Classification around the world

Teaching note written by

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Purpose of the case

The case describes a trade management challenge for a global chemical company that tries to develop a global trade management policy. In the case, a particular challenge is described where one specific country is challenging a classification decision of this company, that is at the same time a deviation from its own global policy.

The learning goal of the case is to offer students insight and analysis capabilities to assess the relevance and impetus of a global trade management policy, as well as argue for or against specific local deviations of such a policy.

Educational plan

The case is written for class or group discussion. This discussion could follow three steps:

1. Problem analysis. Part of this discussion are questions 1 and 2 in the case: how did the discrepancy between classification decisions in India and the rest of the world come about, and is this kind of discrepancy desirable? Participants could discuss these questions in groups and come up with their judgement of what exactly the problem is in the case.
2. Global trade management policy development. Part of this discussion are questions 3, 4 and 5 in the case. The participants can be asked to draft the contours of a global trade management policy, specifically for product classification, and allow for a policy standpoint on global versus local classification decision-making. As an extension of this discussion, other elements of the trade management responsibility, such as value, origin, or free trade agreements could be considered.

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3. Solution strategy. Part of this discussion is question 6 in the case. Basically, the idea is to discuss with participants how this company can get out of this messy situation. The case provides two broad approaches: either come up with a clear global approach and enforce it everywhere, or manoeuvre in such a way in the various regions that acceptable solutions are obtained, even if these are not globally consistent.

Context trade management

In the last few years, the consequences of geopolitical developments have become a lot more concrete for internationally operating companies. After decades of 'global integration' and resulting gradual trade tariff reductions, President Trump's trade war turned this situation around. Tariff hikes of double digit numbers were introduced on trade lanes between China and the US and also Europe and the US. The aggression of Russia in the Ukraine not only halted trade out of the Ukraine, but introduces almost a dozen sanction packages that have all but stopped trade with Russia. The extra-territorial policy of the USA on its sanctions with, among others, Iran, but also its economic battle with China, have also impacted export flows of European countries. The Dutch company ASML is one of the companies affected by such a policy. New regional trade agreements, developments in ASEAN, or the break up between the UK and the EU all have had an impact on the way companies need to manage their international movement of goods.

All these developments mean that companies have to remain very aware of changes in the regulation they are trying to comply with. Their trade management, or compliance departments are where the companies allocate this responsibility. It is therefore not surprising that more and more global companies are stepping away from a laissez-fair policy for trade management, where many business units and their subcontractors took care of trade management formalities. More and more, companies are concentrating global responsibilities for trade management and customs compliance in departments in their head offices.

Background trade management

Trade management in a company could be defined as the function that controls the fulfilment of compliance requirements related to the international movement of goods (and services). Hausman et al (2010) perform an elaborate global trade process analysis to show the breadth of global trade management responsibilities. Many available definitions emphasize the role a trade management department plays in the smooth execution of international goods movements. In such cases, trade management is often translated as customs management in cross-border operations. In recent years, however, the trade management profession has become aware that this operational role is tightly linked with the overall level of compliance that a business aims for throughout its entire operation. In other words, a successful trade management department combines an operational role with a tactical or even strategic role in the company.

The focus on the operational part is driven by software companies that sell so-called global trade management software that primarily supports the identification of restrictions along a particular

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trade route, such as sanctions, particular documentary or information requirements, customs declaration formalities, and so on. A trade management department that focuses on these elements is often occupied with a lot of firefighting because shipments need to go out, or are held up at a border, and cannot proceed without some action from a trade management professional.

Companies who take a broader look, or regard compliance management of strategic importance, usually develop a global trade management function, and allocate broad responsibilities to such a function. The trade management function at the global company level usually gets involved in discussion about product value calculations, product classification, service provider selection, customs broker rationalisation and monitoring, selection of trade management IT tools and so on.

For the global trade management functions, a number of challenges can be identified. First of all, since the function should be in a position to instruct other departments what to do, or not to do, organisational authority is an issue. Much of this authority depends on the position of the trade management function in a company. Observe the following figure.

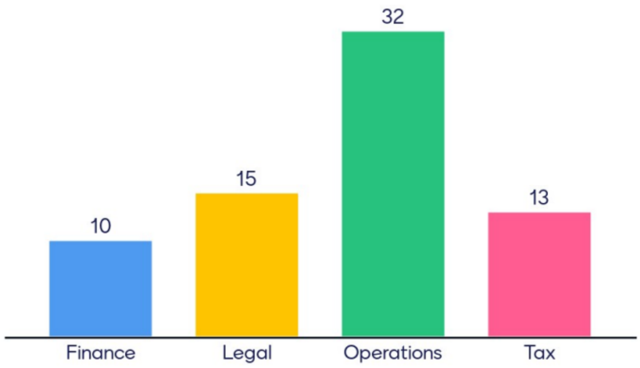

Figure 1: Trade management departments in functional areas
Trade Management Conference, Veenendaal (NL), 14 June 2023

This diagram resulted from a working session with about 70 trade management professionals and the question where customs management belonged in the organisation. Where operations are a logical place for customs operations (making documents, declarations, certificates and so on), other companies choose to put this function under finance, legal or tax departments. Responsibilities might also be split: customs operations are in operations, while strategic functions and responsibilities for sanctions and strategic goods movements are under legal. All these choices come with advantages and disadvantages. The position in operations offers direct access to data and operational milestones. Positions in legal or tax offer much stronger authority to enforce policies and procedures. Split responsibilities combine advantages, but usually result in the need for coordination and alignment.

A second theme in trade management is: how to contribution to value creation in the company. In many cases, trade or customs management is seen as an activity that costs money, especially if mistakes are made. Amptmeijer (2020) suggests using the well-known Porter Value Chain model to clarify the role of customs operations and compliance in the value generation. For this purpose, she criticizes Porter's model for not putting procurement in the sequence of primary input activities. The involvement of a trade management department in the procurement phase is crucial to avoid problems in the inbound logistics flows of the company, with resulting knock-on effects on manufacturing, sales and distribution. This amended customs-oriented value chain model is depicted in Figure 2.

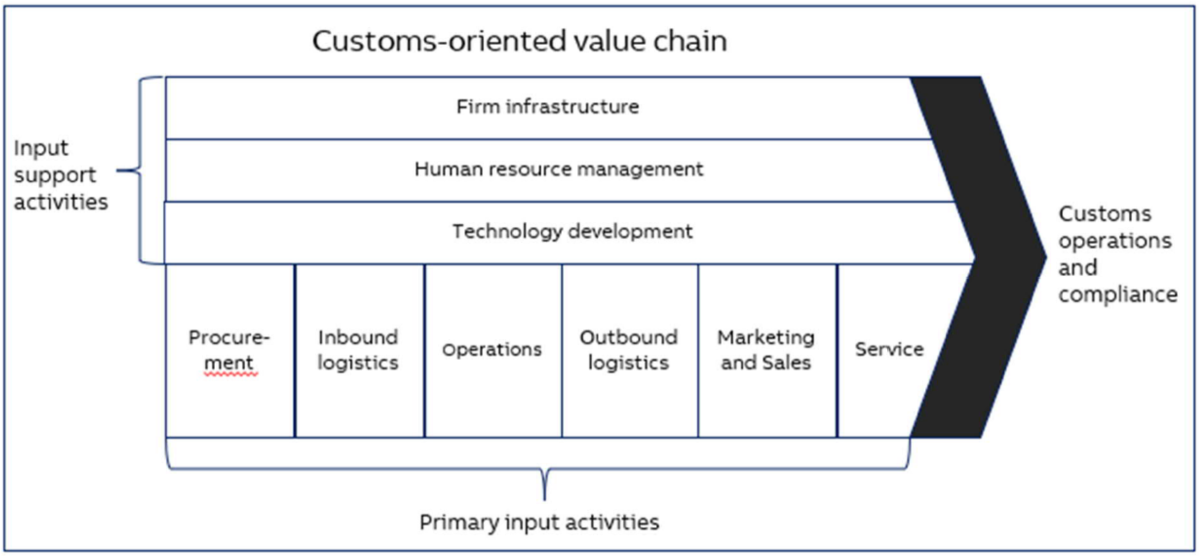

Figure 2: Customs Oriented Value Chain Model
Source: Amptmeijer (2020). The customs-oriented value chain

The model emphasizes the role of customs operations and compliance management in all functions of the company. For each of these steps in the value generation, either the contribution, or the reduction in value creation can be identified and linked to the performance of the customs operations and compliance activity. This is as the same time a rational for arranging proper hierarchy for the trade management department, as well as the explanation why trade management professionals have to link into all operational functional areas of the company. This linkage, in Amptmeijer's company, was carried out through an extensive knowledge and training program, in close cooperation with human resources, for operational workers in a number of different product groups and business units. Standard operating procedures also played an important role.

A third issue is what a trade management department should look like. This is the matter of the trade management department operating model. Hanot (2020) designed a generic model for such a department that contains four dimensions: processes and controls, the management system, data and technology and organisational structure. Only when these dimensions are adequately filled will a trade management department be able to contribute to the execution of the strategy of the company. Here we will focus on the last one: organisational structure. The main question is if the function needs to centralised or decentralised. The general business literature seems to follow the path of centralisation at a global level (see for instance Andersen & Kreve 2023 on procurement, or

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Yip & Madsen 1996 on global account management). KPMG & JP Morgan (2022) evaluate the centralisation of what they call 'trading centers', which is a combination of financial and physical value chains. The merits are in process efficiency, optimizing working capital and counter party risk management.

An alternative to full or 'hyper'-centralisation is a hybrid form of centralised and decentralised activities. This also allows for the selective outsourcing of operational activities to trusted service providers, while maintaining centralised oversight. This development might be covered by the notion of 'glocalization', which is a term that was introduced around the end of the 1980s, but never gained much traction. At that time, it refers to the development of multinational companies dispersing power or control to local branches or business units (Roudometof 2016).

Finally, IT support of the trade management functions is important. Much of this market is cornered by companies such as AEB Customs, Descartes, or CATTS, who provide customs declaration software, or trade compliance software or some combination of these two. Monti (2020), however, identified a long-existing gap between what trade managers needs in terms if IT, and what these standard tools deliver. In brief, the problem is that software tools support operational processes, often through the verification of regulations and prohibitions at the shipment level. A trade management professional, however, needs to have an overview of shipments, compliance requirements and a near real-time insight in compliance performance. The current software does not provide this type of dashboard functionality.

Global compliance policy

If a trade management department is made responsible for global compliance, a global compliance policy needs to be formulated. Such a policy prescribes how the company as a whole deals with particular dimensions of compliance: value calculation, origin of products, application of free trade agreements, goods classification policy, sanction and strategic goods policies. Underlying this are issues such as standardised application of incoterms, partner selection in international transport and logistics, performance monitoring of compliance service providers.

In the case, the particular issue is the need to harmonized classification of goods: making sure that the same goods are classified in the same way in all parts of the world.

There are two sides to this requirement. First of all, there is a global standard for the classification of goods. The classification system itself – the Harmonized Commodity Description and Coding System, or HS system for short – is administered by the World Customs Organization[1], is in existence since 1988, although predecessors were introduced as early as 1931 (WCO 2018).

The rules on how to classify goods are also more or less standardised. The so-called General Interpretative Rules (GIR) prescribe in what order decisions have to be made to properly classify goods. These six rules should provide an unambiguous path to a classification decision. Since this is not always the case, customs organizations usually offer the possibility to obtain decisions on the

[1] https://www.wcoomd.org/en/topics/nomenclature/overview/what-is-the-harmonized-system.aspx

accepted classification of a good before the goods actually start moving, to avoid surprises at any border. This is called a Binding Classification Decision.

On the other hand, given the possible ambiguity of classification, and local circumstances might result in different interpretation of the rules, it is possible to argue for local deviations of a global classification policy. In the particular situation of the case, the products would be classified differently if they are for human or for animal consumption. If there are differences between these two uses of the good in different parts of the world, differences in classification may result. Of course, such differences between the use of products can be supported with documentary evidence.

Another reason why differences can ensue is because customs agencies may differ slightly in their interpretation of the rules. While there may be legitimate reasons why interpretations could offer, it is always wise to look at the consequences in terms of applicable duties. This issue also plays a role in this case, where the classification option with the lowest duty happens to be the option that is used by the company. Often, differences of opinion also result when classifying goods consisting of different materials. Finally, a major reason for differences of opinion between the US and other parts of the world, is that in the US the magnitude of components in a product are measures based on weight, and in other parts of the world, in terms of value.

Components of a global trade policy

Part of the case discussion will be to ask participants to formulate a global trade policy for classification of goods. Such a policy has a number of standard components:

1. Statement of purpose of the policy, and alignment with company goals.
2. Defining the scope of the policy.
3. A description of the company approach towards classification of products:
    a. Responsibilities for classification.
    b. Presence of expertise.
    c. Applying standard procedures.
    d. Information provision on past classification decisions.
4. Scope of the policy in terms of which operational processes it influences.
5. Allocation of responsibilities, in terms of which departments are involved in its execution, and who carries which responsibility.
6. Standard formats and process steps.
7. Reference materials, knowledge base and support tools.

It is not necessary to carry out all these steps. It is important to raise the awareness of participants towards the scope of a proper global classification policy, and to, possibly, identify gaps with the current way of working.

Solution strategy

The case describes a situation that has developed over more than a decade of formal procedures, official complaints and court cases. These activities have not led to a resolution yet, and are further

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complicated by competitors obtaining solutions that seem to provide further impetus to deviate from a concise global policy.

'How to get out of this mess' does not seem to be a formal topic in business research. The internet, however, is full of information that might help. There is, however, some literature on pprblem solving that might also be relevant (see for instance Jonassen 2004).

The first insight that derives from this 'wealth' of suggestions from the bloggers and other internet gurus is: there will always be a mess. So perhaps the whole idea of being able to resolve the problem in the case in a neat and tidy way is unrealistic. This may also mean that some relaxation of the rigidity of a single global policy should be allowed to accommodate the messy environment business are inevitable confronted with.

As a second insight, analysis and a systematic approach are advocated as a strategy. While complete and definite solutions should not be expected, a clear problem analysis is an important step towards solving at least the solvable parts of the problem. Gathering evidence, data, standardizing decisions and approaches will all contribute to tackling important elements of the problem.

The problem solving literature (Jonassen 2004) suggests that, in addition to problem analysis and a systematic approach, learning is also an important ingredient. Businesses should develop learning environments around their 'problems' in such a way that problem solving is not only attempted, but will also become more efficient as a result of the problem solvers learning from their own mistakes and from each other.

In the context of the discussion about a 'way out', these various aspects could play a role:

1. Are the participants able to distinguish between what part of the problem can be resolved, and what part maybe not?
2. Can the participants reflect on the quality of their own problem analysis (and those of others in the group)?
3. How could a learning environment be constructed to support the global role out of a trade management policy for classification that explicitly embed the aspect of learning?

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