3 STEPS TO

NAVIGATING UNCHARTED TARIFFS TERRITORY

INSIGHT2PROFIT
THE B2B PRICE & PROFIT EXPERTS

Tariffs are here. Their impact figures prominently into the strategy and financial outcomes of companies across many industries and segments. It's imperative to understand the tactical choices and trade-offs that will dictate how they impact your business and customers.

The following pages provide a three-step roadmap for navigating uncharted tariffs territory:

1. **Understand your options.**
2. **Decide on a path forward.**
3. **Execute both well and quickly.**

1 **Step One:** Understanding Tariffs and the Challenges/Opportunities They Create

The structure and details of your existing relationships with vendors and customers, your position within your industry value chain, your revenue and cost frameworks, your systems and processes, and your transactional terms and conditions will factor into the options that work best for you. Prior to choosing the best option, you need to understand the set of options from which you are choosing and their underlying context. A bit of background:

- **Importers pay for tariffs (that is you).** Because trade policy has political ramifications, there are many assumptions regarding tariffs floating around that can obfuscate how they work. Effectively, import tariffs are taxes on goods and services brought into a country (export tariffs are much rarer). The tariff is almost always paid by the importer to the customs authority in question. For instance, in the U.S., Customs and Border Protection collects import tariffs on behalf of the Commerce Department. If your company imports a tariff-impacted good, you are the importer and you pay this extra charge. The government and/or citizens of the country on which the tariff is being imposed do not pay the tariff fees, despite this misconception by some.
- **The primary types of import tariffs are:**
    - fixed fee, such as $20 for each pair of shoes imported, regardless of value
    - ad valorem (Latin for "according to value"), which is a percentage of value, such as 10% on steel imports
    - import quotes/licenses, which restrict how much can be imported
    - local content requirements that stipulate the percentage source of imported goods, such as a need to have 33% domestic content for imported passenger vehicles.

  These different types of tariffs have vastly different financial impacts on a given portfolio of imported goods.
- **Tariffs have high visibility.** Some costs to serve are unknown to your customers, such as the detailed cost drivers in your manufacturing plants or the salaries, benefits and productivity levels of your employees. Tariffs are much more transparent, which is good insomuch as it sets the expectation and provides the justification to your customers of higher prices. However, a pass-through of tariff dollars that is too clumsy and obvious provides de facto visibility to your unit costs. Passing through costs too exactly also promotes a cost-plus mentality within your organization, undermining value selling.

- **Tariff changes are announced before they are implemented, creating a unique window.** For physical goods that can be purchased ahead of demand and do not have a risk of obsolescence, buying forward to lock in a lower cost of goods can be a good use of working capital. However, be mindful of when tariffs will become effective and ensure that pre-buy purchases will enjoy the pre-tariff cost before acting. This could involve coordination with your Legal and Supply-Chain teams. If such quick supply-side action gives you disproportionate relief from announced tariffs in the short-term, this is a profit-taking opportunity that should still be passed along to customers as a price increase. Act based on replacement cost of inventory (which would carry tariff), not the cost of physical inventory on your shelf.
- **Tariffs are a policy choice.** Just as current tariffs did not exist a few months ago, they could soon change. This argues for two actions:
  - Each instance of a tariff change, up or down, represents an opportunity for those able and willing to act quickly. The ability to change prices flexibly and quickly at the customer-product level is critical. If the processes, training, systems and other enablers necessary for that capability are not currently in place, it is wise to make that investment now.
  - Given that tariffs are a governmental choice, we recommend that you petition your government to reduce, remove or create exclusions for the tariffs impacting you and your customers. This can be done directly or in concert with trade associations. To be clear, this is not advocacy of political position. Instead it is a pursuit of cost minimization, much as you would do in any other cost category. Doing so has two benefits. First, if you are successful, then you enjoy margin gains. Second, it is important to describe to customers the actions you are taking to minimize tariff impacts for them. Acting as a true partner in working toward your customers' success is critical when asking them for more price.

2 Step Two: Choose a Path

Each situation is unique, but there are some recurring themes that will help you in each of the primary decision areas as you respond to tariffs.

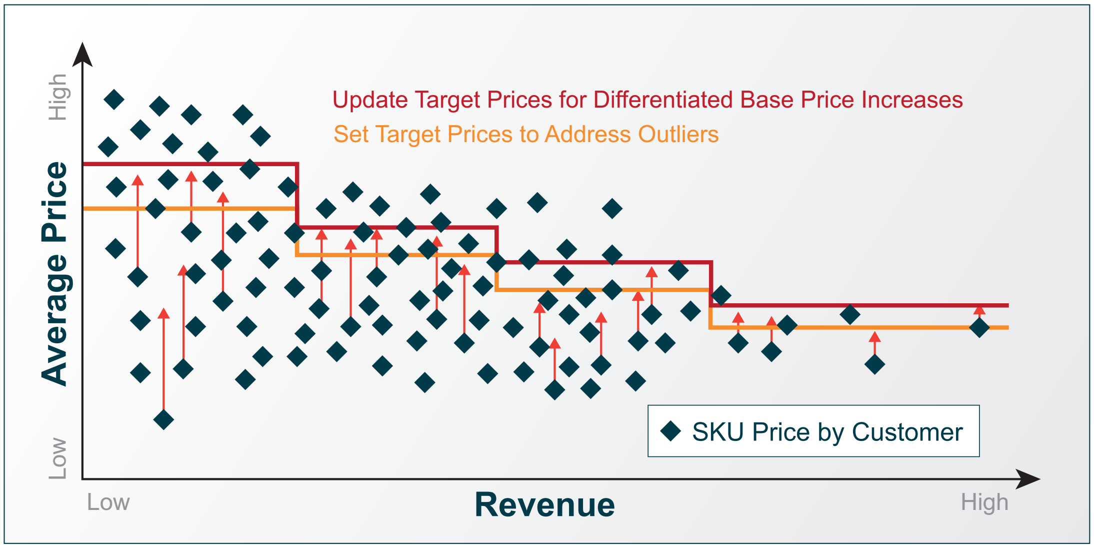
- **Clearly define the financial intention.** We recommend a tariff response that leaves you with the same margin rate, at a minimum. Further, you should seek out and capture opportunistic profit taking where possible. The decision-makers within the business must be clear about the goal if you hope to develop a plan to succeed — this is not a time for broad discretion by each individual functional team. The organization owes those teams clarity: Are you looking to break even? On a cash or rate basis? Are you asking supply partners to absorb a stated percentage of the burden and for customers to take the rest? If you want to be opportunistic and take additional profit under the aegis of tariff increases, then you should state how much and via which avenues.
- **Tariff pass-through should mitigate cost transparency.** While candor and transparency have their place in healthy customer partnerships, proprietary details of your transactional costs should be closely held.
  - **Importing distributors:** Those importing named tariff goods (e.g. raw steel) are most in danger of exposing their individual cost of goods sold when passing through tariff costs. Distributors importing goods not named in the tariff but whose cost is impacted by goods that are named (e.g. hiking boots with a steel shank support) benefit from limited visibility in terms of how the tariff impacts their overall cost structure.
  - **Importing manufacturers:** Generally, manufacturers have raw material and component level exposure to tariffs, but those input costs compete with other value-added costs that insulate any tariff pass-through from excessive cost transparency to customers.
  - **Two scenarios:** For a named tariff good, in one case you pass through the tariff dollar value, and in another you pass through a margin rate neutral amount:

Scenario	Before Unit Cost	Before Unit Price	Before Margin Dollar/Rate	Tariff Rate	After Unit Cost	After Unit Price	After Margin Dollar/Rate
Zero Cash Margin Impact	$8.00	$10.00		10%	$8.80	$10.80	
Zero Margin Rate Impact	$8.00	$10.00		10%	$8.80	$11.00	

How you define “passing through” matters. When costs are rising, flat margin rates result in more profit than flat cash margin. Regardless of the method used, if you communicate to customers that you are merely passing through the tariffs, then you are giving them relatively precise intelligence regarding your $8.00 cost of goods, if they decide to do the simple math. This is true whether you execute the increase within the unit price itself or as a surcharge. This is yet another reason to combine tariff justifications for price changes with broader value and cost-to-serve talking points to avoid a strict cost-plus conversation with customers.

- **Examine the pros and cons of surcharge versus unit price change.**
  - **Speed:** We have mentioned and will continue to emphasize the importance of speed. If systems and processes are set up to accommodate surcharges, then it might be the fastest method to counteract tariffs. For distributors — who sometimes have 30-day or greater price change notices they must provide, have priced catalogs in the field, or otherwise operate in a world that requires more price certainty within certain windows — a surcharge can sometimes circumvent such constraints (e.g. as with fuel surcharges, which can be exceptions to such rules). Even beyond such cases, those organizations that use surcharges and are set up to manage them will find them to be a quicker lever to pull than changing individual prices at the customer or customer-product level.
  - **Stability:** There is no guarantee tariffs will not change over the months and quarters ahead. A surcharge that sits apart from the unit price can be adjusted frequently while maintaining relative stability in the headline unit price observed by the customer. For some businesses, this is important and more palatable to customers.
  - **Communication:** Surcharges, especially when flat, are easier to explain. A clean, repeatable communication plan and supporting materials can be crafted and shared internally and externally that largely side-step account- or situation-specific narratives. The communication plan demands more complexity when changing individual customer-product prices but can still be executed well with appropriate commitment and effort. Much like duration considerations, easier does not mean better. Significant benefits accrue when managing price changes at the customer-product level.
  - **Differentiation:** Often processes and systems are not set up to support differentiated surcharges, so the choice of using a surcharge can lock you into an across-the-board tariff-related price increase. In other words, you cannot give one customer-product combination a 10% surcharge and another a 12% surcharge. This matters because many of the aforementioned profit-taking opportunities we observe are targeted on particular customers or

customer-product combinations that are low-priced outliers. A tariff-justified increase is an opportunity to capture extra price in these situations to bring them more into line, but it does require a differentiated price change approach. As illustrated in the graphic below, bringing price outliers closer to a target level requires different treatment than for those already at or above the target. The desire to differentiate argues for rolling the tariff response into the unit price, versus a standard surcharge.



- **Revenue-based cost-to-serve drivers:** Revenue-driven volume discounts, rebates, customer tiering, commission plans, and other financially relevant programs can be compromised by the step-function price increases that tariffs impose. A customer that needs to buy 100k units to reach $1M in sales and earn a 3% rebate will need only 91k units to reach the same discount if you implement a tariff-inspired 10% unit price increase. Does this still make sense for the business? How are the rebate terms and conditions worded? Can surcharges be carved out in a way that unit price revenue cannot? This could impact how you want to implement tariff-based price increases, considering the detailed cost and revenue frameworks you have in place with suppliers, customers and team members. Tariff-related price changes can materially impact that calculus, and implementation choices should take such factors into account.

3 **Step Three:** Implement Your Plan

When addressing impending tariff increases, a “plenty good enough” plan implemented with focus and speed is better than a slightly better plan stuck in a cycle of ongoing debate, internal vetting and minor adjustments that delay action. Quickly decide upon viable options and plans from Step Two, and then get on with it. We cannot overemphasize the importance of speed and timing. Worth repeating: think replacement cost and do not take solace in the fact that the inventory you currently have is at pre-tariff cost. To replace that inventory you will need to pay a post-tariff cost.

- **Decide upon the approach.** Are you holding steady or attempting incremental margin gains? Are you executing via a surcharge or price increase? Should you change any supply sources or pursue price relief from suppliers? When are you communicating? When are you implementing with customers?
- **Communication and action:** Get all stakeholders and actors aligned on the organizational priority.
  - Communicate internally regarding expected financial outcome; quantify if you are targeting an up, down or flat margin rate or cash margin on impacted imports.
  - Stipulate how you plan to achieve the financial outcome, such as share to be borne by cost concessions from suppliers and price increases to customers.
  - Be clear about whether every supplier or customer will receive equivalent targets or whether the approach will be differentiated, and on what basis.
  - Include specific expectations regarding timing and the process to handle and escalate exceptions that supply and/or sales groups believe are justified.
  - Craft external communications with key messages and talking points centrally. They can be delivered with case-specific points of emphasis and additional commentary by the teams closer to those suppliers and customers, but there should be a single and consistent message to external audiences.
  - Set up measurement and reporting processes that will provide visibility to all levels regarding performance against plan.

> Tariffs are a specific type of cost increase, but a cost increase nonetheless. You manage through cost increases frequently, so there is nothing to fear if you have an understanding of available options, clarity on which options you are choosing and why, and a robust plan to implement. This is an opportunity to remind customers about your value proposition and to increase prices under the cover of highly visible tariff increases, protecting and enhancing margins in the process.

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