

# Taking Costs Out of the Supply Chain



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Fact: International trade has doubled in the last decade. This remarkable growth has been driven by strong consumer demand, redistribution of GDP wealth, changes in the geopolitical landscape and the widely publicized move to outsourcing into areas of lower-cost production.

Another eyebrow-raiser: More than 40 percent of companies worldwide now trade in eight or more geographies – many with hundreds of individual suppliers. This phenomenon has not only expanded supply chains, but it's also put tremendous pressure on buyers to keep costs down.

That's quite a departure from the historical supply chain goal of pushing costs elsewhere. Today, trading partners are looking for ways to mutually benefit from shared savings.

## Turning to banks

As businesses continue to drive costs out of their global supply chain, they expect their financial services providers to keep pace. Ten years ago, large U.S. buyers would mandate zero fee, or even a revenue share, from banks participating in their Letter of Credit Programs. Suppliers would absorb the cost and filter it back through increased cost of goods.

That was then. This is now. Today's buyers are asking, "How can we reduce the overall cost of the supply chain so that everyone wins?" The result: increased visibility into the physical supply chain and a willingness to

leverage financial strength to support the flow of goods. Buyers are looking for integrated solutions to manage the physical flow of goods and inventory costs, and they expect their banks to provide competitive financing and risk mitigation tools.

## From LC to OA

One way that banks are answering the call is via a significant transition. Letters of Credit (LCs), the longstanding primary international trade vehicle, are being replaced by less costly Open Account structures that meet the cost and risk objectives of both buyers and sellers. The keys to making this happen are the Internet, for exchange of information, and access to existing data flows like Purchase Order and Invoice details.

Banks are leveraging validated PO information to provide suppliers with critical pre-shipment financing. In many cases, they're utilizing the buyer's invoice approval process to discount receivables at rates lower than suppliers can get on their own.

The net financing cost savings, including LC fees, can be as much as \$700 on an order of \$100,000. Translate this to a Cost of Goods Sold savings over an annual flow of \$500 million, and it could mean \$3.5 million restored to the bottom line.

## Payment process discipline

The move to Open Account structures is bringing more discipline to the payment process. Companies that take advantage of their bank's core capabilities can still make use of document preparation and examination expertise, which assist in making more informed and expedited payment decisions.

Since 80% or more of documents presented under Letters of Credit were discrepant, added costs and settlement delays were automatically built into the process. Absent a required document review process, but understanding what is necessary to clear goods, exchange

title and factor in time value of money, buyers and sellers can leverage the bank's existing operations and understanding of the trade flows. As a result, payment is made sooner (benefiting the supplier), while the buyer extends its actual payment terms or DPO. The potential benefit is millions in cash flow gain.

## Reducing inventory costs

The sharpened focus on global supply chain savings can also reduce the cost of carrying inventory. By extending pre-shipment financing to cover the in-transit period, buyers can keep an uneconomic asset off their books for a longer period of time.

Another option is to identify a third party to take title to the inventory during the shipping period. The key here is for that third party to demonstrate real added value to the supply chain process.

## Right suppliers, right countries, right time

At Citi, we believe that the supply chain trends described above offer tremendous opportunity for buyers who do global business. The cost savings and cash flow benefits can be huge.

The watchword is patience, as results are not seen overnight. In most cases, both buyers and sellers must be educated as to the real benefits of a fully integrated program. And a strategy must be built behind the implementation, so that the right suppliers in the right countries at the right time are targeted. Progress can be slow, but we at Citi believe that "slow and steady wins the race."

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