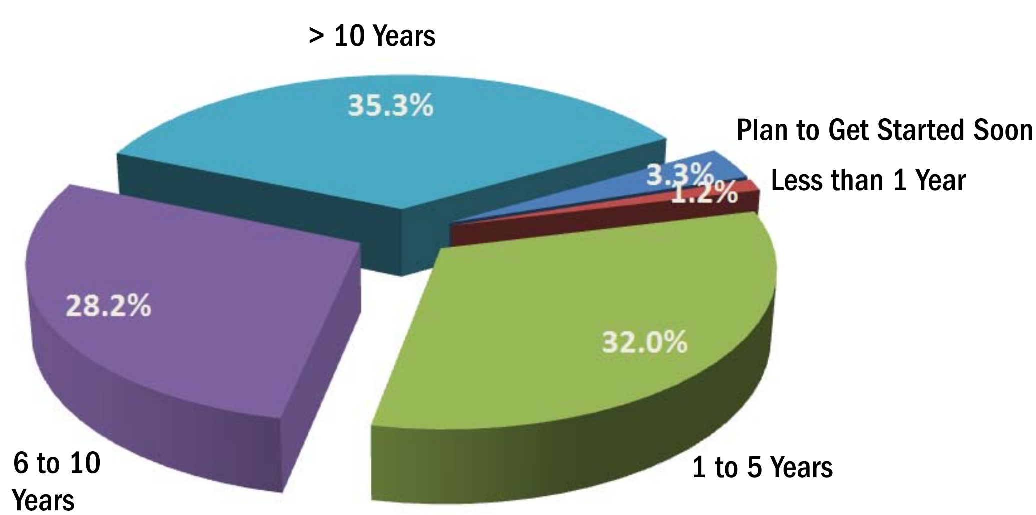


According to survey results, nearly 80% of all respondents across industry groups use FTAs. The reason: FTA utilization is important for companies to stay competitive and take advantage of all the cost-cutting opportunities that global trade will afford.

Trade agreements and preferential programs are now regarded as a must-have for most global companies' strategic growth model. Only 14% of companies surveyed have no plans to ever use trade agreements.

The popularity of the FTA program is evident in the fact that survey results found that over 60% of respondents have managed trade agreements for more than six years. Many of these companies most likely commenced their involvement with FTAs after NAFTA was implemented and have been taking advantage of agreements as they have been phased in.



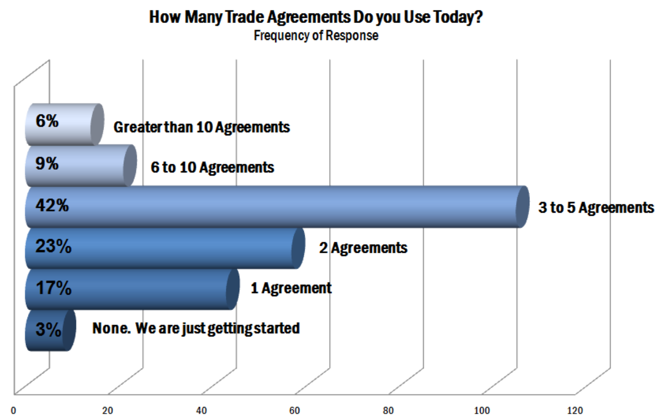


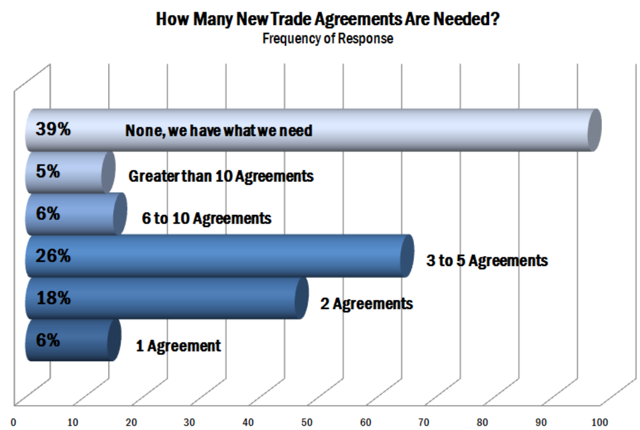
The survey found that 80% of respondents indicate that their companies manage two or more FTAs. And, 15% manage six or more FTAs.

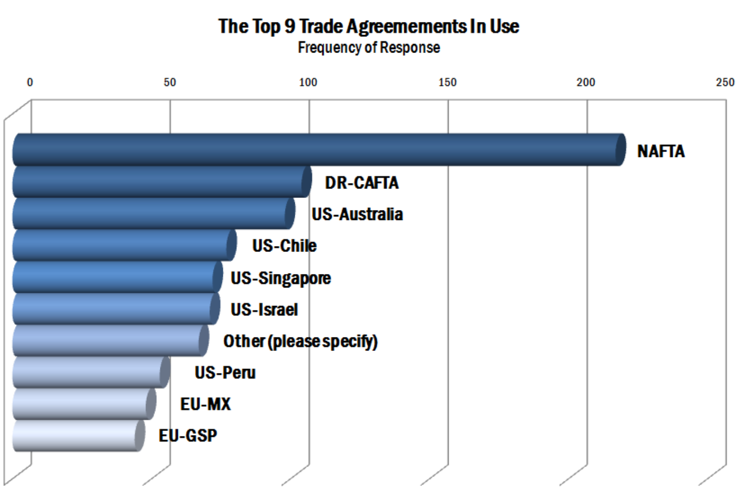
This broad range of responses indicates that companies responding to this survey can be at different maturity levels with respect to their global trade programs. In addition, sourcing models, complexity of IT infrastructure, and international sales markets can all play a part in how many (or few) trade agreements a company manages.

Many companies are searching for ways to streamline their international operations and lower total landed cost in their global supply chain. As such, over 60% of respondents indicated that they needed to grow their FTA portfolio. The majority of these companies want to increase that portfolio between three and five agreements, while over 10% of companies, perhaps in the middle of implementing an aggressive growth strategy, need to implement six or more agreements.

While the European Union (EU) and the United States have made considerable investments in FTAs and Preferential Programs, as is evident by the number of existing agreements, survey results find that U.S. bilateral agreements are the most popular.







For the United States, NAFTA is by far the most widely used FTA, followed by the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), US-Australia FTA, and some other U.S. agreements. The United States currently has agreements with Canada, Mexico, Australia, Chile, Singapore, DR-CAFTA (Guatemala, Honduras, Nicaragua, El Salvador, the Dominican Republic, and Costa Rica), Israel, Jordan, Oman and Peru. Some other prominent agreements are also awaiting legislation such as those with Panama, Columbia and Korea.

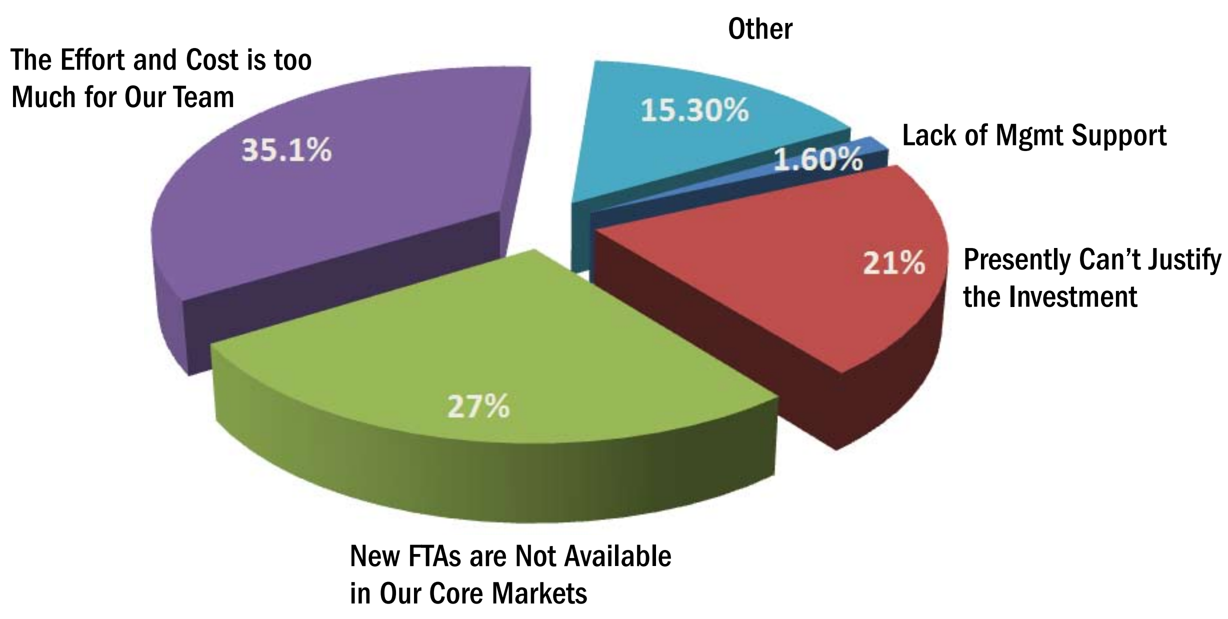
Data revealed from companies with 10 or more FTA portfolios is also revealing. Among those findings:

- 50% of the respondents save over $10 million annually with their FTA portfolio
- 27% of these companies are retailers
- 79% say their top business driver is reducing cost of goods purchased
- 65% say they need at least three more FTAs, while 30% say they need 10 more
- 100% have had an FTA program for at least six years
- 100% are FULLY READY for an audit with all documentation and supporting analysis

In addition, respondents in this class of companies indicate that the largest impediment to adding more FTA programs to their portfolios is an actual lack of available FTAs in their operating regions. New FTAs are being negotiated and signed every year and we expect that these companies would expand their portfolios if these new FTA programs existed.

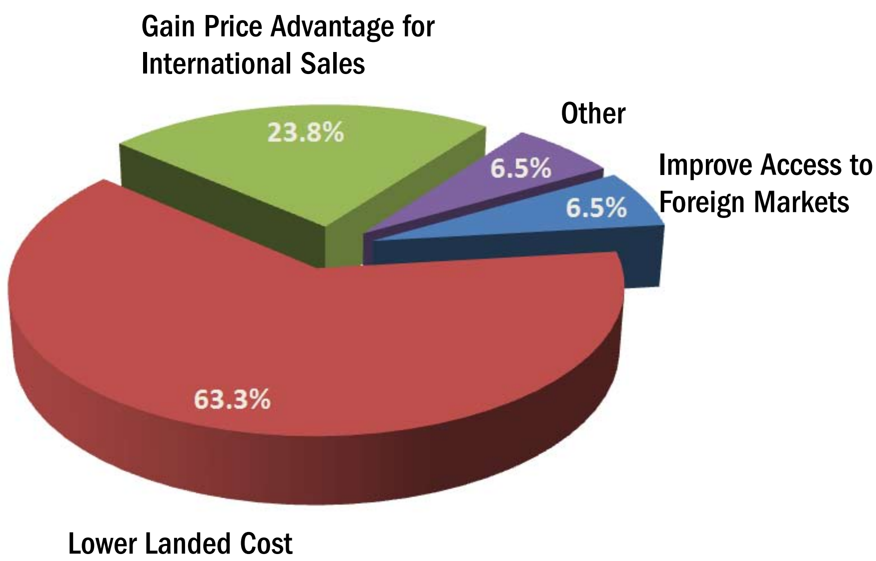
The survey found that companies that do not plan to expand their use of FTAs, regard the effort and cost associated with implementing an FTA program too large of a hurdle. This could be directly correlated to the size of their teams or relate to the fact that the manual effort involved with managing agreements is perceived as being too much work, particularly given everything else on compliance professionals' plates today.

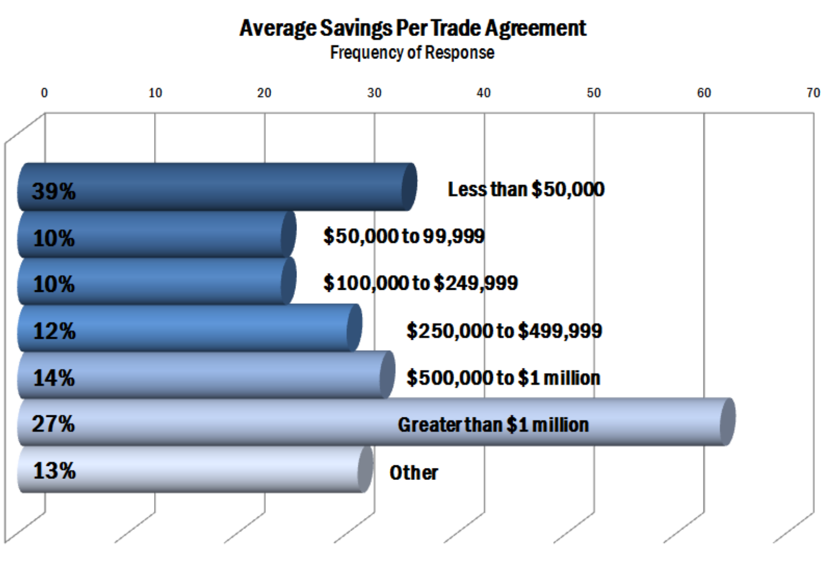
In any event, 35% of respondents revealed they are not expanding use of FTAs due to the effort and cost involved; 25% said that new FTAs are not available in their regional markets; and 33% said that if they had a better way to manage trade agreements, they would try to expand their portfolio.



There are many benefits to using FTAs. Among them, they lower landed cost, offer a price advantage for international sales, and improve access to foreign markets. The strongest driver for investing in a FTA program is to drive down the cost of purchasing raw materials. From an import perspective, this can allow for cheaper procurement options. From a manufacture's standpoint, trade agreements allow for leaner manufacturing options, thereby creating a lower production costs. Those manufacturers that export to countries that offer FTAs experience a dual benefit by being able to side-step duties and taxes.

The bottom line: lower cost of production and entry to foreign markets can considerably increase a product's profit margin.

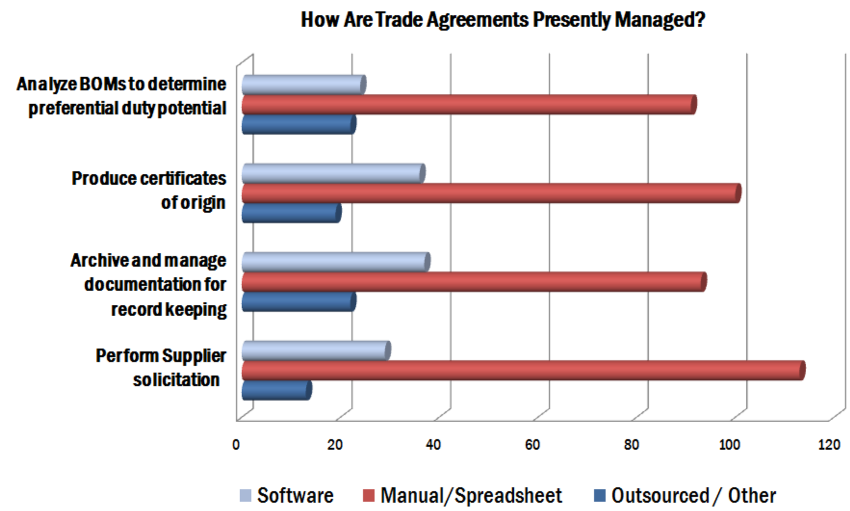




Not surprisingly respondents indicated considerable savings per trade agreement. For example, 41% of respondents reported that on average they could reduce duties by more than $500,000 per trade agreement, while 27% said that their savings opportunity was more than $1 million per trade agreement.

Assuming an average savings of $500,000 per agreement, this can become a major cost savings area when companies start adding three, four, five or more agreements to their FTA program.

Implementing sustainable procedures is the key to managing a program for FTA utilization. Manufacturers should periodically test their compliance with the rules of origin to ensure the criteria has not changed since the last FTA eligibility determination. It is also important to re-run a qualification check any time a Harmonized System (HS) changes or a major tariff update occurs. And customers should be engaged when a product they have purchased has its eligibility status changed. Importers need to also understand if documents supporting the preferential claim are valid. Companies should be diligent to re-solicit their suppliers annually to ensure product eligibility has not changed.

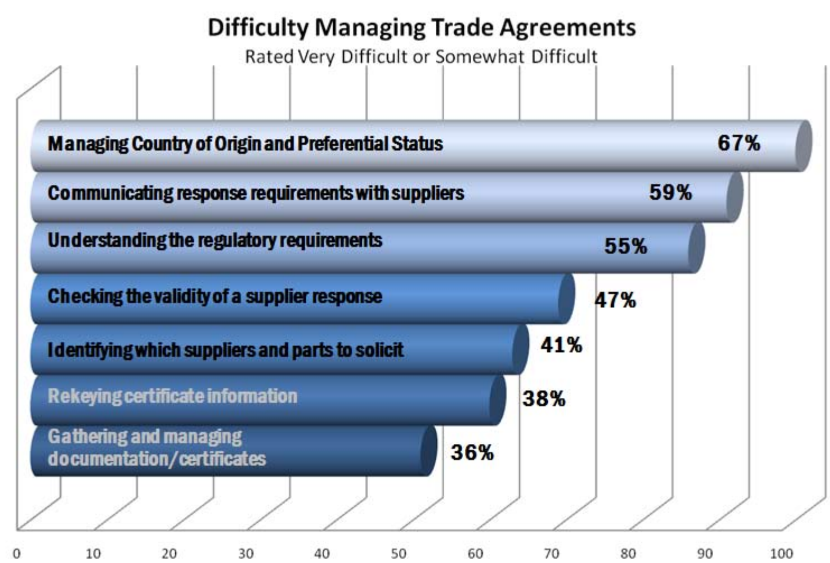


Automating the FTA process can further save a company money as well as time. To understand how widely companies were automating their FTA processes, the survey looked at four different scenarios. Consequently, it found that about 65% of respondents across the entire sample manually administer their trade agreement program. Large companies, with $1 billion revenue or greater, were about twice as likely to use software to automate the process.

The survey also found that 50% of large companies use software while only 25-30% of all respondents use software. Software solutions today come in many different packages, ranging in cost and functionality to scale to fit the needs of companies of all sizes. The bottom line is this: Relying on manual processes can be an additional risk for companies because of the knowledge base and training required to keep employees up to date on compliance measures.

5.1 Challenges with Supplier Solicitation

The solicitation process presented a number of challenges for respondents. First on the list was obtaining country of origin and preferential status from the supplier. This is a major headache for 67% of respondents. Other notable pain points are communicating requirements to suppliers, checking the validity of what the suppler has claimed, and managing documents and certificates coming in from the supplier.

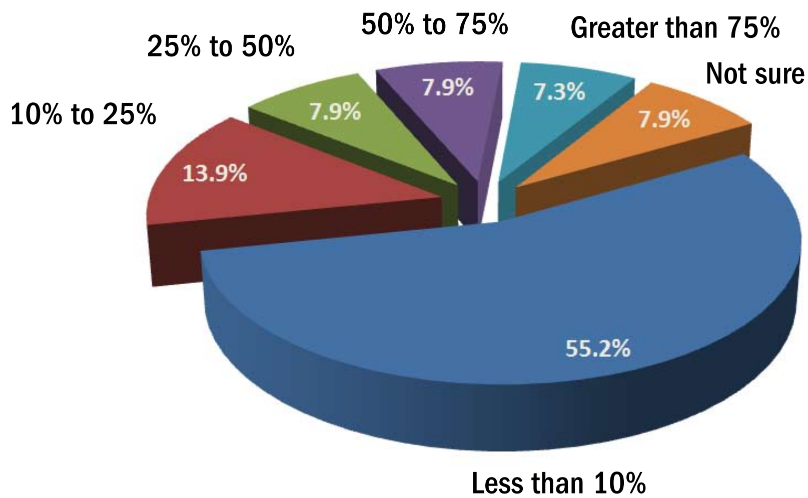


5.2 Certificate Error Rates

While 37% of respondents have error rates greater than 10%, a significant number of respondents (23%) actually have error rates above 25%.

Having to follow up on one out of four certificates received back from a supplier creates major headaches for compliance personnel who will need to follow up with them to correct mistakes.

Consequently, supplier education is paramount to receiving valid documentation. Strong control mechanisms like software also help reduce mistakes and perform basic error validation prior to allowing a document to print resulting in fewer errors and follow up work by compliance teams.



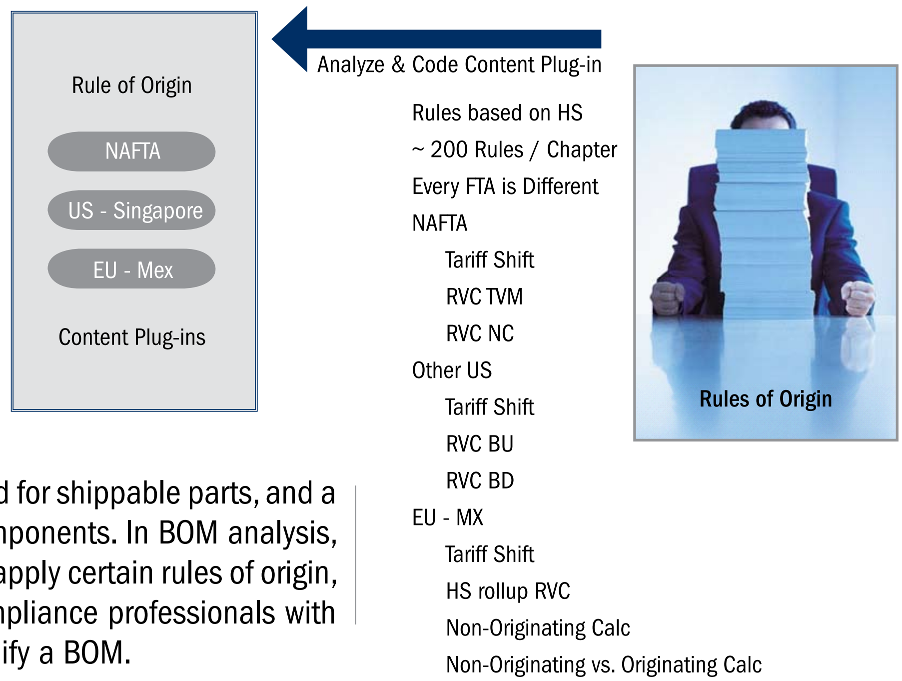
Most trade lawyers believe the error rate is significantly higher – somewhere between 50% to 80%

So what does that mean to companies engaged in FTAs? Here is a check list of questions:

- Do you understand the preference rules, which criteria to use and how "regional value content" is calculated?
- Who is primarily responsible for certifying origin?
- What of the following documentation is required to make a claim: Mandatory Certificate of Origin from exporter in importer's possession prior to claim or Optional Certification or Certificate of Origin by importer, exporter or producer?
- What records must be kept? For how long?
- Are there special "marking" rules?
- Are there savings provisions or exceptions?
- Are there direct shipment rules?

5.3 BOM Complexity and Data Integrity

Today's warehouse management systems coupled with companies' vertical integration strategies can create very complex bills of material (BOM) structures for shippable parts. Keeping in mind that BOM structures are designed to benefit quick and dynamic assembly, compliance professionals may find they have problems trying to keep up. Many companies operate in a make-to-order type of environment with custom product building. This leaves compliance teams with very little time to analyze a BOM for preferential origin. Its here where manual processes tend to break down, meaning companies can only qualify a fraction of their shippable parts.



HS classification has typically been required for shippable parts, and a secondary focus for raw materials and components. In BOM analysis, the HS of all the components is relevant to apply certain rules of origin, particularly with tariff shift. This leaves compliance professionals with a lot of pre-work before they can even qualify a BOM.

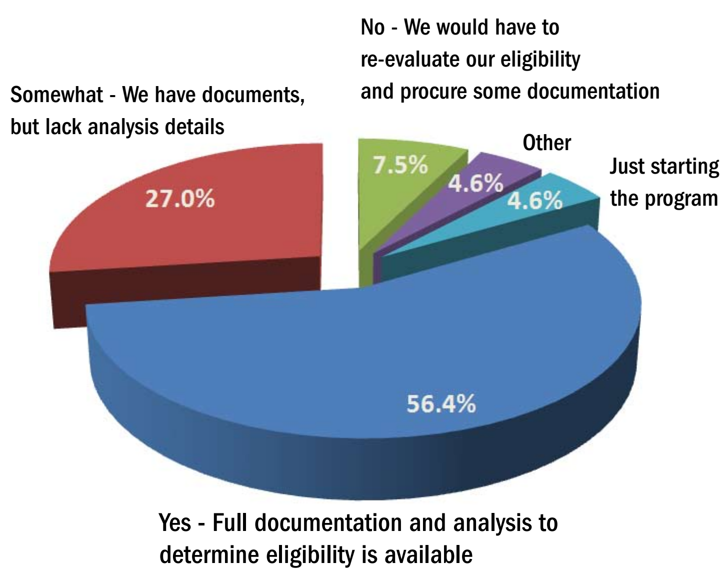
TIP: Keep procedures current and record all analyses

5.4 Preparation for a Customs Audit

Trade attorneys see record keeping as a sign of compliance program maturity. Reaching this level of maturity requires that every major event is tracked, the resource that performed a task, and the date and time it was performed.

56% of respondents believe that they are fully prepared for an audit, while 27% are somewhat prepared but lack details of the analysis.

This level of record keeping becomes quite difficult to maintain manually and can be an important by-product of an automation project.

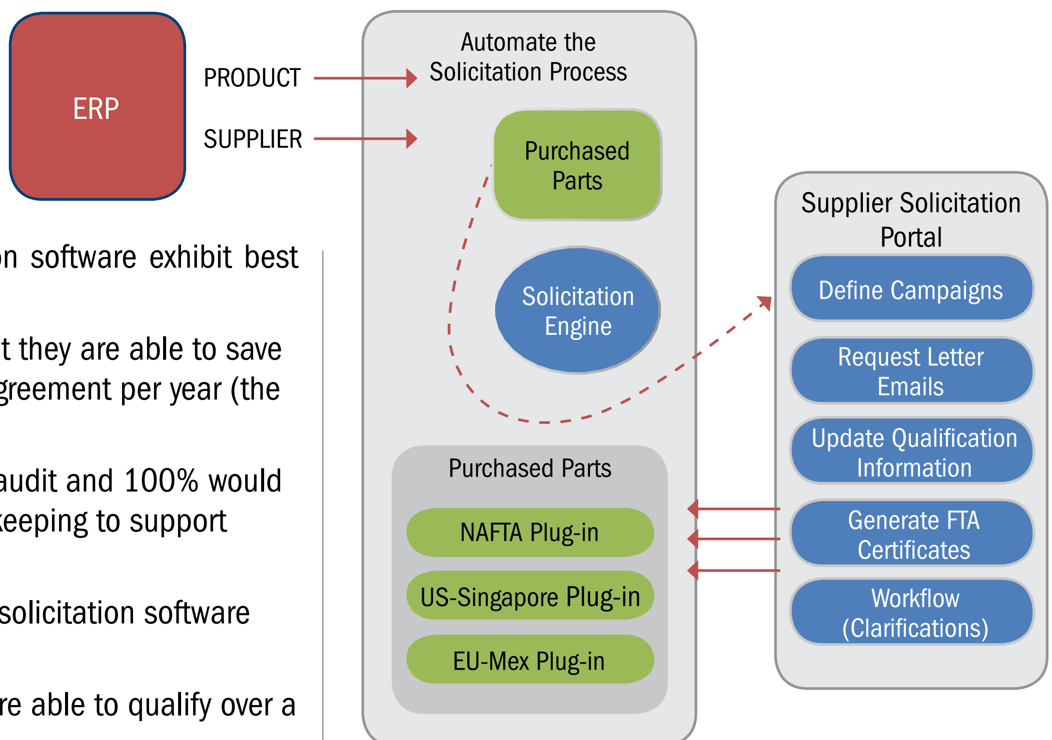


There are two primary automation areas for Trade Agreement Management Supplier Solicitation and BOM Qualification.

6.1 Automating Supplier Solicitation

Companies involved in FTAs can reduce manual efforts by 80% by automating the supplier solicitation process. This capability is usually implemented by:

- Use an integration with purchase order information to build a complete database of suppliers and purchased parts
- Customize solicitations with company-specific templates and attached documents templates to align with corporate guidelines
- Use a solicitation engine to send mass email campaigns with selected purchased parts to all suppliers, or a specific subset of suppliers
- Allow suppliers to key FTA response information directly via the portal and generate certificates in real-time



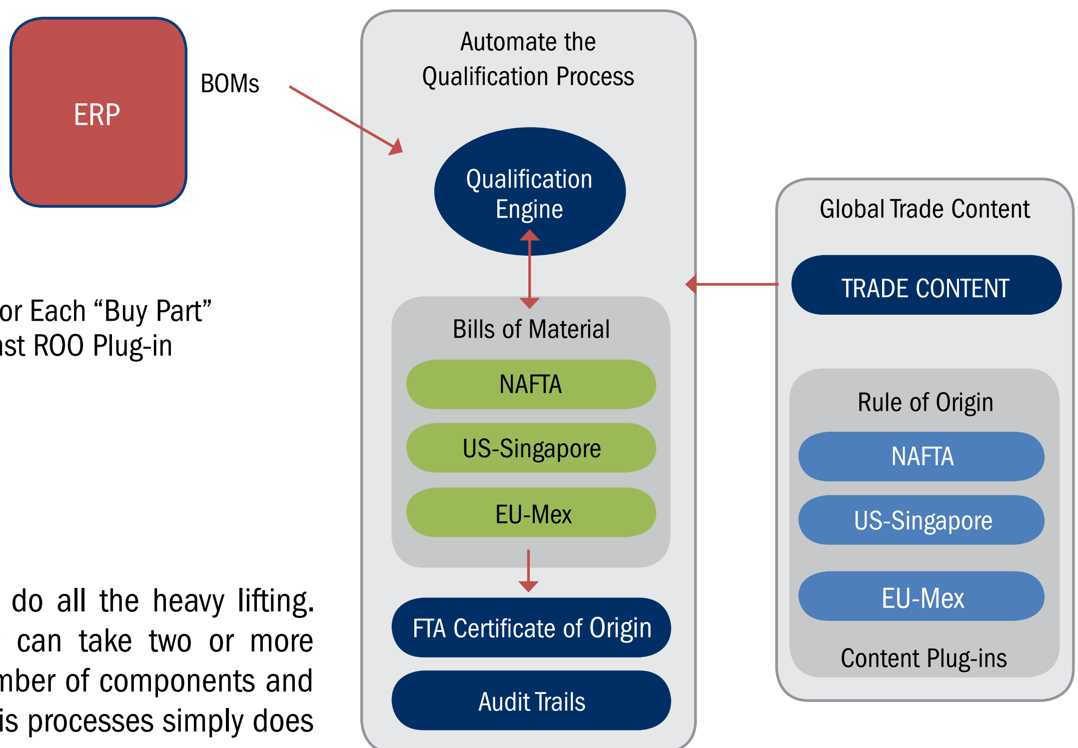
Companies that use solicitation software exhibit best practices in many areas:

- 56% of companies find that they are able to save over $1 million per trade agreement per year (the average was 27%)
- 84% are fully ready for an audit and 100% would be ready with some housekeeping to support qualification analysis
- 100% of companies using solicitation software qualify their own parts
- 80% of these companies are able to qualify over a quarter of their parts
- 79% experience an error rate of less than 10% (the average was 55%)
- More than half of companies using solicitation software are able to manage with less than five resources

6.2 Automating BOM Qualification

The next step to automate trade agreements requires that Bills of Materials are loaded directly from the ERP system. Then, the necessary trade agreement is determined and the proper rule of origin content pack is selected. These rules are loaded in the qualification engine and all required certificates are collected to make a final determination.

The key to automating the BOM qualification process is to have a flexible qualification engine that can interpret rules of origin from multiple trade agreements. The concept is to integrate rule of origin parameters in a "content pack" that can extend the functionality of the qualification software without requiring a software upgrade.



1. Load BOM from ERP
2. Determine Agreement
3. Collect and Confirm Certs for Each "Buy Part" (Component) Analyze Against ROO Plug-in
4. Make Determination
5. Update Audit Trail

The engine is then ready to do all the heavy lifting. Qualifying a BOM manually can take two or more hours, depending on the number of components and the complexity of the rule. This processes simply does not scale in a high volume environment. Automation can easily support complex BOM qualification of 2 per minute.

Companies that use qualification software exhibit best practices in many areas:

- Over 60% of companies today use more than three FTAs
- 25% indicate they need to add at least six more FTAs
- Over 50% report they are saving over $1 million annually per agreement
- Nearly 80% are fully ready for an audit
- 50% are able to qualify over HALF of their manufactured product (a good benchmark is 25%)
- Over 50% of these companies have had an FTA program for over 10 years

Companies need to be aware of a number of critical considerations when implementing an FTA program. First, they need to have a firm grasp on how to use trade agreements most efficiently and competitively. Second, they need to be aware that FTAs help increase a company's market share through targeted sourcing decisions. And third, companies need to invest in compliance and training.

Prudent executives should also consider how phased-in rates and timing of implementing an FTA program impact their company's bottom line. Executives must also note that most agreements are product specific. Therefore, the analysis is not one merely of whether a product was "manufactured" in an FTA country, but rather whether or not it requires a Bill of Material (BOM) analysis.

Executives should particularly keep in mind that NAFTA is one of the most complex FTAs ever written, especially since most U.S. companies that are involved in FTAs utilize NAFTA. Because it is so comprehensive, however, its language has been and continues to be used as a model for writing many of the subsequent FTAs available today, particularly U.S.-bilateral agreements. If a company can learn how to administer NAFTA, then managing other FTAs is fairly easy. In essence, once a company employs a software program to manage one trade agreement, the effort to implement another one becomes marginal and more simplistic. The overhead has already been put in place.

Management Dynamics is setting the standard for on-demand Global Trade Management (GTM) solutions for Global 2000 importers and exporters and logistics service providers. Combining an expansive trading partner network, enterprise-class software and specialized trade content resources, we enable you to dramatically improve the performance of your global supply chain.

Since 1990, Management Dynamics has been developing and delivering software and related content and services for GTM. We help our customers transform their business and gain market share by leveraging our industry and technology expertise. Our solutions are currently deployed to over 14,000 users in 70 countries and our customer base includes some of the world's leading retailers, manufacturers and logistics providers. For more information on our Trade Agreement Management solutions, request a brochure.

Management Dynamics, Inc.
One Meadowlands Plaza
East Rutherford, NJ 07073
201.935.8588
Solutions@ManagementDynamics.com
www.ManagementDynamics.com

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