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## Key Trends in Transportation

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The state of transportation in 2008 is being defined by two major market conditions, namely a drop in GDP in the United States during the first two quarters and significant increases in the cost of fuel across the board for all types of transportation providers. If the first half of 2008 is representative of the remainder of the year, fuel surcharges will tend to overshadow any pricing advantage obtained through competition or procurement activities.

## Air Cargo

Air cargo costs will continue to rise disproportionately faster than any other mode through fuel surcharges during 2008. With the fall of the US Dollar, no imminent increase in worldwide production of oil, added political instability of African producers, and uncertainty related to production from Venezuela, Middle East countries and Russia, expectations continue for a sustained rise of the price of a barrel of crude.

Undoubtedly, for customers using air modes, seeking ocean solutions and migrating to a longer lead time remains a viable option for some, given the disproportionate magnitude of the surcharges for these two modes. As of April 2008 some airlines have switched the method for calculating surcharges from weight to volume, in an effort to collect additional revenues to cover fuel costs. Furthermore, the quality of on-time delivery standards for the ocean industry allows for advanced planning by manufacturers, while the air cargo industry is instead more and more constrained by security and airport capacity issues.

The air cargo price and service problems are further aggravated by the loss of commercial capacity due to the reduction in the number of flights across the US, the closure of airlines, and the looming potential for government mandates to separate passengers from commercial cargo for security concerns. This reduction of capacity will further increase costs. Look for 2008 to be the year when the breaking point for operating certain types of equipment will be reached, requiring equipment such as B4747-200s to be retired from cargo duties, given their less efficient fuel consumption.

From a procurement standpoint, 2008 might be a year in which maintaining higher rates during the low season might help alleviate the capacity and rate hikes to come in the 3<sup>rd</sup> and 4<sup>th</sup> quarters' capacity crunch

## Ground Based

US ground transportation companies, as of June 2008, are experiencing record diesel prices that unless recovered via Fuel Surcharges, risk putting out of business many providers, which will reduce the current overcapacity in the market. With the failure of many smaller, owner-operator outfits, market conditions will improve in 2009 for LTL and TL providers through gained pricing power. The year started with significant ground transportation price increases overall, with some LTL providers raising prices by 5.4%.

It's evident that competition across the board will be based upon each carrier's ability to compete not only with price, but also with their ability to shield customers from increased fuel surcharges, hence

eroding their margins. If this continues, look for 2008 to also include strikes and work stoppages around the country.

Shippers should be aware that while 2008 is a buyer's market, purchasing managers should focus on those carriers that can offer not only the price points but also the service level required. 2008 should not suffer from driver shortages, but lower cost carriers in this market may not be able to ramp up capacity once this economic downturn ends.

## Rail

Intermodal operations exercised large rate hikes last year that are sure to remain in place or increase in 2008.

Over the past 12 months, rail transportation has enjoyed relatively high rate increases through its agreements with ocean carriers to provide inland delivery. However, given the trend of increasing fuel costs, additional cargo will migrate from air to intermodal and will certainly increase the utilization of the rail network. With more rail service being provided to metropolitan areas, rail rates are likely to stay at their higher levels or increase.

This mode continues to command pricing power. This is in part because even in a declining economy, railroads can diversify into servicing other markets including commodities such as ethanol, coal and other raw materials.

## Ocean

Ocean carriers have maintained a level of soft rates to compensate for increases attributable to complementary intermodal services such as rail. While ocean service rates may remain steady or even drop, shippers will be affected by two major issues during the 2008 season. First, most shippers will find it difficult to maintain fixed contracts on fuel for the ocean and even intermodal portions of ocean freight. Most service providers will seek to attach their cost of service to publicly available indices for fuel and marine diesel costs. Increases for fuel will be reflected in all segments of ocean shipping from the vessel operator to rail transfer and last mile trucking. In addition, 2008 may also be affected by labor disruptions in the West Coast. Both of these conditions will cause shippers to seek alternative routes and ports of entry to minimize shipping costs, albeit at the expense of incurring additional days of in-transit inventory.

Look in 2008 for shippers to continue a shift to direct shipments to customers, bypassing warehousing infrastructure in North America. Furthermore, with the price increases in fuel, 2008 might also become the year in which Mexico becomes an attractive alternative to Asia for sourcing large, freight-inefficient products. Also, given this outlook, the transpacific lane will start to see more and more by-pass of West Coast ports for east coast bound containers, which will travel through the Panama Canal, directly to markets from Miami to New York.

## Parcel

No major changes to the landscape of competition among the largest three players in this mode are expected over the year. As with all other modes, fuel remains the largest risk during the year, and shippers will be looking to rationalize their needs to move as much as possible to Ground Service and to rely less on the Next Day type of service.

This year will witness the emergence of the United States Postal Service as a major competitive player as new legislation now allows the USPS to determine its product pricing, change prices when needed and introduce new or customized products in response to consumer demand. These changes and the ability to execute volume-based discounts open the door for the USPS to be able to compete on a fair playing field with its three major competitors.

## Additional Trends

Given the operational focus on efficiency, several trends will start to materialize this year. Drastic measures in packaging, loading patterns and dunnage will be highlighted in 2008 to maximize cube and minimize transportation moves. Also look for CTPAT conditions and certifications to increase, as China will allow inspections in 2008 to finalize certifications at the manufacturing point.

The most significant trend to watch over the balance of the year will be the changes in direction and inclination of fuel cost rates. With a sustained rise in fuel prices, look for companies to start moving operations to a hemispheric model and away from the current China-centric model for outsourcing.

In addition, certain conditions may cause disruptions for importers from China. The Olympics will certainly cause some issues for sourcing, especially for those operating with ties to the Beijing area. Further aggravating importers' outlook, is a looming work stoppage for the West Coast ports in the US. Already, as of May 2008, symbolic stoppages have occurred. Union negotiations might put at risk supply chains across the US, in what otherwise would have been a lower than average volume period in a slow economic year.



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