# Digital future and distribution channels

An excerpt from the 2016 EY Global Trade Symposium report

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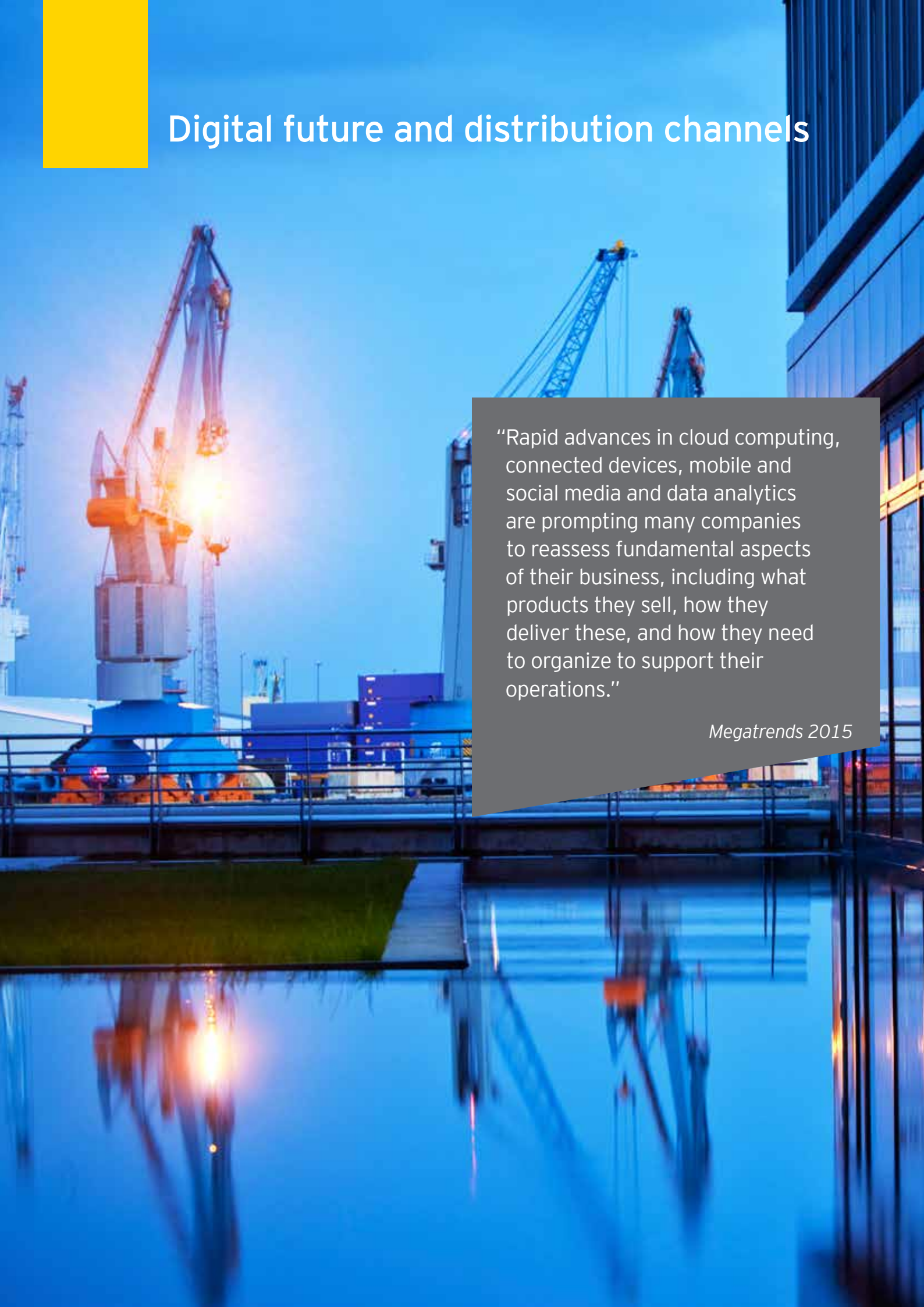
# Digital future and distribution channels



"Rapid advances in cloud computing, connected devices, mobile and social media and data analytics are prompting many companies to reassess fundamental aspects of their business, including what products they sell, how they deliver these, and how they need to organize to support their operations."

*Megatrends 2015*

Digital transformation is changing business models. A recent Economist Intelligence Unit survey reports that almost 80% of companies are seeing changes in how their customers access goods and services, and the majority of these companies are changing their pricing and delivery models.[1] The participating trade professionals have directly experienced these changes. In fact, for the participating trade professionals, "change" does not adequately convey the complexity caused. More frequent than a movement from one model to another is the use of multiple models, with adaptations and variations growing constantly.

"Customers are demanding a relationship with the brand in a different way," explained one executive. "Consumers (and how they think and what they want) are changing the way we operate. We have to be responsive to the very specific consumer expectations of the right time and place of delivery: it could be their home, a kiosk or a convenience store. It is a different paradigm."

Others described the historical situation in which one distribution model was used and refined to optimize efficiency. That is no longer the driving factor.

> "We used to limit our business to a single model. We can't do that anymore, and each model creates new difficulties."

A number of the trade executives described model derivations as customer driven. One summed up, "We either meet the requirements or lose the customer."

## Supply chain partners

The variety of delivery models invariably involves different uses of supply chain partners. One common example of this is in the e-commerce area, where third parties are commonly used to provide the e-commerce platform, handle collections and manage varying aspects of logistics. Another example described by manufacturers was a different approach for importations of manufacturing parts and aftermarket spare parts.

"It is complicated when we own one channel but not another," explained one executive. Classification, for example, can be the responsibility of different entities on importations of the same product in the same market through different channels. "We have to have specific procedures to ensure consistency," stated one executive.

The extent of these procedures and the extent of interaction with supply chain partners who have assumed responsibility for import compliance with respect to a distribution channel generated significant discussion. While a company may want to have complete information on product classification appearing on commercial invoices in situations in which a related party is the importer of record, when an unrelated supply chain partner takes on this responsibility, the answer may be different. "Our distributors don't want 'advice' on the invoice," commented one executive, "and we don't want to give advice that can point back to us." Another reported: "We give distributors two invoice options: the six-digit HTS [Harmonized Tariff Schedule] used at export, or a blank [no HTS stated] invoice. Some of our difficulty comes when a supply chain partner provides us the tariff classification that they want to use. We validate it and when there are inconsistencies, we open a discussion. An important question is what type of disclaimer should be used when providing any information." Others agreed that disclaimers are important. "Putting a statement on the invoice that classifications are provided for informative purposes only, and that each importer/exporter is responsible for their own tariff classification is our standard approach," commented an executive. While a disclaimer was agreed to be a leading practice, executives were quick to note that it is not dispositive. "When an issue comes up on our product, we are right back in the conversation."

[1] Economist Intelligence Unit, *Supply on demand: adapting to changes in consumption and delivery models,* 2013.

The executives also expressed concern that rules may be changing, which require more direct involvement in e-commerce transactions involving supply chain partners. Uruguay was cited as a country that looks at the identity of the shipper in certain circumstances and may look to aggregate shipments even when separate importers are used. Turkey has also announced formal plans to require logistics providers to file aggregated shipment information for e-commerce sales attributable to an entity. These types of rules make the demarcation of responsibilities among supply chain partners especially complicated.

## Valuation differences

Perhaps the most difficult problem to address is the differences in valuation that arise when similar products are imported using different channels. One example cited was the import of parts for manufacturing as compared to spare parts for aftermarket sale, which are often priced differently. Manufacturing parts are often packaged in bulk, while aftermarket spares are packaged individually for the consumer. Moreover, the transfer pricing approach for aftermarket spares is often based on the parts distributor receiving a routine profit margin for distribution, as opposed to a cost-based approach for manufacturing parts. "The authorities are looking carefully at the price differentials," noted one executive.

Another significant price differential arises when a business sells both to distributors and directly to consumers through an e-commerce platform. In some cases, the e-commerce consumers are the importer of record. "From a cost perspective, we keep the entire margin, but duty is incurred on the retail price," explained one executive. In other instances, e-commerce platform providers served as the importer, but prices remained significantly different than prices for the same product sold to distributors. The trade executives explained that the traditional distributors incur costs for facilities and developing sales networks. In addition, they also bear the cost of advertising and promotion, which also directly benefits the e-commerce channel. Prices are necessarily different.

> "The big challenge in differing sales channel prices is the growing use of reference price databases."

One global trade executive explained that the same trend impacting business is impacting customs authorities — the availability of data. Authorities are able to quickly access data on imports of the same product conducted by different parties. Even when a situation in which pricing differentials should be easily explained, such as when an e-commerce sale directly to a consumer at retail price varies from a distributor's wholesale importation in bulk, questions arise. And when simply presented with two prices declared on import for an identical item, a common reaction by a customs official is to question why all imports were not at the higher price. Moreover, the databases assembled by a number of customs authorities are not accessible

by importers, and products referenced as "comparable" may have little more in common with the imported product than the HTS number. "The practice is growing, and it is a serious issue," concluded one executive.

## Rapidity of change

The need for flexibility and adaptability was acknowledged by the trade executives but was tempered by the magnitude of trade impact for seemingly minor business changes. "We have between 2,000 and 3,000 permits with a variety of government agencies that are tied to the importing or exporting entity," commented one executive. "When the business wants to make a change, who is going to take care of all of those?"

"Two key points drive these changes: having information and being able to ship goods anywhere in the world," stated one executive. Because the data set is always expanding, new and different models can generate quickly. Several executives noted the need to be involved in preliminary discussions of model adjustments. "Those conversations come up all the time," stated one executive. Finally, the change in models is not limited to issues on physical product flows. "Our biggest concern is technology transfer," commented one executive. Others added that cybersecurity concerns also become derivative of some model changes, requiring new and different types of issues for identification.

## Our point of view

"Changing" is not an accurate description of the state of distribution models. They are multiplying, with variations configured for specific situations. Channels can no longer be easily described as "e-commerce" or "distributors." Instead, there are variations material to trade compliance within each broad channel. Complexity is added by supply chain partners assuming different roles with different models and rules adapting to new business models. Trade executives must develop approaches that are flexible and adaptable to accommodate variation. At the same time, early involvement in discussions on models, and clear communications on the trade complications that may result from changes in those models, need to be a regular part of effective trade management.

The availability of data to regulatory authorities and how that data is used may be the most complicating factors that will impact businesses utilizing a variety of distribution channels. Notably, the use of valuation databases by customs administrations seems to be on the rise, and much of the anecdotal experience with these databases indicates that misuse is widespread. The International Chamber of Commerce recently issued a Policy Statement titled *The Misuse of Customs Valuation Databases,*[2] which discusses the increasing use of databases that seem to conflict with the requirements of the WTO Valuation Agreement and offers a series of recommendations to curtail the practices. In the context of multiple sales channels, which will invariably result in differing import values, the pricing variations will be readily apparent to the authorities. In this respect, the business need for multiple sales channels created by digital transformation seems to be on a collision course with the increasing availability of data from the digital transformation of government authorities.

[2] Document No. 104-81, *The Misues of Customs Valuation Databases*, October 2015, (accessed via http://iccwbo.org/News/Articles/2015/ICC-releases-statement-on-Misuse-of-Customs-Valuation-Databases/).

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