

Managing Your Supply Chain: Accurately Calculating Total Landed Costs

Calculating the total landed cost of materials and finished goods arriving from offshore sources is not always an easy task. Though this fundamental aspect of supply chain management is very important, too many businesses rely on shoddy guesswork that often leads to failed ventures. To safeguard your investments it is helpful to use a landed cost calculation model that accurately projects the total cost of sourcing materials from start to finish.

Why Calculate Landed Costs?

When shopping around for new suppliers, it is tempting to sign a contract with the cheapest source available. However, smart manufacturers never take the purchase price of a material at face value. Additional costs are hidden everywhere - insurance, shipping fees, customs expenses, and other variables quickly add up. Without a way to predict the total landed cost of materials, you are taking an enormous risk that can lose you a lot of money.

Consider the following real-world scenario:

A U.S.-based retailer is selling porcelain tile to its customers for \$1.95 per square foot. Seeking to extend their profit margin, the retailer requests price quotes from suppliers in China. Several respond and one is offering the tile at a bargain rate of 75 cents per square foot. The retailer quickly places an order for 7,000 square feet.

Upon receipt of the tile at their warehouse, total landed costs have accumulated to a point where the venture is deemed a failure:

Invoiced purchase price:	\$5,250
Shipping fees and duties:	\$4,900
Domestic delivery cost:	\$2,000
USDA examination & x-rays:	\$900
Storage container:	\$1,500
Total:	\$14,550
Total landed cost per square foot:	\$2.07

This example shows the types of unforeseen costs that can quickly add up and increase the total delivered cost of your imports. Without a formula that accounts for these costs before the purchase is made, you may end up with material that you now must use or sell at a loss.

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Common Import Expense Categories

Although your total landed cost can be influenced by a wide range of factors, there are some common fees that you can expect and plan for. These costs typically fall into one of five different categories. Use this breakdown to run a detailed inventory of your operation and see what expenses your landed cost model is missing:

1. **Purchase price.** This is the base price you are paying for the materials or goods you are sourcing. Keep in mind that not even the purchase price remains completely static - it may change due to exchange rates or under certain conditions outlined in the payment terms you agree to. Various banking fees also apply.
2. **Transportation and logistics.** Transportation costs include both foreign and domestic inland shipping fees, as well as the direct line haul cost. Also pay attention to packaging, insurance, broker fees, and any other miscellaneous logistics expenses.
3. **Customs.** These costs include customs inspections, broker fees, tariff rates, harbor fees, and the merchandise processing fee (MPF). If your imported goods are going to be re-exported or used in the manufacture of exported goods, you may be able to save money through duty drawback.
4. **Overhead and administration.** Overhead and administration costs are often overlooked or unaccounted for when calculating total landed cost. Things like adjusting to a relationship with a new supplier and trips taken to build the relationship can have a calculable financial impact on your total landed cost. Overhead also includes things such as paying staff members to oversee transactions and research potential suppliers.
5. **Risk and compliance.** Complying with various regulations and trade policies also costs your operation money. In addition to these compliance costs, it's a good idea to account for the risk of supply chain disruption, especially when working with new offshore partners.

Using a Landed Cost Calculation Model

To best manage your supply chain, use a landed cost engine that gives you an accurate estimate of your final expenses. There are several ways to go about doing this, ranging from basic plug-and-play spreadsheets to commercially-developed calculation software. There are also several free calculators available online. If these options aren't satisfactory, you can develop your own in-house algorithm.

Before you set out to create your own landed cost prediction model, understand that it is always difficult to calculate your final costs down to the penny. It is therefore important to plan ahead for the unexpected by adding a safety buffer to your model so you aren't caught completely off-guard by unforeseen expenditures.

Building an accurate model takes time and experience. The best way to perfect the process is by checking your model's predictions against the actual invoices for every one of your imports. Use real-world data to tweak the model until it offers suitable accuracy for your needs.

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