



Exploring the unexplored: The hidden potential in Incoterms[®] rules

How CFOs can increase transparency and unlock cost savings in unexpected places: fresh perspectives on improving processes and technologies related to the Incoterms[®] rules for international trade

Sometimes value is hiding in plain sight. In order to uncover it, you might just need to focus on areas that have previously been neglected. A case in point is the hidden potential in Incoterms[®] rules, the well-established standardized definitions of commonly used shipping and trade terms devised by the International Chamber of Commerce (ICC). These terms are used in every area of commerce, but instead of scrutinizing the efficiency hidden in

many Incoterms[®]-related processes and technologies, we tend to just take them for granted. Often, it is unclear who actually “owns” Incoterms[®] oversight within an organization. And this despite the fact that there is considerable room for improvement and unforeseen paths to savings in this area if you only look close enough. Increasing transparency in this domain will enable companies to

exploit untapped potential. In this edition of Deloitte CFO Insights, we are recommending an innovative approach to improvements around Incoterms[®] and exploring what it takes for CFOs to make it happen – a timely subject given our current environment of economic concerns and supply chain disruptions as well as the fact that companies have already exhausted many of the available efficiency options. ➔

The current situation

Incoterms® rules are generally perceived as a logistics issue. Rightly so, as they determine three key elements of logistics between trading partners: what portion of the freight costs are paid for by the seller or buyer respectively, which party bears the risk at which point (e.g., in the event of damage or loss), and whether additional transport insurance should be mandatory. Equally, we are all well aware that logistics expenses eat up a large portion of revenue, while traditionally offering very little transparency as well as mostly opaque cost structures and allocations to specific customer and product groups. Logistics therefore represents an obvious area for efficiency gains from the perspective of Incoterms® rules, but the potential gains here are about much more than just logistics. Asset efficiency, operating margin, revenue growth and compliance are other key areas where we see huge potential. The trick is to look at both the value chain and the supply chain through the financial lens. In a multi-disciplinary task force, Deloitte asked experts from Tax & Legal,

Audit & Assurance, Financial Advisory, and Consulting to identify the most important levers, tools and benefits that will enable companies to take a streamlined end-to-end approach to optimization. These levers are particularly relevant for organizations from industries with high inbound and outbound volumes, such as manufacturers and retailers, especially those involved in cross-border multi-modal trade with packaged freight.

Due to COVID-19, many of these players have seen some of their freight costs explode. Large-scale cancellations of civilian flights, for instance, have dramatically reduced capacities for air cargo being coloaded. Even more pressingly, the negative implications for financing in the current economy have made improving working capital an existential priority for many companies – though they have already tapped out most of the traditional routes to improvement. In addition, the lack of transparency about logistics-related costs and profits makes it more difficult for companies to

implement needed adjustments to their product portfolio when critical changes arise in supply chains and demand, while true product profitabilities are not known. Multinational groups face additional challenges through the inconsistent use of Incoterms® rules, which can lead to a lack of transparency and additional reconciliation efforts. These are all areas where a fresh look at the potential related to Incoterms® rules may offer new opportunities. The time is particularly ripe for this approach: the Incoterms® rule set has just been updated for the next decade, and many companies are still in the process of aligning their procedures to the new rules. So why not make the most of the momentum and unlock a broad range of benefits on top?





New solutions around old concepts

Incoterms® rules, it has to be said, are not exactly a recent phenomenon. Established in 1936 and updated at regular intervals by the ICC, these standardized terms appear in 90 percent of sales and purchasing contracts in 120 countries across the globe¹. In practice, they are to be used in combination with a specified place descriptor. For example, take the term “FCA Seller’s Premises”, which implies – among many other things – that it is the buyer’s responsibility to pay for shipment of the goods from the seller’s premises to their destination.

However, these rules affect much more than the contractual obligations relating to logistics. They also directly influence important accounting and business processes, such as revenue & inventory recognition, consequently invoicing and invoice handling, tax exception allocation within drop shipments, mirroring the tax functional profile, yard & dock management and many other.

That gives them considerable bearing on a host of related technologies and functionalities: warehouse management systems (WMS), transport management software (TMS) and ERP systems, interfaces to carriers and freight forwarders, and track & trace technology. The devil is often in the details here. For instance, SAP Business Partner makes it difficult to designate many Incoterms® rules by

business partner, offering only a limited functionality for “Named Places”. Generally speaking, even though only a handful of different Incoterms® terms are defined per se, they provide for an almost infinite number of possible combinations and complications. There are around 25 main constellations, but once you factor in the specification of Named Places such as Port of Load, Port of Discharge and many others, that number of combinatoric options is infinite.

Through a detailed process and technology analysis, Deloitte experts have assembled a comprehensive catalogue of scenarios that can help individual organizations find relevant pathways to improvements. Before detailing some of these benefits in more depth, we would like to point out why we believe that Finance departments should take the lead in this process.

What’s in it for Finance?

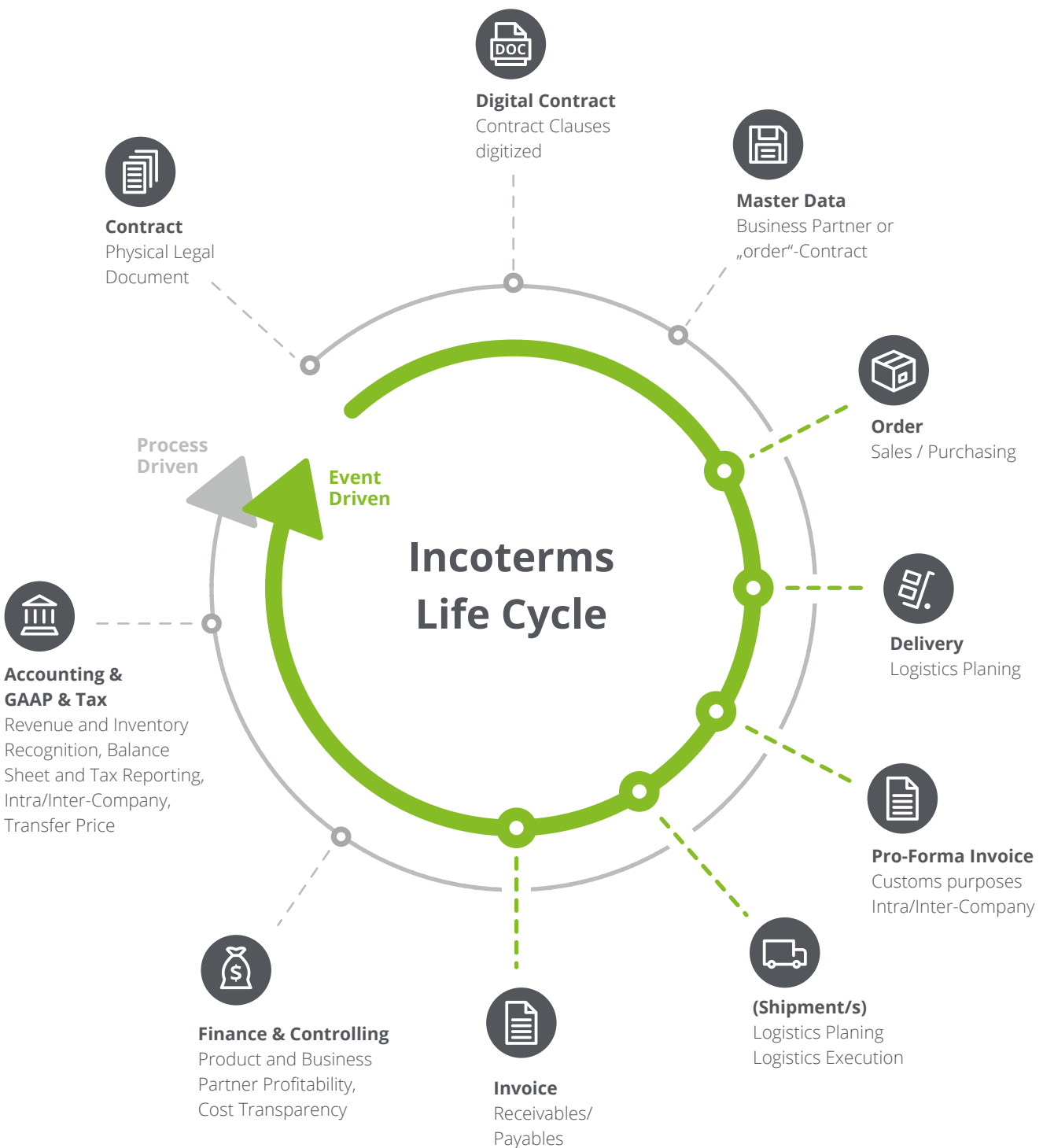
Deloitte’s analysis of the field shows that CFOs are best placed to realize the benefits around Incoterms® rules: by adopting a new holistic perspective, they can unlock hidden potential. Financial steering of the value chain can affect the logistic chain, including inbound as well as outbound, while the logistic chain acts as a significant driver for the value chain. On the financial steering side, it is possible to improve targets in the areas of asset efficiency, operating margin, revenue growth and compliance, including aspects such as

product & customer profitability, working capital management and risk management. On the logistics side, purchasing & inbound (COGS) and sales & outbound (SG&A) costs such as transport, import duties and tax, insurance and warehousing are at issue, among others. It is crucial to understand in this context that the Finance function is destined to act as an integrator between business and IT on the one hand and to bolster initiatives with comprehensive evaluations of the potential financial impacts on the other.

¹ For more details, see www.incoterms2020.de.

By changing the way you look at the processes related to Incoterms® rules, you can achieve benefits in a number of areas alongside the Incoterms Life Cycle:

Fig. 1 – Incoterms Life Cycle



Cashflow & Working Capital

Adopting measures related to Incoterms® rules helps to optimize inventory levels and billing procedures. You can screen the cash conversion cycle and improve rates in terms of Days Sales Outstanding (DSO), Days Payable Outstanding (DPO) and Days Inventory Outstanding (DIO). When you improve these processes, you can unlock efficiency savings and avoid losses due to lack of alignment with tax and revenue recognition.

Processes & Technology

Closing gaps between finance and logistics across parties increases process efficiency and data quality, e.g., based on payment terms or in- and outbound dock control. You can improve processes further with technologies such as IoT Track & Trace, RPA based contract screening, S/4HANA, WMS-ERP-TMS-Freight Forwarder integration, etc.

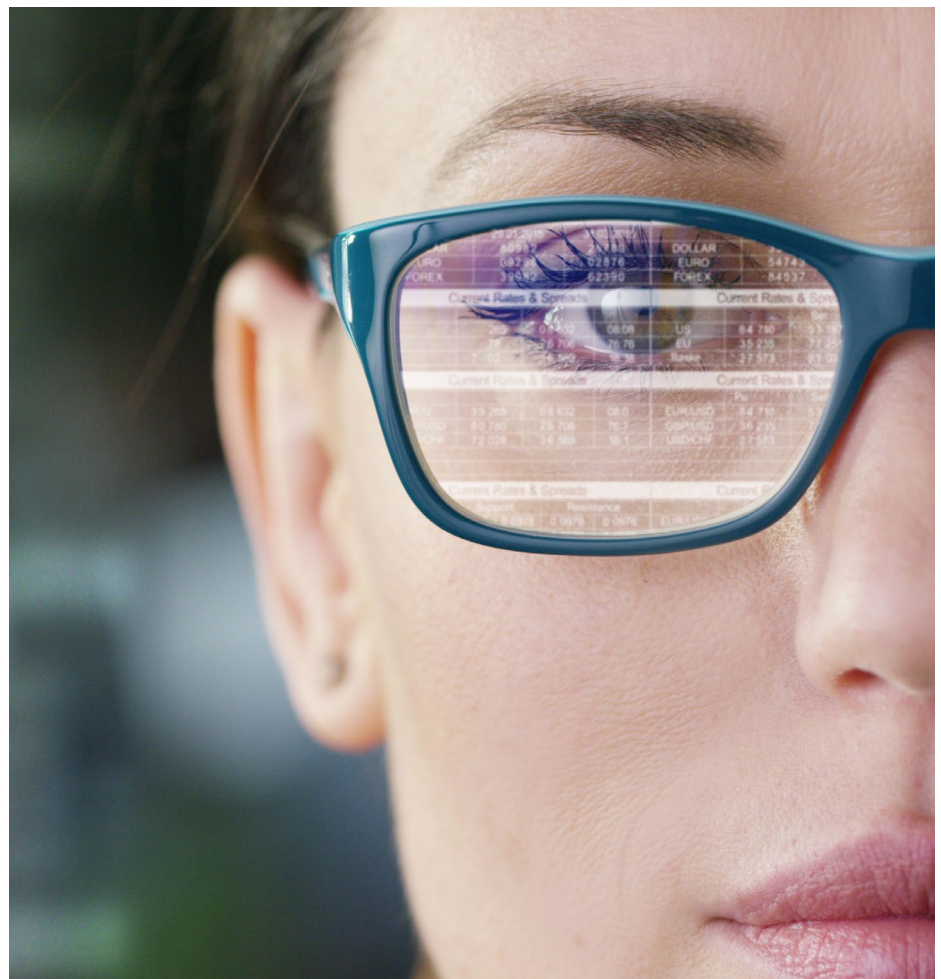
Tax & Global Trade Compliance

Aligning Incoterms® rules between business partners helps you to improve compliance and cost structures on tax side, e.g., with regard to relevant billing, tax point determination, drop shipment alignment, or even mirroring the tax functional profile (POC - Principal Operating Company) correctly.

Regarding the global trade side, compliance for both customs and export controls can be improved as well taking Incoterms® logic and their factual implementation into consideration with regard to one's own intended export responsibilities.

Controlling & Data Analytics

Analytics Improvements lead to heightened transparency around estimated and actual freight charges, enabling you to allocate costs based on cause (depending on your shipment strategy) and to enhance the results further by using optionally a Data Bionics Tool for better decision making.



Audit & Accounting

By adopting the recommended measures, you can ensure that inventory and revenue are both recognized correctly on the balance sheet (depending on Incoterms® rules and GAAP). Even better outcomes are possible if you combine revenue recognition modules with Track & Trace technology solutions.

Legal & Contracts Master Data

Boost transparency into your End to End processes. Make sure what has been negotiated is reflected along the entire Incoterms® Life Cycle. Integrate dynamically digital contract data and design digital legal processes compliant with international standards such as Incoterms®. Leverage your contract clauses, manage risk and compliance to bring benefits to your value and supply chain.

Vendor & Customer Assurance:

By improving your interfaces with 3rd parties, whether through automated or manual means, you reduce the costs of implementation and maintenance as well as optimizing data exchange between parties.

In practical terms: where to start

Thinking through the financial effects of practices around Incoterms® related Processes and Technologies, it is not exactly rocket science, but that is not to say the subject isn't still rather complex. It affects so many different players across functions and so many intricate details of trade terms that most companies will not even notice the potential they are missing out unless they look at it from an E2E angle.

The good news, as we mentioned above, is that your company is probably already updating the way you implement Incoterms® rules at the moment, due to the recent ICC update of the rules 2020. While you are at it, we recommend you grasp this opportunity to leverage the hidden potential around Incoterms® rules and unlock additional financial benefits that will definitely make a difference to your bottom line. But even if you already updated your Incoterms® rules

framework to the new version, your company is bound to benefit from a detailed look at options for improvement. You could start by asking a set of pertinent questions about how your company deals with Incoterms® rules:

- Do you have a governed process in place within your finance department regarding Incoterms® rules and changes of Incoterms® rules?
- Do you include actual freight costs in your purchase, sales and transfer prices?
- Do you factor Incoterms® rules into the VAT treatment of complex supply chains, e.g., in relation to drop shipments?
- Do you have multiple sales or purchase contracts in place with different Incoterms® determinations for individual business partners?

- And, perhaps most importantly, who owns Incoterms® management within your organization?

At first glance, the processes related to Incoterms® rules might appear to be a rather commonplace business issue. But once you dive in a little deeper seeking answers to these questions, you will realize that the huge potential for improvement makes them hidden champions of efficiency. In our current environment of economic uncertainty and increasing cost pressure, and in the midst of a routine upgrade of Incoterms® processes in many corporations, the time is right for CFOs to seize this opportunity.

Making it happen: Options and solutions from Deloitte's toolbox

What are the Incoterms® issues in your organization, what is the potential you could unleash by addressing them and how do you start out in practice? As a first step, consider establishing a touch point in order to create awareness of their vast impact within your company and a common understanding of the Incoterms® Life Cycle.

Deloitte experts have developed a concise format for this purpose – the remote I²PaT Lab (Incoterms® and the Improvement of related Processes and Technologies), facilitated with the innovative Greenhouse.

The second step is to take these insights to the next level, implement solutions and reap the rewards. For this, Deloitte experts recommend conducting a thorough health check to establish transparency, realize

end-to-end savings and benefits, and empower your staff. Deloitte's I²PaT Health Check does just that. This six to eight-week program consists of several steps: a rough and detailed analysis, interviews, systems data and processes validation, impact training and individual future outlook, including quick wins and future opportunities. Make sure you assemble a team of relevant cross-functional participants, provide sample data and enlist IT support for data processing – this will enable you to make a positive impact on P&L, working capital and compliance.

We also recommend considering a technical update of your existing ERP solution. Deloitte's I²PaT SAP solutions offer a set of fixes, including best practice customizing, which also opens up integration synergies beyond the supply chain towards finance and accounting.

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