

# Overcoming **Classification** Obstacles



WHITE PAPER



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Classification remains a top challenge for trade professionals. As companies grow internationally, product classifications become more complex in terms of both people and process. Global team members may use different processes in order to reach a classification, resulting in discrepancies, incorrect duty payments, and noncompliance. Without the sharing of information across locations and geographies, companies may find huge disparities in how items are classified and the processes used for classifying.

In this white paper, we'll explore the common obstacles that companies face when classifying products and how you can streamline classification to create a repeatable process across the organization.

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### The Act of Classifying

The act of classifying products begins with the producer of the good, whether the good is a small raw material or a complex manufactured product. Before the supplier can ship a raw material to a manufacturer in another country for processing, or ship a finished good to a retailer or distributor, the product has to be classified at the 6-digit World Customs Organization (WCO) level and then at the country level. This identifies the product being moved with a standard description, unit of measure, value, etc., so that no matter which customs organization is reviewing the entry or exit of that product, everyone recognizes it as the same product. In some cases, the producer classifies the goods and relays their tariff numbers to their customers. In other business transactions, the manufacturer is responsible for supplying the customer with information about the product, so that the customer can classify the product.

Regardless of which arrangement is in place, the following questions should be answered when classifying a product:

- What is it?
- What is it made out of?
- What is the function?
- How is it used?
- What documentation (including drawings/specs, etc.) exist to support these answers?

Beyond those questions, what else is needed? You may need to consider the company that has to manufacture the finished good. What do they need to know in order to classify their finished good? Dealing with a large number of products, and even products with similar or related Harmonized Schedule (HS) numbers, can be difficult. Just a slight variation in classification can mean major differences in the duties that are paid.

The overall goal for companies is to streamline classification and create a repeatable process across all countries and divisions. By doing this, companies can create an efficient, consistent classification organization that directly and positively affects the bottom line.

Let's take a look at three of the most common classification challenges and discuss best practices for overcoming these obstacles without extending already overtaxed resources.



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## Obstacle 1 Keeping Up With Global Regulations

Around the world, government regulations are constantly changing. For example, in 2018, the United States updated the tariff schedule 270 times while Brazil updated 244 times. Imagine if your company was doing business in four countries, two of them being the United States and Brazil, and your job was to make sure that all the regulatory data needed for compliance was kept up-to-date. You would most likely spend 30-35 hours of your week just looking for updates, figuring out how those updates affect the company, and then communicating changes to everyone in the supply chain. This doesn't even account for the time you would spend when a country has two tariff schedules. A total of 52 countries have two tariff schedules in use today — one for import and one for export.

Furthermore, every 5 years, the WCO makes updates at the 6-digit level. The January 2017 update was issued as the sixth version of the HS since 1983. According to the WCO, 21 chapters were impacted, 220+ subheadings were added, and 88 subheadings were removed.

Keeping up with global regulations is more than just monitoring for changes and adding them to a spreadsheet. When a regulation changes, a company must quickly figure out how that change affects goods within its supply chain and make sure that all partners are aware of the change, so that reporting requirements are fulfilled and goods are not stopped at a border for noncompliance. The timely dissemination of information is paramount for trade compliance.



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## Obstacle 2 Managing Growth

When most companies launch new products or expand into other markets, the classification department is asked to classify and maintain more products without additional resources. Managing one product line could equal hundreds of individual products, along with country tariff information that must be kept up-to-date and shared across business units, locations, and the supply chain.

In addition to the increased volume of product classifications, you may be dealing with similar or related products, such as shirts in various sizes or candy in several flavors. So, instead of one classification for a shirt, you must keep up with multiple classification records for the same shirt but in different sizes.

What if someone doesn't realize that the classification information for the boy's shirt is different than the men's shirt, and when shipping the boy's shirt, they use the information for the men's shirt? Now there is a risk of incorrect duty payments and noncompliance with government regulations. Ultimately, you will be left with an unsatisfied customer when the order is not received on time — all because one small classification detail was overlooked due to an inefficient and manual classification process.

New product lines also frequently include goods regulated by agencies that require classification with additional data elements. The trade compliance team may now be required to identify and record data elements such as genus/species, harvest date, and permit numbers, which were not previously required. At a time of volume growth, these added challenges make staying compliant with manual processes very difficult.



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### Obstacle 3 Sharing Classification Data

In real estate, it’s all about location, location, location. When it comes to product classification, location can have a significant impact on your overall compliance and how streamlined your processes are.

As an example, let’s look at a company with multiple distribution centers that have the same products and product lines. In distribution center A, located in Seattle, Washington, USA, a product is classified as 8536200020, and at distribution center B, located in Southampton, United Kingdom, the same product is classified as 8538909999. And finally, in distribution center C, located in Mexico City, Mexico, the product is classified as 85389005.

Which classification is correct, and how did the same company determine three different classifications for the same product? The 6-digit classification level is usually a good place to start to find the answer to that question. This scenario can happen in any large corporation when product information isn’t being shared across the organization. When product information is stored in a centralized location, the entire supply chain can operate from a “single version of truth,” rather than various documents or excel versions.

### Best Practices in Product Classification

Managing global product classifications is much easier when you have the right tools and processes in place. Once the common obstacles are recognized and addressed, building a successful classification program is possible, especially when the following best practices are applied.

1. **Collaborate** – The first step is to set up standards that everyone should follow. When building your classification guidelines, look beyond just the classification team and talk with representatives from sourcing, shipping, and receiving, as well as representatives from the manufacturer/supplier. By bringing all those parties together, companies find common ground on which to build their classification process.
2. **Document** – The most important aspect of standardization is documenting how a good is classified and any product specifications, so that another team member responsible for trade in a different country can review the information and understand why a good was classified in a certain way. It is important that goods are not classified solely on the product description for several reasons, including the subjective nature of the descriptions and the fact that many companies have misleading descriptions for their products.
3. **Automate** – By automating the classification process, companies create a more streamlined process that allows for the accurate sharing of information across business units and geographical locations. Through automation, companies are able to run reviews of the data to find HS discrepancies at the 6-digit level and then standardize from that point. You can even use automated tools to manage tariff numbers that are about to or have recently changed, as well products classified with them. This allows you to proactively choose new classifications ahead of time.
4. **Share** – Once your classification guidelines are documented, it is important to share all product classifications across the supply chain so that the parties involved — importing, exporting, shipping, accounting, brokers, freight forwarders — have the correct classification for each product. Sharing that data through an online central repository is an excellent way to make sure that when updates are made, those updates are disseminated across the supply chain instantly.

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