MULTICHANNEL MERCHANT

OPERATIONS SPECIAL REPORT

Cross-Border Shipping: Overcoming Global Headwinds, Trade Issues

By Tim Parry

The global shipping landscape may go through at least one seismic shift soon, and merchants who do cross-border shipping need to brace themselves for the potential of a major change.

That's because of two geopolitical moves with the potential to impact the shipping world. Cross-border shippers need to be aware and create contingency plans.

With Theresa May out as the prime minister of Great Britain, the future of Brexit – the UK's exit from the European Union approved in a 2016 referendum – is up in the air. As it stands, the UK is slated to leave the EU in 2019, but May's departure made that outcome far from certain; an October vote is scheduled.

Then there's the Universal Postal Union. Claiming the United States can't compete in the cross-border ecommerce shipping game based on a deck stacked in favor of China, President Donald Trump has threatened to pull out of the UPU, a unit of the United Nations that sets postal rates among its 192-member countries. A UPU vote is planned for September.

"We're going into peak season with all of this stuff going on, and it couldn't be at a worse time for U.S. shippers," said Patrick Kelley, Executive Vice President of cross-border shipping services provider OSM Worldwide. "Businesses have to plan now for the worst case. They can't afford to wait until the fall to see how these votes go."

How should U.S. merchants prepare and react to major changes like these, and how can they quickly adjust their shipping and marketing plans?

At this point, Kelley says everyone is afraid to say because of the uncertainty about both outcomes – Brexit and the UPU membership.

"Research and reaching out to reputable partners to assist in the guidance is critical," Kelley said. "Also, knowing that your respective shipping partners have alternatives is key."

In this report we'll look at global issues affecting cross-border ecommerce shipping, how they could disrupt costs and routes, and how to prepare your business for worst-case scenarios.

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Potential Universal Postal Union Pullout by the U.S.

Trump has called out China, which has not seen its subsidized cross-border postal rates rise at the same pace as its growing economy. Under the current rules, the UPU sets lower rates for developing countries. But this has allowed Chinese merchants to ship a package from Beijing to Boise, for example, for less than the cost of shipping it from one U.S. city to another.

Gavin Macrae, founder and managing director of UK-based logistics consultancy Pine Monkey Associates, said China has an unfair advantage over many other member countries because the UPU still treats it as if it's a "developing economy." Macrae feels the UPU's rules are antiquated, harkening back to a world based more on letters and flats than small parcels, and thus haven't evolved to meet the realities of today's maturing ecommerce market.

This means Chinese ecommerce companies such as Alibaba and JD.com, and even San Francisco-based Wish.com, which has a large China-based selling community, can ship orders to the U.S. at a fraction of the cost of U.S. competitors targeting Chinese consumers – or even domestic ones.

Jim Okamura, a partner with retail consultancy McMillanDoolittle, says he's seen a trend of Chinese manufacturers ramping up production to sell and ship goods into the U.S. market. Okamura also sees more cross-border shippers taking a gamble by shipping items to the U.S. via delivery duty unpaid (DDU) instead of delivery duty paid (DDP) to avoid paying tariffs, thus risking unhappy customers stuck with the bill.

"The more cross-border ecommerce grows in volume, the more regulatory scrutiny we'll see," Okamura said.

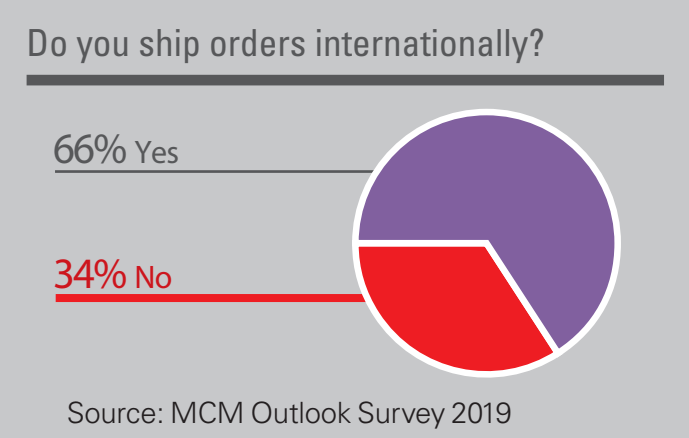
Many Chinese manufacturers and merchants also ship single item orders to the U.S. based on the relatively high di minimis rate of $800. That means any package shipped from China or any other country to the U.S. that's valued under $800 is not subject to duties and taxes.

"Like most companies we're trying to figure out what to do with new tariffs (against China) on something like apparel or winter goods that we make, and then we're facing increased importation costs."
Brian McAllister, Burton

Meanwhile, when a U.S. consumer buys from a U.S. merchant, the consumer is responsible for paying sales tax plus a higher shipping cost, which can make purchases from domestic merchants less attractive.

Those shipments from China to U.S. customers are also subsidized by the U.S. government and come at a loss to the U.S. Postal Service. Inbound cross-border shipping costs also dramatically undercut the likes of FedEx and UPS.

If the U.S. was to pull out of the UPU, it would be free to negotiate postal rates with individual countries. However, the September vote to pull out would need to receive a two-thirds vote by member countries. Macrae says that more-developed countries such as Canada are siding with the U.S., and Politico reports that Nordic countries Denmark, Sweden, Finland, Iceland and Norway, where Chinese ecommerce sites have grabbed a substantial market share, are strongly supporting a pullout.



Should the U.S.'s pullout plan from the UPU get the votes it needs from the Universal Postal Congress, the change would go into effect on January 1, 2020.

The downside to pulling out of the UPU, Macrae says, is the amount of work the U.S. would need to do to negotiate unilateral postal rates with each of the 192 member countries. He said the U.S. could choose to adopt the UPU's rates for some countries and renegotiate with China and others where Trump feels merchants have an unfair advantage.

Macrae notes that the threatened UPU pullout plays into Trump's protectionist trade stance. Should cross-border shipping rates climb, U.S. consumers would be less apt to buy from Chinese merchants. But Macrae also sees Trump's argument as a no-brainer, since the USPS is taking a big hit because the UPU's pricing structure predates the ecommerce boom.

At the National Postal Forum conference in the spring of 2019, Deputy Postmaster General and Chief Government Relations Officer Ron Stroman noted that the USPS is preparing the best it can for a potential UPU pullout by working with foreign posts on a contingency plan, but no formal details were released.

How would a UPU pullout affect international shipping by U.S. merchants? The positive effect would be to make it more expensive and thus harder for Chinese merchants to severely undercut domestic sellers by sending essentially the same goods to the U.S., often as counterfeits.

As for the potential impact on outbound cross-border shipments, a UPU pullout could mean an increase in the cost to ship to other countries, as they could see the benefits gained by U.S.-based merchants and follow suit.

While hundreds of U.S.-based retailers and brands ranging from American Eagle Outfitters to Home Depot and L.L. Bean have manufacturing facilities in China, they ship to their U.S. customers from domestic facilities. This is due to a general mistrust of goods originating from China.

For this same reason, millions of Chinese consumers buy baby products such as formula, diapers and car seats from U.S. merchants, because they believe the quality control and safety here is much better.

The Trade War with China

Brian McAllister, North American distribution manager for snowboard and outdoor gear and apparel retailer Burton, says U.S. brands that manufacture or distribute goods in China may be more worried about Trump's Chinese tariff threats than the pullout from the UPU.

Trump has already raised tariffs on certain products coming from China from 10% to 25% and is set to negotiate more tariffs in June. The National Retail Federation estimates that China supplies 42% of all apparel, 73% of household appliances, and 88% of toys sold in the U.S.

Most of Burton's goods are made in Asia, while a small portion of its snowboards are made in either Europe or the U.S. Getting its own products from China to its North American distribution center in Ohio could become costly.

"I think like most companies we're trying to figure out what to do with new tariffs on something like apparel or winter goods that we make, and then we're facing increased importation costs," McAllister said. "What do we do with that? Do we pass it on to the consumer? Do we eat the cost? Those types of things I think are our biggest challenges right now, more so than the way we distribute the product to consumers."

McAllister said tariffs could change the way Burton does business. It could ultimately mean limiting product selection because consumers only have a certain threshold for increased costs.

"Obviously we know we want to look at different ways to try to continue making those products," McAllister said. "But if it doesn't make sense to make them any more, then we may just have to have a smaller offering to remain profitable."

In its first-quarter 2019 earnings call, The Lovesac Company CEO Shawn Nelson said tariffs on Chinese-made goods is only a short-term "speed bump" for the furniture maker.

"We are on a straight path to exit China as a manufacturing source almost completely over the next 18 months," Nelson told investors and analysts. "We would prefer to see the tariffs be suspended and to keep the most efficient parts of our China supply chain intact to support our growth."

Brexit: In or Out?

While the U.S. is more in control of its destiny in China, it has little or no say in Brexit negotiations. Macrae said the current plan is for the UK to exit the EU in October, even without a free trade agreement.

If the UK can remain a part of the EU Customs Union, known as a soft Brexit, then the effects could be minimal for U.S. shippers. If it's told it must leave, that could open the door for the U.S. to negotiate a free trade agreement with the UK.

The positive impact could be for the U.S., Canada and other countries. A Brexit would allow the UK to establish unilateral free trade agreements. It could also establish its own di minimis and value-added tax (VAT) guidelines for other countries.

But based on U.S. history, Macrae says a free trade agreement between the U.S. and the UK may not come swiftly and quickly.

The UK could also be at a financial disadvantage if it misses out on free trade within the EU. The EU is moving toward a zero di minimis value with VAT applicable on everything. Sweden has already implemented this.

Tammy Niemier, director of international sales for OSM Worldwide, said Brexit would bring negative logistical impacts on the overall supply chain, including backups with ferries, channels, airports and sea and inland ports.

London's Heathrow Airport is the most popular entry point for shipping packages into Europe, so enactment of Brexit would have a major impact on U.S. retailers doing business in Europe. Again, if the UK remains in the EU Customs Union, then all bets are off.

If it does not, using Heathrow as a primary entry point for goods destined for Europe may become much more problematic, Niemier said. Packages passing through Heathrow to Europe would have to clear customs twice – once there and once at their final destination.

But that scenario may be better than the alternative, said Kai Li, who has worked in cross-border ecommerce roles at Amazon, Shopbop and Revolve. The alternative is to split shipments so that packages destined for the UK go to Heathrow and packages sent to the EU go to another airport, such as Amsterdam or Frankfurt. But Li says when the volume of packages is split into two destinations, the cost to ship will rise.

"Air cargo cost is based on the total volume and the total weight of the shipments," Li said. "The higher the weight is, the lower the cost per kilo or per weight unit it is. Now we're splitting the shipment, so the per-unit costs are going to go up significantly."

Not only that, Li said, but U.S. merchants will need two separate sorting centers and two local logistics facilities, one each in the UK and somewhere else in the EU. And if you also operate a returns center in the EU, you'll need to operate one in the UK as well. So those costs for U.S. merchants will more than likely rise by 20%.

Li believes most U.S. retailers that do business in the EU have already put their Brexit plans in place by moving operations from the UK to somewhere else in Europe. Setting up logistics centers takes time, which is why most have already made Brexit plans of their own. Also, the merchants that did their VAT registration in the UK needed the time to register for VAT in the EU country they now call home.

Okamura said U.S. merchants should not have a knee-jerk reaction and ramp up omnichannel in the countries they do business in. If retailers already have an omnichannel plan in place, that's great, he said, but doing so as a quick fix to avoid the impact is not advisable.

Burton's McAllister thinks there will be a lot of business changes around Brexit and how his company services its UK customers.

"We would probably be servicing them more like a country like Switzerland, where we've got a cross-border implementation in place," McAllister said. "We will have to really think about how we get there with the higher costs, tariffs, taxes, all those things."