Global trade management: adapting to polycentric markets
The Ernst & Young Customs and International Trade 2011 Symposium Report
Globalization is projected to accelerate through 2014, but in markedly different ways than previously anticipated. Most notably, globalization does not mean uniformity across markets.
The World Trade Organization (WTO) reported a record-breaking 14.5% increase in global trade in 2010, returning trade to peak 2008 levels. Trade has continued to increase much faster than the general economy through 2011, and continued growth is expected. But while trade has returned, business is experiencing a very different dynamic across markets. The World Bank reports that the majority of developing countries have, or are close to, having regained full-capacity economic activity levels. Some markets, like China and India, are poised for double-digit growth. Growth in developed markets, such as the US and the European Union, is far more tentative.

The divergence in economic performance, and the resulting divergence in policy reactions from governments, is making global trade more complex. Business has to adapt to market-specific approaches at the same time that cross-border trade is expanding. The failure to-date of the WTO Doha Round adds to the complexity by encouraging bilateral or regional trade agreements rather than multilateral solutions. Executives managing the trade function are increasingly being called upon to effectively execute on multiple strategies simultaneously. And, they have to be able to adjust approaches quickly to mitigate emerging risks or take advantage of new opportunities.

This dynamic trade environment frames the background for the latest in a series of reports prepared by the Customs and International Trade practices of Ernst & Young's global network. Ernst & Young regularly invites select groups of key executives from wide-ranging industries to examine leading practices and evolving strategies of global trade departments. Each participant company is an established global trader, with import and export operations in multiple jurisdictions, and recognized as a leader in its industry. In a discussion format facilitated by Ernst & Young professionals from around the world, the executives provided their views on leading practices in the current dynamic environment.

Our Global trade management: adapting to polycentric markets report summarizes the findings and identifies leading practices from the Ernst & Young Customs and International Trade Symposium. We are confident you will find the report insightful and valuable to your organization.

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Introduction

For the past decade, Ernst & Young has assembled key executives responsible for international trade departments at multinational companies to examine leading practices in global trade management. Over the course of these studies, trade executives have reported pursuing a steady course towards demonstrably adding value to their companies through proactive management. Our reports summarize key measures and strategies employed by executives to attain regulatory compliance and avoid financial, business and personal risks. Among the leading practices shared, executives identified having a strong assessment and understanding of global trade risks, clear ownership of those risks within the company, documented processes and controls, global coordination and strong executive communication plans.
The 2009 economic crisis had an impact on trade management

The progression of trade management in 2009 appeared to directly align with the path reported in prior years, despite finding that businesses in 2009 were reshaping at a rapid pace as a result of the economic crisis. Business reported increasing emphasis on entry into new geographic markets, off-shoring of operations and being intensely focused on cash management. Trade was at the epicenter of much of the change, increasing challenges for trade executives and bringing in to focus the customs function’s impact on supply chain management.

Many corporate trade functions moved significantly forward toward global coordination and globally consistent processes. While the economic crisis did not change the primary goals of the trade function, it accelerated the emphasis on tying these goals to broader corporate initiatives and clearly demonstrating added value. There was a heightened importance of showing relevance: how can the trade function be relevant to the company? Leading practices were refined to better understand the direction of the business and align trade goals, metrics, objectives and resources to broader business goals and objectives. Prioritization to optimize alignment with larger corporate objectives was key. Executives predicted it would be increasingly important to execute, measure impact and communicate the value delivered by the trade function – beyond ensuring day-to-day compliance with rules and regulations.

A new dynamic in globalization

Two years later, the global landscape has changed yet again. Whereas 2009 involved significant reshaping of business operations, business is experiencing a new dynamic in globalization in 2011 – unbalanced and varied markets which demand a new flexibility in approach.

This new dynamic is the subject of a report authored by Ernst & Young and draws on research conducted by the Economist Intelligence Unit. Winning in a polycentric world: globalization and the changing world of business (November/December 2010) reports the results of a survey of 1,050 global business leaders worldwide, in-depth interviews with senior executives and high-level experts, and analysis of Globalization Index 2010 data – measuring the 60 largest countries by GDP according to their degree of globalization. The report identifies high-performing companies, those showing both profit and revenue growth, to evaluate growth strategies and tactics. Winning in a polycentric world reports a substantial shift in business approach that is underway, and expected to continue. Globalization is projected to accelerate through 2014, but in markedly different ways than previously anticipated. Most notably, globalization does not mean uniformity across markets. In the well-known book The World is Flat, Thomas Friedman argued that globalization was “flattening” the world – creating a level playing field of global competition where historical and geographical divisions are increasingly irrelevant. From the vantage point of our post-crisis world, recent survey results indicate that “flat world” theories now seem wide of the mark. Significant variances in growth rates are accentuating market differences rather than similarities.

The differences in economic growth – China and India are nearing double-digit growth, while the US is tentative, and Europe is struggling to sustain a recovery – are directly resulting in divergent government policies. Monetary policies are tightening in some developing markets, while stimulus spending is occurring in developed countries. Tax and regulatory policy is equally divergent. Never before have opportunities, or competition, been so widely dispersed but so unevenly distributed around the world.

Priorities for success in a polycentric world

The descriptive term “polycentric” refers to a globalized but diverse landscape. What that means for companies is that while opportunities and competition are more widespread around the world than ever before – markets are likely to differ in some fundamental ways. Consequently, a uniform approach by business to multiple markets is unlikely to yield the results of varied, polycentric approaches. Ernst & Young took responses from the Economist Survey and summarized those into four priorities for succeeding in a polycentric world.

- Redefine global and local
- Develop a polycentric approach to innovation
- Rethink relationships with government and tax administrations
- Build diverse leadership teams with strong global experience

Our 2011 report

Trade executives are squarely in the middle of this new dynamic; dealing with market variance and the resulting changes in corporate approach in multiple markets every day. Our 2011 symposium provided trade executives an opportunity to explore each of the Winning in a polycentric world success factors in the context of international trade. This report, as a companion to the broader corporate study, considers how this polycentric approach impacts international trade operations. ■
Workshop format

The 2011 symposium followed a facilitated workshop format. This report summarizes the discussion and highlights selected statements made by participants during the discussion; quotes, however, are not attributed to any individual. Opinions expressed are those of the individual participants and are not necessarily those of the organizations they represent.

**Industry**

- Pascal Dorel | Cisco Systems, Inc.
- Robert Basinski | CooperVision, Inc.
- Joffrey Decock | Daikin Europe N.V.
- Danny Lippens | Dole Europe Import
- Patricia Hall | General Electric Company
- Tony Huggett | GlaxoSmithKline plc
- Christine Miner | Johnson Controls, Inc.
- Roger McCracy | Momentive Specialty Chemicals, Inc.
- Beth Foster | Novartis Pharmaceuticals Corporation
- David Busam | Renault-Nissan Alliance
- Allard van Nes | Royal FrieslandCampina N.V.
- Scot McManus | Terex Corporation
- Lynn Barratt | The Walt Disney Company

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Chapter 1
Redefine global and local

Businesses today face a tension between the flattening effect of globalization and significant variation across global markets. Winning in a polycentric world describes the importance of redefining global and local:

“The need for local relevance across a growing number of key strategic markets is demanding a higher level of decentralization. But this alone is not enough. Unfettered autonomy for local managers will quickly lead to inefficiency and undermine the advantages of global scale. As a result, leading companies are adopting a more balanced approach whereby local autonomy is combined with globally consistent strategic direction, a shared corporate culture and set of values, and the ability to draw upon capabilities and resources from anywhere in the world.”

International trade executives are directly experiencing this dynamic.

Shifting corporate approach: global direction with local execution
Many participants reported a general corporate move away from the historic “centralize as much as possible” model. One executive remarked: “Our company has recognized that centralized management does not have all the details to make the best decisions. We are moving away from centralization as a push model.” Another noted her company moving towards a “hybrid” approach: “[share] a central structure, but let local businesses run their operations.” A third explained that her company was “looking at moving away from centralized decision-making, finding that it wants to localize more to have faster decisions and growth in emerging markets.”

This shift in corporate approach was uniformly welcomed by trade executives. Trade executives have long recognized that the customs function has a number of elements that are quite conducive to centralization, but some aspects are quintessentially local and need a certain degree of local presence. To this extent, trade executives are arguably ahead of the curve in developing strategies for effectively balancing global direction with local execution. One executive summarized: “We find the best of both worlds.”

Finding the right balance
Trade executives were clear that there is no single point of equilibrium between central and local control that has universal application, and in fact, the appropriate point of balance may vary from time to time. The executives agreed that the focus of centralization should be primarily on process: with the end-to-end process well defined, then the suitability of the process, or portions of the process, for centralization can be determined. “We always start with process,” stated one trade executive. “Once we have that defined, we look carefully at our approach to centralization to be sure it is additive. The whole has to bring more than the value of the individual parts.”

In those situations where business decisions are made to keep processes or parts of process local, centralized oversight enhance effectiveness. “We realize that

Descriptions used by trade executives to define global and local

- Centralized corporate governance
  - Approach and process
  - Validation, quality control, consistency and structure
  - Strategy and advice
  - Visibility, assessment and monitoring

- Local trade teams
  - Decisions and implementation
  - Information, culture, language
  - Entrepreneurial, virtual

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local operations are local,” stated one executive. “But we do determine KPIs and targets for local process, controls and strategies.” Another stated “local use of common platforms can be very effective.” Examples of common platforms included process and controls for bonded manufacturing operations in different countries, and processes for managing free trade agreement documentation requirements. In both cited examples, local rules controlled the detail, but there are significant consistencies among the rules that allow consistent frameworks with localized application. In fact, trade executives believed that effective centralization included ownership of the content of common controls, regardless of whether the execution of a particular control was deployed at a central or multiple locations, and regardless of the direct oversight and/or reporting line of the person executing the control.

The trade executives were cautious in limiting their comments to their own particular experiences. However, they were remarkably uniform in estimating the amount of centralization or use of standardized procedures that approximate a healthy balance: 70% centralized/standardized, and 30% local. “About 70% of the policies and processes are common everywhere,” one executive explained. “There may be some variance, even within a single company, as to how it actually gets done in a particular country, but that seems to be about the right split as to what effectively can be standardized.”

**Issues with broad consequences**

Any amount of decentralization increases the risk of inconsistent approaches in different locations. Sometimes local personnel may be unaware of broader consequences of particular actions taken. This is significant challenge for customs executives.
One executive defined his approach:

“We define things as ‘at site’ or ‘above site’ issues. At site issues are things that are of importance solely to the site, like properly preparing customs declarations. Above site issues can have a broader impact. We have to have visibility across the enterprise so we can assess the enterprise-wide consequence of above site issues. It is important that business understands when there can be above site impact, and keeps us informed.”

Executives agreed on the importance of this distinction and several supplied examples of above site issues that had been clearly communicated as such throughout their respective organizations. These included: decisions to request customs rulings, decisions on dutiability of royalties and communications with authorities on customs valuation/transfer pricing issues. These types of decisions, while possibly carrying duty-neutral consequences in one jurisdiction, could inadvertently have significant negative consequences in another. Executives added that consistency in these areas is paramount for effective management, and that country-specific deviations must be carefully evaluated.
Using an enterprise risk management framework to achieve balance

Many of the trade executives have aligned their approach to managing trade risk with corporate-wide enterprise risk management (ERM) initiatives. ERM goes beyond evaluating internal controls to address risk management on an enterprise level. Applied in both setting and executing on strategy, the process is designed to identify potential events that may affect the entity, while providing reasonable assurance of the achievement of entity objectives.

Many US companies have adopted the standard framework for internal controls for customs compliance, as U.S. Customs and Border Protection chose to model its audit approach on the standard internal controls framework more than a decade ago. The use of the ERM framework marks an evolution from the standard framework, which may be graphically depicted by comparing the traditional COSO internal controls framework with the COSO-ERM framework, as shown below.

Adoption of the ERM model with the added emphasis on strategy, objective setting, event identification and risk response, was identified as an effective approach for balancing the demands of a function which relies heavily on local execution. Discussion among the trade executives centered on the importance of risk assessment, monitoring and risk response in the trade environment. Trade executives uniformly believed that a robust, centrally managed risk assessment program was a leading practice. Even with strong communication protocols and metrics, executives reported loss of detailed visibility to potential risk without formalized risk assessment. Similarly, the trade executives own the responsibility for monitoring. Several had people specifically dedicated to monitoring or auditing the effectiveness of controls occurring at global locations.

Risk response, however, was the responsibility of the process owner, which is often the local team. “At a central level, we own the responsibility of assessing risk and providing the results and solution recommendations to the business” explained one executive, “but the business owns

COSO internal controls framework


COSO-ERM framework

the implementation.” Other executives agreed: “Other departments may own the fix, but we monitor and make sure the process is being improved.”

**Communicating with stakeholders**

The participating trade executives recognize that effectively operating in a polycentric environment requires understanding varying perspectives on relevance. “Trade isn’t the most important thing going on,” stated one executive discussing communications with stakeholders. “Bring a key risk or opportunity to the table – or preferably both.” Another executive emphasized the importance of opportunities: “Compliance follows profitability. If the business is not profitable, compliance spend is seen as a luxury.”

Trade executives commonly collaborate with cross-functional stakeholders and balance multiple spheres of influence within their organizations. Many trade executives are also experiencing new stakeholders and spheres of influence in all parts of the world. One executive summed it up: “I am always being pulled in multiple directions.”

Trade executives reiterated the findings in previous symposiums that it is important to understand the perspective of the audience and communicate in terms important to and understood by the particular stakeholder. They went on to describe how new stakeholders can create new perception issues. “It is always good to go back to the company vision and strategy,” commented one executive. “Think about your stakeholder as a customer...
Trade executives have proven remarkably adaptable to the demands of balancing global and local priorities.
and sell it. Now, people are totally engaged.” Another added, “a key part of our success has been the power of collaboration among people. We need to be able to encourage that.”

Stakeholder councils
Regular communications with key stakeholders is clearly a leading practice, and several companies had formalized this process by creating a committee, or council of stakeholders. While specific composition varied, the groups were cross functional and typically high level. “Ours is vice president and c-level positions,” noted one executive. “It is sponsored by the CFO.” He went on to add that the composition of the group dictates the agenda, and that with a high-level audience the agenda must be very focused.

The frequency and approach of the meetings varied. In one instance, the groups met in person twice annually. In other instances, they were regular monthly calls, and a single in-person meeting. Others reported a variety of combinations in between, such as quarterly meetings. Agendas were often supplemented with “at-a-glance” dash boards which summarized KPIs for the period, and allowed the agenda to focus on specific issues that required discussions and action.

The trade executives believe these stakeholder councils have proven to be effective, and anticipate even greater greater corporate focus on local relevance.

Change in approach to mergers and acquisitions
The business shift towards greater local influence can be particularly apparent in the approach business takes to mergers and acquisitions. A number of the participating trade executives have experienced recent merger or acquisition activity. “Our company has grown largely through acquisition,” commented one executive, “and our corporate culture is to allow those businesses to remain semi-autonomous in many respects, with finance and tax being primary exceptions.” He went on to comment that since customs involves both tax and operations, he is always dealing with multiple stakeholders.

Rather than having a post-merger integration plan, one executive described building a “convergence matrix” to blend the best attributes of two organizations. “We capture current activities, and ideally where we all want to be. From there we create a gap analysis and road map to future state.” Using this approach recognizes the need to be flexible and adaptable, without compromise of fundamental goals, directly considering the increasing emphasis on local relevance. He went on to add: “IT is a critical partner in this exercise. This is the ideal time to automate and build scale.”

Other executives agreed that the current environment requires a more open look at how goals are best accomplished, rather than “bringing the target into the fold.” “We tend to think of ourselves as more advanced than target companies,” commented one executive, “and we often are. But in the case of our recent acquisitions of [target] we found that they did some things really well, and [we] learned a lot from them.”

Our point of view
Trade executives have proven remarkably adaptable to the demands of balancing global and local priorities. They recognize the benefit of scale, but are selective about application. “Centralization” for many of the trade executives could be accomplished through the deployment of standardized processes for execution by local personnel. It was not necessary that the process be executed in one place or by a team that the executive directly controls, although when additive to the efficiency or effectiveness of the process, that view was advocated.

The respondents were also very aligned on thoughts as to what types of activities were conducive to centralization and standardization. Their focus on process, and appreciation for variance in local rules, undoubtedly added to their confidence in understanding how competing demands are best balanced. While many of the executives acknowledged that their own companies had not yet achieved ideal balance, they know where they are going, and why. ■
Chapter 2
Develop a polycentric approach to innovation

The second element of success identified in *Winning in a polycentric world* is to develop a polycentric approach to innovation.

“Rather than innovate centrally, then adapt or defeature products to suit different price points, companies are increasingly decentralizing the innovation process and setting up multiple innovation hubs in key strategic markets. Products, processes or components are developed primarily with local markets in mind, but re-applied when appropriate in other markets. An open approach to innovation helps to facilitate the transfer of ideas and innovations.”

This trend has two very distinct impacts on the customs function: the developments of centers of excellence and the increasing significance of free trade agreements.

**Centers of excellence**
Developing a polycentric approach to innovation means recognizing expertise and autonomy in multiple locations throughout the world. *Winning in a polycentric world* quotes Navi Radjou, Executive Director of the Centre for India & Global Business at the Cambridge Judge Business School:

“In the polycentric model, you accept the fact that there are multiple centers of excellence around the world. The key point is to know which center is good at what. Then you bring them together into a global network.”

The participating trade executives reported extensive use of the centers of excellence concept.

**Flexibility**
“One of the great things about COEs,” commented one executive, “is that they aren’t expected to be the same. Different staffing, different focus – it is all OK.” “Our company has 12 COEs,” stated another executive, “with size ranging from 1 to 20 people.” The flexibility was significantly appreciated by the trade executives. Centers of excellence could be created to support centralization of resources for a subject (like classification or origin management) to provide broader support of regional teams or for special initiatives.
Finding synergy

Centers of excellence do not just appear; there is
cognizant effort to identify those areas that can benefit
from this approach. One executive cited a cross-functional
working team established at his company with the goal
of identifying corporate synergies amidst an integration
of two Global 1000 companies. One corporate working
group was specifically established to find subject-matter
areas appropriate for shared services. Importantly, the
working group included people from multiple jurisdictions
around the world to realistically evaluate who in the global
organization was good at what – just as professor Radjou
referred. As a result of this exercise a shared service
center of excellence was created in a low-cost jurisdiction
specifically focused on harmonized tariff classification.
The team was co-located with engineers and technical
data. The executive commented: “We kept the same
FTE count, just spread differently. We replaced part
of a person here and there, dabbling [in classification]
with more expertise and more consistency.”

Another executive reported that his business was in
the process of developing a center of excellence to
determine and maintain master data for transactional
reporting throughout North America, including tariff
classification, country of origin, export classification and
other regulatory data. The goal is to compile the data
comprehensively at the earliest possible stage for each
business unit, for example, at production planning or
purchase order creation. A key element to success is the
deployment of standardized global product taxonomy,
which provides better information on new products and
makes classification less time consuming. “Our goal
will be to touch the process one time to get all the
necessary data.”

Defining scope

With the purpose of the center of excellence identified,
trade executives cautioned that scope and remit must be
carefully thought out. Determining “who is good at what”
can be a significant undertaking. At a certain level, the
WTO framework harmonizing trade rules can suggest a
fairly far reaching scope for a center of excellence that
is focused on subject matter. Several trade executives,
for example, highlighted experience with centralized
Customs classification centers of excellence that provided the six-digit HS for global consistency. When looking beyond six digits, however, practice varied. In some cases, local country teams were responsible to classify beyond that point. And, echoing *Winning in a polycentric world* comments about distance from activity, one executive noted that “the last digits needed the most technical detail, so we reverted back to having the part of the organization closest to the materials to provide the full classifications in their jurisdictions.”

**Protocols for centers of excellence**

In all cases, the centers of excellence followed specific working protocols and internal controls to achieve the connectivity, validation and approvals established at a centralized level. One example of a key internal control or checkpoint on the local completion of classification: no one in a local jurisdiction could seek a classification ruling without central trade management approval, so that an evaluation of global impact of that position could first be made. Another example raised during discussions was corporate trade management oversight ensuring that documented processes existed to classify all products before they entered commerce. The local team completed the classification, but in accordance with a process, timelines, tools and approach validated by the central organization.

Centers of excellence with a topical focus were not limited to classification. Several companies managed free trade agreement qualification in a center of excellence. Activities at these centers included solicitation of certificates of origin, validating origin data and determination of qualification of manufactured products. One executive noted a center of excellence that had been created around self-filing.

Uses of centers of excellence extended well beyond subject matter. Some businesses used the model to have better visibility and connectivity to activity in a region or at a specific business unit. “At the corporate level, we are adding boots on the ground, creating centers of excellence with people [located] around the world, alerting [corporate] to what is going on,” explained one executive. “With centralization, you get standardization, but you cannot see what is happening around the world.” A network of regional customs centers of excellence were the answer for this company. Others also referred to their centers of excellence as being broad in scope and subject matter, but limited to a region or business. “We are trying to create a European knowledge center,” stated one executive, “which will be able to support multiple businesses.”
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Free trade agreements
The development of multiple innovation hubs that target products for local markets has increased the number and diversity of specific product flows, or trade lanes. Manufacturing locations are expanding, but they are not making identical products for all destination markets. Sourcing changes are more frequent, and are often locally driven. While this by itself will be a challenge for a customs function, its significance is amplified by the potential applicability of free and preferential trade agreements (collectively referred to as FTAs) to reduce customs duties on both component parts and on finished products.

The WTO currently reports notifications of 380 active and pending regional trade agreements among members. That number does not include unilateral preference programs – trade preferences granted to products imported from identified countries without reciprocal benefit required, such as the generalized system of preferences in the EU and the US which provide duty-free treatment to many products from developing nations. Each agreement has distinct rules of origin, which condition qualification for the reduced customs duty rate on the extent of activity occurring in the country of manufacture, such as the amount of value added in the country of manufacture, the extent of change of tariff classification of imported materials or the specific manufacturing process undertaken. Moreover, for companies that sell products to governments, there is an additional set of rules. The eligibility of products for government procurement is typically defined by customs rules of origin, so that the ability to sell products to governments is also origin dependent.

Typically, each manufacturing process must be evaluated separately based on the FTA applicable to the destination country; products destined for multiple FTA locations generally require multiple evaluations. This requires strong internal controls and processes. Executives report a significant focus on establishing common procedures to determine or verify origin, and to establish processes to confirm an appropriate audit trail – with appropriate recognition that the requirements of each FTA must be separately considered. “One common element of FTAs is that enforcement is increasing,” reported one executive. “While customs authority may have previously been content seeing a certificate of origin, they are now asking for further evidence. We have to be prepared, and be able to go one level deeper.” Another concurred: “We need FTA benefits to be price-competitive, but the business often does not appreciate the complexity of the rules, so they assume qualification based on assembly location. We need discipline here to overcome that.” The executives agree that they have been spending more time and effort in this area, and expect the trend to increase. One summed up: “These things are not self-executing.”

Strategic sourcing
Ideally, companies build consideration of FTAs into the procurement processes. As a number of executives pointed out, this involves more than determining the landed cost of alternatively sourced products. It also involves determining the impact of the source of an input on the FTA eligibility of the output. For example, a Chinese component part imported into Mexico might have a lower landed cost than a Mexican sourced part, but if the Chinese component detrimentally impacts NAFTA qualification, the overall combined landed cost of both the component part and the finished product might be higher. Executives pointed to a number of examples of tentative decisions to change sourcing for manufacturing components that would have ended up costing the company more. As a result, they are becoming more involved in the strategic aspects of sourcing. In some instances, this has been formalized. “The strategic importance of government procurement qualification is very important to our business,” stated one executive. “We have a specialized sales team dedicated to this sector, and have a customs
resources dedicated to the team.” The executives identified embedding FTA consideration into the procurement process as a leading practice.

The executives also pointed out that there is an important cost/benefit component to the decision to use FTAs. This includes evaluation of the internal costs necessary to support the process and compliance requirements to claim FTA duty rates. “FTAs are costly to maintain,” said one executive. “There are situations where establishing the required procedures for a particular agreement is not worth it.”

Corporate decisions to add or change manufacturing locations were cited as a prime example of an opportunity for strategic involvement of the customs function. “FTA eligibility will only be one factor, of course, but it is an important one.” One participant commended that it is important to think about the interaction of special programs when new plant location decisions are under consideration: “When you can be the first entrant into some locations, you can effectively raise tariff rates for competitors in addition to getting your own benefits. In Brazil, for example, you may be able to eliminate use of Ex-tarifário duty rates by competitors, since there will now be local production.”

**Automation and training**

Automation is clearly important to help manage complex supply chains with multiple FTA opportunities. But even companies with extensive automation had additional non-automated internal controls that bolstered the processes, and many reported extensive automation for some FTAs, but not all. A cited example of a non-automated control was careful coordination with procurement on supplier contractual terms around FTA qualification with some of the executives identifying additional benefits in requiring use of supplier portals to input FTA qualification and the use of punitive contractual provisions for inaccurate or late origin confirmations.
The particular approach to organization and segmentation of centers of excellence for the customs area is quite strategic.
Robust training in the area is also a leading practice. Training efforts by these executives were extensive and reached beyond customs personnel to others in the company and to suppliers. Particularly with enforcement increasing, helping procurement departments and suppliers understand what is required – and why – can close gaps in data. In industries which are very FTA dependent, supplier training has become much more commonplace and the reported impact is positive. “[A large competitor] does a great job of training,” noted one executive, “and when they do we benefit too.”

Our point of view

The business trend toward increased reliance on centers of excellence is directly reflected among this group of customs executives. The particular approach to organization and segmentation of centers of excellence for the customs area is quite strategic. Some centers of excellence may be global, dedicated to classification, for example. Others may support regional process consistency or supply expertise where local markets are too small. Customs executives continue to be short on resources and the centers of excellence have been a creative solution to resource deployment, with the flexibility to adapt to specific needs.

A more diversified approach to innovation has created complexity for customs executives, but has also created an opportunity to demonstrate value to the business, particularly with FTA benefits. This was succinctly summarized by one executive: “It is where the risk is, and where the money is.” With the possibility of trade liberalization through the WTO Doha Round stalled, FTAs – along with the risks and opportunities for savings – will continue to grow. We anticipate more internal demand for customs resources to support FTA optimization, and also anticipate a greater reliance – and greater spend – on automation to help manage the increasingly complicated landscape.
Chapter 3
Rethink relationships with government and tax administrations

The third recommendation in *Winning in a polycentric world* is rethinking relationships with government and tax administrations.

“Government is playing a bigger role in business than at any time in living memory. This new dynamic requires companies to think carefully about how they engage with the public sector. On the other hand, there are new risks to be managed. Many governments are increasing taxes and stepping up tax enforcement. This requires companies to manage and anticipate potential risks on a global basis. But partnership with government also creates opportunities, particularly in emerging markets where a more top-down approach to managing the economy may be adopted.”

Nowhere is this partnership dynamic more developed than in interactions between the business community and customs. In addition to the general trend towards more interaction, customs administrations have for the past decade widely promoted voluntary “gold card” programs designed to provide importers with tangible supply chain benefits in exchange for taking more responsibility for customs compliance and supply chain security.

The advent of special programs
Beginning in late 2001, as a response to the September 11 terrorist attacks, the United States created a supply chain security program called the Customs-Trade Partnership Against Terrorism, (C-TPAT). C-TPAT is a voluntary program that provides benefits to importers and their supply chain partners in exchange for importers documenting and monitoring supply chain security.

Primary benefits to importers are reduced numbers of inspections by U.S. Customs, and priority processing for U.S. Customs inspections when possible. The program has been very successful and has grown to include nearly 10,000 private sector participants.

Shortly thereafter, U.S. Customs created two additional voluntary partnerships programs, Importer Self-Assessment (ISA) and Free and Secure Trade (FAST). Both programs require participation in C-TPAT. ISA is a voluntary trade facilitation partnership program for trade-compliant companies to assume responsibility for managing their own compliance in exchange for less oversight from customs authorities. FAST is a trusted shipper/traveler commercial clearance program for known low-risk shipments entering the US from Canada and Mexico. All three programs aim to provide benefits to participants in exchange for adherence to certain minimum standards so that U.S. Customs can focus on high-risk trade.

WCO framework: global expansion of SAFE framework
Building on the examples of C-TPAT, ISA and FAST, the World Customs Organization (WCO) adopted the SAFE Framework of Standards to secure and facilitate global trade (SAFE Framework) in 2005. The SAFE Framework has two pillars, Customs-to-Customs network arrangements and Customs-to-Business partnerships. The latter involves the creation of Authorized Economic Operator (AEO) programs, designed to improve supply chain security and facilitate trade for approved participants. To date, 162 of the 177 WCO members have expressed their intention to implement the SAFE Framework, with at least 13 AEO programs established in about 40 countries (including the 27 EU member states and the US programs referenced previously). Each AEO program is unique to its implementing country, but they all are share certain standards set forth in the
SAFE Framework, such as compliance with customs requirements; satisfactory management of commercial records; financial viability; consultation cooperation and communication; and education, training and awareness. The SAFE Framework also provides a foundation for the creation of a mutual recognition system, which may soon become the third pillar. Several AEO program countries have already signed mutual recognition agreements.

When and how to participate: the business case and return on investment

Each of our participating companies is involved in at least one formal partnership program with a customs administration. Many are involved in multiple programs, and many identified being an early adopter as a leading practice. “We want to influence how these programs will function,” said one executive. “The best way to do this is from the inside.”
While being an early adopter of special programs was identified as a leading practice, the participants also cautioned that each program must be carefully examined to determine when and how to participate. It is critical that business objectives are clearly defined and a business case for the program developed. The business case should present tangible expectations from, and cost of, the program. Expectations should be quantifiable so as to be measurable. Many have experienced pressure from customs administrations to participate in programs and caution against agreeing to participate without careful consideration. “Despite the rhetoric from Customs,” commented one executive, “the programs are not about patriotism, and not about apple pie. They are about reducing costs.”

Several participants noted that customs administrations could do a better job of promoting program benefits that provide business “better ammunition to work with.” One cited example was U.S. Customs ceasing publication of inspection rate differentials for C-TPAT members as compared to non-members. With these statistics, business could calculate the average of supply chain costs of non-participation in terms of supply chain delays for increased inspections. Without them, measurements are less certain and may be too “soft” for presentation to senior management. Other meaningful measurements have evolved from some programs. On the US-Mexico border, some participants are able to measure cost savings of participation in the FAST program in terms of trailers and drivers needed to transport daily production – the difference in delivery times for FAST participants allows drivers to make two trips across the border every day, while non-participants’ Customs clearance times limited them to a single trip. Another cited example was the measurement of cost, both internal and external, of undergoing a customs audit. One executive reported the cost of a U.S. Customs Focused Assessment in excess of US$1 million, despite the audit uncovering no significant issues. This became the baseline for different business units considering participation in the US ISA program.

The rationale for participation can vary quite a bit among programs. For example, most that have adopted AEO programs report doing so for the benefits provided importers. In contrast, one executive noted that his company’s rationale for participation in Japan’s AEO program was based on the benefits provided to exporters. “We do not import that much in Japan. We are in AEO in Japan specifically because it provides benefits to exporters.” The trade executives went on to emphasize the importance of local understanding of program requirements and the business case supporting participation.

Careful estimation should also be made of the effort to maintain each program, and several participants pointed to the “catch 22” aspect of some program requirements – program requirements changing to require additional time and effort from the participants after the programs are already in place. It is prudent to advise those unfamiliar with program details that they can and do change. “Monitoring program evolution” was cited as a leading practice. Regular dialogue with customs administrations as to changes under consideration can sometimes help influence the direction of some programs, although participants were quick to note that a number of programs have changed requirements with little advance notice.

**Collateral benefits**

The participants also identified a number of less tangible, collateral benefits from program participation. Consistent with the Winning in a polycentric world recommendation of focused efforts to understand agency time and direction, participants often found participation in customs partnership programs effective vehicles to “keep an ear to the ground.” In an environment where enforcement is on the rise, governments are searching for sources of revenue and protectionist measures adopted in the midst of the economic recession are still present, the additional line of communication with customs administrations can prove very valuable.
Participants also identified intangible benefits in building “positive brand identification” with customs administrations. “We have a brand image with government agencies just like we do with consumers,” stated one executive. “We participate in special programs to build the brand.” Another executive identified the “contingency planning” aspect as a program benefit. For example, US C-TPAT participation promises importers priority treatment in the event of a port closure. “It is hard to measure, but there is an element of business insurance in our participation,” stated the executive.

Profile and prestige of the department, and as a result, investment of resources, was identified as another key collateral benefit. “Once we establish that AEO was necessary for long-term strategy, we had to invest more in systems,” stated one executive. “Systems are important to success.” Another was more direct about the linkage between automation investment and special programs: “Programs are all about process, and automation is process.” All participants acknowledged that special program participation took time and effort to interact with both customs administrations and internal management; most thought the burden was well worth the effort. “This put us on the map. We became viewed as a team worthy of investment.”

Another reported collateral benefit was increased structure and discipline around the function, both in terms of internal controls and in choosing and measuring performance of supply chain partners. “Even though programs are not the same operationally, they are the same philosophically,” noted one executive. “A common element is internal controls.” Another stated: “AEO is a way of life. It is a philosophy with high standards. We live every day with these high standards, and there is added value to the company in operating this way.” Participants identified enhanced compliance as a collateral benefit of focusing on process and a documented audit trail, and noted special efforts to make this part of corporate culture which benefited all locations, regardless of participation in special programs.
Chapter 3 — Rethink relationships with government and tax administrations
Expected direction
Participants believe that programs are not just here to stay, but bound to expand. Consequently, they view it critically important to influence the direction of the programs in order to provide:

- Adoption in more countries
- More mutual recognition
- More convergence of requirements, making it easier for business to leverage internal controls and process
- Expansion of programs to include other governmental agencies that have some responsibility for imports along with customs, for example agencies regulating health, safety or the environment

Proactive interaction outside of formal programs
A trend of increased interaction is not at all limited to a framework of special programs; it extends to all forms of interactions with customs authorities. “Proactive interaction has been extremely valuable in developing markets,” stated one executive. “We have had great success with early dialogue.” Some executives reported that early dialogue with customs officials coupled with significant investment in a new market can provide benefits that may not be generally available to all importers. One example cited was establishing a “pilot program” for expedited processing. “You can define what the benefits can be if you are willing to go in and have an early dialogue,” stated one participant.

The executives explained the advantages of regular interaction with authorities. Building on earlier comments about using special programs to enhance the corporate brand, one commented: “Any interaction is about building the brand. Working with customs does not necessarily have to include a specific program. For years we kept our distance, now we are proactive, open and collaborative. It pays dividends.” Another stated that her company was investing heavily in centers of excellence specifically to help better engage with customs administrations on a consistent basis: “We expect this to be a game-changer in emerging markets around the world.”
There can be significant consequences to having a poor reputation with customs authorities. Participants were quick to point out that customs reputational risk differs from that of other types of taxes. While an ill-advised tax scheme can result in *Wall Street Journal* exposure, an ill-advised customs scheme can have significant and long-term reputational consequences, particularly in emerging markets; among them allegations of smuggling or violating anti-terrorism programs. “It would not be in my best interest,” mused an executive thinking of the statutory source of some US export control violations, “to have to explain to our Board that we have an issue with the ‘Trading with the Enemy Act.’”

As a result, the participants agreed that a leading practice is to leverage the framework and discipline of internal control-based special programs to general operations and to communicate the approach to customs administrations proactively. The resulting dialogue is reported as genuine and positive. Many view this as an evolution of the “proactive risk management” leading practice identified in our 2006 symposium report. Some participants went so far as to identify benefit in taking a proactive approach with auditors – explaining procedure and internal controls and attempting to work collaboratively. Others cautioned that the approach to auditors must be carefully determined and can vary substantially based on the jurisdiction involved.

**Influencing policy**

The dialogue initiated by the participants very clearly extends to administrative policies. With much of the focus on activity that is within the purview of customs administrations, much of the interaction falls on the trade executives, as opposed to being pursued by government affairs departments. In fact, one executive saw this as an opportunity to build corporate value: “We look to see who in our organization owns a particular government initiative. If no one, I will step up and own it.”

The participants are currently active in promoting initiatives for change that may apply to multiple customs administrations. The most frequently identified were: paperless entry, account-based management and coordination between governing agencies with jurisdiction over imports (e.g., environment and health and safety regulators, along with customs).
Global trade management: adapting to polycentric markets
Our point of view

Winning in a polycentric world concludes that the following are keys to effectively operate in the new environment with governments:

- Develop effective relationships
- Work closely and collaboratively
- Respond quickly and effectively to change

This approach is quite well developed with customs executives. Business is benefiting from active, strategic engagement with customs administrations worldwide.

The rise of formal partnership programs with customs administrations is clearly a driver. As business works to better harmonize program requirements and to work with authorities to implement mutual recognition agreements, the opportunity to leverage process and reduce program entry costs further encourages expanded participation. Yet, experienced global traders are cautious in commitment, discounting the hype surrounding special programs and requiring a clear value proposition before committing. The executives are quite cognizant of programs evolving and are carefully monitoring ongoing participation.

Outside the framework of special programs, strategic engagement is also viewed as a leading practice. Establishing ground rules with developing country traders do rely on local professionals for assistance, they are engaging authorities directly both to have first-hand experience with the dynamic of interaction and to “build the brand” of the importer.

Interaction has been focused on dealings with customs administrations on regulatory processes and procedures, rather than with legislators. This is in part due to the nature of the statutory scheme – primary customs legislation for valuation and classification is harmonized by the WTO, and WTO members have bound commitments on duty rate structures. Nevertheless, there are opportunities to achieve both process efficiencies and duty reductions through statutory as well as regulatory changes, and with the success achieved by leading global traders in strategic engagement with customs administrations, we see strategic lobbying as a logical next step.
Chapter 4
Build diverse leadership teams with strong global experience

The final attribute needed to succeed in a polycentric world is to build diverse leadership teams with strong global experience.

“The skills and capabilities that are required to succeed in fast-growing markets are different from those needed in more mature markets. While business success in developed markets has been recently rooted in process and efficiency, emerging markets demand experimentation, risk-taking and entrepreneurship. The need to balance these very different capabilities will require companies to rethink the balance and diversity of leadership teams. They must also ensure that they have the right talent management processes in place to develop a new generation of diverse business leaders with the vital combination of skills.”

Center of excellence personnel
As described earlier in this report, a number of trade executives reported establishing centers of excellence with a regional focus as a method for effectively managing a partially decentralized function. The centers of excellence allow for flexibility in market approach and skill sets, while continuing to embed a globally consistent strategic direction. “We provide tools and advice,” stated one executive following this process, “to be developed and refined locally.”

Recognition of differing skill sets by markets was high. “We need different skill sets in different places,” said one executive. “We need a more entrepreneurial mindset in emerging markets.” Finding the right mix of personnel continues to be a major challenge for trade executives. “Particularly in emerging markets,” noted one executive, “the skill set we are looking for is amazingly high. Besides customs knowledge, they have to be self-starters and understand how to build networks.”

The center of excellence concept is meant to be adaptable, and trade executives expect it will be continuously evolving and improving. The composition of teams is also expected to change with new developments and opportunities in markets. The executives did note that this also adds an element of new challenge, although understanding the dynamic of the centers was expected to go a long way towards effective management.

Virtual teams
Our 2009 symposium report noted a rise in the use of virtual teams. These teams included both company and outside resources, with out-of-market resources added to supplement local resources. Particularly in emerging markets where critical mass was difficult to develop or maintain, virtual teams were identified as a leading practice.

The 2011 symposium participants reported more developed and innovative uses of virtual teams. While the lack of resources in a particular market remains a primary reason for virtual teams, the flexibility provided utilizing virtual teams has expanded well beyond market-dedicated teams.

Two specific trends for expanded use of virtual teams were identified. First, several participants reported success with cross-jurisdictional teams assembled for particular initiatives, for example a team to explore advance planning initiatives or to establish internal control metrics. Similarly, several participants reported virtual teams assembled for a specific project, such as new country expansion.
A second major trend was the expansion of the teams to include personnel both inside and outside of the customs function. One executive characterized these as “situationally, rather than jurisdictionally.” Expansion of virtual teams to include personnel with the appropriate business background, even if for a temporary period of time, has proven very effective.

The importance of effectively utilizing virtual teams was emphasized by several participants. One noted: “This is a big untapped opportunity – potentially a game-changer for us.” While a key advantage to virtual teams is the flexibility, one participant reported institutionalizing the virtual team concept: “We effectively have some permanent virtual teams.”

**Mobility**

Global mobility was recognized as a catalyst for expanding diversity and global experience by *Winning in a polycentric world*. The customs executives also recognized the value in global mobility, but in practice mobility was infrequent. One company has made rotations of customs personnel a priority for a number of years and thought it “a great way to diversify experience and perspectives.” The practice had slowed, however, during the recession. Other participants faced more limitations. One stated: “We move people only when necessary. It is simply too expensive.”

Another factor that discouraged mobility was the lack of depth in the department; there was a feeling that movement might fill one hole, but create another. Additionally, participants cited the benefits of having local language capability to interact with authorities. Most participants believe global mobility would remain more aspirational than achievable, particularly in the near term.

**Diversity**

While mobility has not proved a practically effective avenue to building diverse teams with strong global experience, there is a clear effort among significant global traders to make diversity a priority. “We are investing in inclusion and diversity at all levels,” stated one executive. Because of the global nature of the customs function, the emphasis on diversity leads directly to a broader global experience and an appreciation of varying perspectives. Participants stated that this was quite important to developing effective common documents and policies. Failure to appreciate the variety of perspectives among those trying to assimilate and implement frameworks can cause a failure in intended results, even if the content is carefully planned. Differences in approaches
to implementation should also be considered, and can be a key to both effectiveness and efficiency. “When I talk to Americans, they think ‘very American,’” commented one European executive. “They often do not immediately recognize that they may be making some invalid assumptions.” Another executive added: “And in China, colleagues may have very different ideas from the Americans or the Europeans.”

The awareness level of the benefit of diversity is uniformly high. Participants are actively working to achieve a global perspective. “We are refining our message both from a cultural and risk management perspective,” stated one executive. “We simply have to be sensitive,” stated another, “and approach situations intelligently and thoughtfully.”
Appropriate talent management is a high priority the customs executives, especially those who are very clearly challenging norms and thinking about new and better ways to optimize human capital.

Our point of view

*Winning in a polycentric world* identified three practical techniques which can lead to benefit from diversity of perspectives and global experience:

- **Think differently:** collaborate in the face of uncertainty. Inclusive leaders collaborate imaginatively to tackle the challenges of our increasing global, volatile, uncertain, complex and ambiguous world.
- **Learn differently:** seek out different viewpoints and experiences. Immersion in a variety of perspectives and cultures is critical for the leaders and employees of tomorrow to compete globally.
- **Act differently:** sponsor people who are not like you. Unintended biases are so ingrained that leaders must make conscience efforts to not only recognize and overcome them, but also stretch the face of their leadership team.

Insightful trade executives are acting on each of these. They are keenly aware of different perspectives around the world and are actively working to leverage multiple perspectives to benefit the business. Misaligned or misunderstood expectations or communications can result in increased risk or missed opportunities, which further enhances the need for inclusiveness.

Trade executives are particularly innovative in this area. They are promoting centers of excellence, which allow consistency of guidance while cognizant of the need for local adaptation. Where critical mass does not exist, virtual teams are created, and this trend continues to expand to include broader groups of personnel, and for broader purposes. And while global mobility is not the norm, diversity is a priority and is being achieved.

There does appear to be a significant difference in thinking among global trade executives in 2011 compared to 2006. In 2006, trade executives reported that a centralized customs function with global responsibility...
was a leading practice, although they readily conceded that few organizations actually had achieved a centralized, global structure. In 2011, this is not viewed as optimal. Instead, recognition of differing needs in different markets has advanced the thinking. Perhaps this is a recognition that the environment has changed, and that the world has become more polycentric. Regardless of cause, it is clear that these leading customs executives are indeed thinking, learning and acting differently than just five years earlier.

Appropriate talent management is a high priority for the customs executives, especially those who are very clearly challenging norms and thinking about new and better ways to optimize human capital. One participant summarized: “Talent management may be our biggest opportunity. We have to develop the right skill set, right personnel, right training, and in the right place. We have to do this with a culture of inclusiveness and a cultural awareness. We have to. ”
Concluding thoughts

Our 2009 symposium report concluded that the biggest challenge for trade executives was effectively demonstrating relevance to the organization. To demonstrate relevance, trade executives were refining their own proactive management approaches in order to better align trade function goals with corporate strategy; they were also measuring and demonstrating achievement. The polycentric aspects of the world economy of 2011 did not change trade executives’ focus on aligning with strategy and measuring results, but it has changed the organizations’ perception of relevance. Local relevance, with potentially significant variance among markets, is increasingly recognized as critical to growth. Successful organizations balance the demands of local relevance with the benefits of global scale.

The participating trade executives report significant efforts to understand local relevance and to selectively add the benefits of global scale to find the right balance. They have adopted standardized processes with localization where needed, and with local execution in many instances. They have adapted to varying market needs with centers of excellence and virtual teams. They are actively building brand recognition with local authorities, both through the use of special partnership programs and independently. They are thinking and acting differently to take advantage of diversity of perspective and global experience.

If the trends identified in Winning in a polycentric world have become a permanent part of the global landscape, the need for trade executives to continue to adapt will intensify in the future. Divergent local priorities will put increasing pressures on trade departments to keep frameworks scalable yet locally adaptable. Measuring and demonstrating value in this environment will be particularly challenging as priorities may be viewed differently depending on perspective. Being viewed as relevant by multiple stakeholders in multiple markets creates an even greater challenge than that identified in 2009, a challenge that trade executives must master to be effective and efficient.
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