Understanding Total Landed Cost (TLC)

Whether you are in the import or export business, projecting realistic costs integrated into the supply or delivery of products is significantly essential. Proper projections assist you in understanding reasonable prices in breaking even with desirable profit margins. Not only will you attract and retain customers, but you will also remain financially afloat.

By engaging with foreign suppliers and markets, you give your business the upper hand of competing globally with international standards, better opportunities, and also a wide array of products to choose from globally. However, the key to success for making a profit is to understand the Total Landed cost of the product and adjust your product price accordingly.

So, What is Total Landed Cost?

Apart from the initial cost in the manufacturing and development of a product, there are other associated expenses, some of which are hidden, until the product lands at doorstep of the buyer. These costs include transportation of the products inland within the home country, recipient country, and at the ocean or air. Additionally, customs duties, taxes, insurance, sea freight costs, rates you will incur due to the different currency strengths for conversion, and also charges paid to the handlers of the product.

For instance, if product A costs 5$, sell it at 15$, yet you paid 25$ for the whole process up to delivery, you will have ignored the vital aspect of the Landed cost of the product.

In a nutshell, the Product purchasing cost plus the associated cost incurred in bringing the goods from the manufacturing site until Buyer's at the doorstep, all inclusive, is termed as Total Landed Cost. It is mandatory for all procurement professionals to know the concept of TLC and apply it diligently in making an informed decision while sourcing goods from foreign countries.

Total Landed Cost (TLC) vs. Total Cost of Ownership (TCO)

Total Landed Cost is not the same as Total Cost of Ownership. These are often mixed and not clearly demarcated. It should be noted that TLC is a part of the TCO calculation. TCO is a wider term covering the TLC, storage, training, cost of inventory, maintenance, after-sales support and other wider elements to derive the lifetime cost of a product. A TCO focus provides a complete depiction of all of the costs incurred before, during, and after a transaction to support budgeting, informed decision making, lease versus buy comparisons, and managing a product or service over its useful life including its afterlife and disposal.

What Makes Total Landed Cost Important?

Assumption of landed costs as a business importer can gravely hurt your business. By approximation of all the costs, you can come up with selling prices that will entice your customers, while remaining financially relevant. By importing the goods, the prices should be lower than acquiring the products locally. Consequently, you will be able to grow your brand and increase your profitability index.

Getting the total landed costs correctly will help you not to over-charge or under-charge your customers. Undercharging will gravely affect you and possibly drop your business; while, excessive prices can drive away your customers.

Before selling prices are established, you should be aware of the landed costs of your business products before determining how much the goods will retail. Accordingly, you factor in the costs for recovery, as you can't place that burden on the consumer directly.

If certain crucial cost elements are overlooked and / or not included in TLC calculation, eventually, such charges would accrue in the final calculations as hidden cost eating into the profit margins.

What are the key commercial elements of Total Landed Cost?

International logistics are inevitably complicated and present a whole new range of ever changing challenges. Understanding the commercial aspects, included in your calculation, will have a direct impact on your business. Is it difficult to derive TLC? The answer is No. For ex: In order to derive a proper **imports'** TLC analysis, total landed cost is sum of three major categories given below:

1. FIXED COST

1.1 The Product Price
1.2 Shipping Costs (Voyage charges by Ocean, Air, Land or Rail)
1.3 Packaging
1.4 Documentation
1.5 Inland Transportation (origin and destination)
1.6 Insurance
1.7 Customs Duties, Taxes etc.

2. VARIABLE COST

2.1 Terminal Handling / Port Charges (origin and destination)
2.2 Customs Clearance Charges

3. SUBJECTIVE COST

3.1 Pre-Delivery Inspection (PDI) charges
3.2 Penalties (Demurrage, detention charges etc.)
3.3 Overhead Costs

1. FIXED COST

1.1 The Product Price

The unit price item laid down by the manufacturer is what you consider. The price typically includes the cost of conversion of the raw materials into a finished product, by the manufacturer. Product price is the main element on any commercial negotiation; hence the buyer shall negotiate it diligently, evaluating the price components meticulously covering all perspectives.

1.2 Shipping Costs

After the Product price, the significantly visible cost element is Shipping Cost. The shipping cost varies depending on the mode of transportation selected for movement. There are three main modes of transport:

a. **Air** *(saves time but the cost is high, hence used for high value items and urgent requirements)*
b. **Sea** *(saves significant cost compared to Air used for containerized and bulk movements)*
c. **Road / Rail** *(Saves time and moderate cost and is used for medium/heavy bulk load movements)*

The mode of transport is decided based on Speed, Availability, Dependability, Capability, and Flexibility. Before commencing any commercial negotiations, the options on available modes of shipment should be ascertained as it has direct and significant impact on TLC.

1.2 Packaging

Packaging is very important and certain countries have very clear guidelines for any foreign products entering their country. Certain elements that impact the packaging cost are Palletisation, Fumigation, DGR compliance, Shrink-wrapping, temperature control measures, data loggers, dunnage, etc. Any hazardous item classified under Dangerous Goods (DGR) category must be packed in accordance with the UN approved packing material. Documentation is done either by the Supplier of product or alternatively by the nominated freight forwarder. It is essential to check the requirements before an import or export is planned. These charges should be negotiated for inclusion in the product price.

1.3 Documentation

Documentation is another important criterion without which Goods cannot cross or enter the frontier. Depending on the type of import, requirements change for various countries. Primary documents needed for export / import are:

a. *Commercial Invoice*
b. *Certificate of Origin*
c. *Packing list*
d. *Way Bill (Bill of Lading, Air Way Bill, Truck way Bill etc.)*

Apart from these four documents, there are other requirements dependent on the type of goods being handled. For example, Halal and Health certificate is a must for importing meat into GCC countries. Similarly, other requirements like Legalisation of shipping documents, Attestation by relevant Chamber of Commerce, Radiation Certificate, Material Safety Data Sheet (MSDS), Phyto-sanitary certification for import of plants etc. Any mistakes in documentation can cause a lot of misunderstanding and long delays. It is imperative to ascertain the document requirements before any import / export is planned to any foreign country.

1.4 Inland Transportation (Origin and Destination)

Origin: Transportation from the manufacturing site to the closest port of dispatch (Airport / Seaport). Responsibility of loading the goods, inland transportation depends on the incoterms negotiated in the Purchase Order or Agreement. An appropriate vehicle meeting the product requirements is necessary to maintain the integrity of the product during inland transportation. For instance, if the goods are perishable in nature, a refrigerated transportation is mandatory, or goods declared under DGR category must essentially be transported in the DGR approved carriage. A buyer shall negotiate the prices and its incoterms diligently to address these crucial elements.

Destination: Transportation from the arrival port (Airport / Seaport) to the final destination. i.e. up to Buyer's door step. Depending on type of goods (Normal, Perishable, DGR etc.) appropriate transporting vehicle shall be arranged from the arrival port until final destination. Certain type of equipment needs specialized low-bed trailers. For ex: Aircraft engines can only be moved on the ground using Air suspension trailers mandatorily. Certain large equipment has over hang, which should be studied even before transportation is planned to avoid any roadblocks or may require special permission from traffic authorities to avoid certain routes / time. In order to avoid any issues at destination with the transportation of complex equipment, some of the agreements are concluded on DAP / DAT basis wherein the product supplier is liable to complete the final delivery including offloading at buyer's doorstep.

1.6 Insurance

Nothing comes completely guaranteed during transit. Goods during the transportation are prone to lose through theft or even mishandling. In scenarios such as these, you need to include insurance.

Having a valid insurance cover for your goods guarantees protection during transit before the customer receives the shipment at final doorstep. The insurance company gives reimbursement depending on the extent of damages, worth of goods, and the type of insurance cover. For instance, you can opt for protection against fire, vandalism, and also destruction in the unfortunate event of an accident.

1.7 Custom Duties, Taxes

A customs or import duty is a tariff or tax imposed on goods that are transported across international borders. Whether importing or exporting, goods attract a custom levy fee. When importing, you submit import fees and export fees if exporting. These charges vary from one country to another, as they follow regulations stipulated by the local Authorities. Most of the countries follow the categorization of goods as per internationally recognised Harmonized System also known as HS codes. Some entities operating within free zone are granted exemptions and Customs and other duty amounts may fall within such exemptions. For non free zone operating entities or general taxable companies, the amount of customs duty percentage (%) should be checked with the local authorities for inclusion in the TLC calculation. It should be noted that the Customs duty is applied on the CIF value of the goods and not alone the product price. Apart from Customs Duty, there could be some more taxes like Value Added Tax (VAT), Goods and Services Tax (GST) etc. that may add to the TLC.

2. VARIABLE COST

2.1 Terminal Handling / Port Charges (Origin and Destination)

Terminal Handling Charges (THC) is the charges collected by Sea / Air terminal operating authorities at each port against handling equipment and maintenance. THC varies at port to port of each country, as the cost of handling at each port differs one to another port, depends up on the total cost of port terminal handling at each location. Typically, these charges are billed, as per usage, by local Airport / Seaport Authorities.

Origin: Terminal Handling Charges at the port, plug-in charges for reefer containers, X-ray screening, K9 services (sniffer dog), crane charges, storage cost until the boarding the vessel / aircraft, etc.

Destination: Container offloading charges, X-ray screening, K9 services, plug-in charges (Reefer containers), storage cost until the container/shipment is dispatched from the arriving port.

2.2 Customs Clearance charges

A customs broker is a specific term used to identify the intermediary between the importer and the Government's customs department in the country of import / export. By academic definition, a customs broker is defined as a private individual, partnership, association or corporation licensed, regulated and empowered by local Customs department to assist importers and exporters in meeting Government requirements governing imports and exports. The services by these approved brokers are on chargeable basis. Although, not a very high amount these charges must be included in the TLC calculation.

3. SUBJECTIVE COST

3.1 Pre-Delivery Inspection (PDI)

Certain products would require a pre-delivery inspection to mitigate the risks of compliance to specification. In such cases, the Buyer or his representative visits the manufacturing site and conducts PDI. There is a cost for travel, accommodation and perdiems for staff. Alternatively, there are few commercial entities existing worldwide to perform such services, at an additional cost, to scrutinize the manufactured equipment before dispatching from the port of loading. This cost should also be included if such service is required.

3.2 Penalties (Demurrage / Detention Charges etc.)

There are additional cost elements that are subjective in nature. For sea freight, shipping line demurrage charges if the container/s is not collected and returned within free period, Sea Port demurrage charges for the shipment if not cleared within free period, truck detention charges due to delays in offloading thereby delaying the release of the arriving truck etc. However, these costs are subjective and should also be considered with a buffer percentage (%).

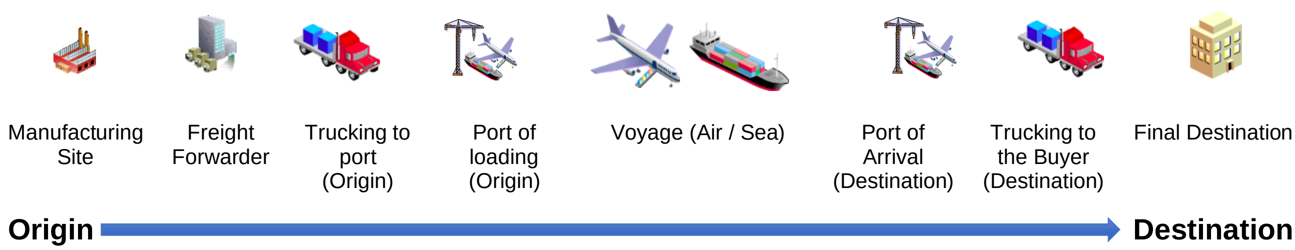
3.3 Overhead Costs

While having business transactions, some damages are not categorically traceable to a particular unit of value. The expenses are miscellaneous and therefore, would drastically affect your business if ignored. The cost includes manpower supervision, document handling, courier fees, shipment escort fees, track and trace charges, and sometimes even processing fees.

Conclusion

In summary, before a final procurement decision is made comparing the prices of foreign supplier with that of domestic, it is essential that the comparison is made on apple-to-apple basis for a fair assessment and also avoid ambiguity attracting audit attention. The selling price of foreign supplier on CFR/CIF incoterms compared to that of local supplier on DAP basis, is definitely incorrect. Price comparisons during imports should factor the pertinent details discussed earlier in this paper and must address the hidden costs.

In the sense, all charges incurred till the product reaches buyer's doorstep must be included for a fair comparison. Below given process flow explains various steps involved in the import process.



Understanding the role of total landed cost will help in sourcing high-quality, affordable products. More so, it will also help you remain financially conscious of all the prices involved.

By conducting a meticulous TLC analysis, you uncover additional opportunities that could potentially make an even bigger impact on the cost reduction and also process optimisation.

About the author:

R V Srinivas Rao
MBA, MSc, FCIPS, CIPC, CISCM, SPSM

R V Srinivas Rao (Rao) is a postgraduate with various supply chain qualifications including prestigious Fellowship with CIPS, UK. Possesses over 22 years of strategic and operational supply chain experience handling various portfolios within Procurement. A regular speaker at supply chain events and a strong advocate for professional standards in procurement and supply management. Founder member of CIPS Qatar branch now holding the position of Branch Chair. ***email:*** ***rvsrao@yahoo.com***