

Gas too cheap?

Low price signals low global demand — something painful for the supply chain

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Logistics is by definition a challenging profession, and after a year of rollercoaster fuel prices and deepening recession, the coming year looks to be downright daunting.

“2008 will be a year to remember,” said Satish Jindel, president of SJ Consulting, “but only until 2009 ends.”

Last year’s failure of several truckers, the U.S. retreat of DHL, layoffs across the industry, steep declines in shipping volume alongside production slowdowns at General Motors, plant closings of Chinese contract manufacturers and a growing list of bankruptcy filings at brand-name manufacturers and retailers point to a thoroughly ugly new year for everyone in the freight economy.

Shippers will face dwindling choices of transportation providers even as fuel prices decline to lows not seen in a decade. Pricing for warehousing, transportation and logistics services are softening as distribution center operators, carriers and service providers lower prices furiously in the bid for whatever business happens to be moving.

Sourcing and procurement strategies will be tested on the one hand by weakening demand in both developed and developing countries and on the other by rare bargains from increasingly desperate but potentially unstable new partners. Shippers will rely more on software and technology services at precisely the moment when their IT budgets are under the worst strain in a generation.

Supply chains will be under intense pressure from new environmental and security regulations just as manufacturers and retailers await the rewards of unprecedented government fiscal stimulus to sustain employment and rescue the economy. In the meantime, however, supply chain managers are coping with new directives aimed at less at

gaining efficiency in managing the flow of goods and more at the basics of keeping company balance sheets in equilibrium amid a crisis in credit.

“It is highly probable that we will have a significant number of bankruptcies, not because the company is not profitable, but because they don’t have any cash,” said Lee A. Clair, a partner at Norbridge management consultants. “You don’t go bankrupt because you’re not profitable; you go bankrupt because you can’t pay your bills.”

“I’m actually rooting for higher oil because it signifies that the economy is picking back up,” said Rick Jordon, vice president of AlixPartners. “From a selfish perspective, \$1.68 gas is great for me and my family, but on a global basis it’s too cheap.”

So the onset of recession first in the United States in late 2007 and then in Europe in early 2008 showed up in November as the first decline of exports from China in seven years. The collapse in sales of Detroit automobiles not only hurts YRC subsidiary and auto component hauler USF Holland but mine owner Rio Tinto and all its carriers and suppliers whose services are no longer needed to transport automotive raw materials and components that are no longer in demand.

“As the logistics industry goes, so goes the economy, and vice versa,” said Adrian Gonzalez, director of the Logistics Executive Council at ARC Advisory Group. But globalization of supply chains and the emergence of globally integrated finance mean that what once might have been a regional downturn or a continental recession can now quickly transmit crises worldwide.

Despite more than \$2 trillion of stimulus so far by the U.S. government alone, banks continue to sharply curtail lending, raising the risk to even credit-worthy shippers, carriers and logistics providers that they will experience financial cardiac arrest like that which hit Circuit City after its suppliers suddenly decided they preferred cash to the retailer’s heretofore good name.

On the international level, shippers are pressed to get the letters of credit that keep supply chains fluid and the tug-of-war between shippers, logistics operators and carriers over terms of payment is turning logistics channels into battlefields over cash.

“I don’t think the financial crisis has been as big a story in 2008 as it will be in 2009,” said Hal Feuchtwanger, managing director of global logistics at i2 Technologies, which was on the receiving end of a \$346 million buyout offer from JDA Software until i2’s stock price fell by half in September’s financial earthquake.

Experts say shippers who spent much of 2008 watching fuel prices will need to pay close attention to the health of their transportation providers in the year to come.

“Truckload is the preponderance of the transportation industry” — carrying 70 percent of U.S. freight — “and whatever happens to it will have an effect on everybody else,” Clair said.

Truckload companies with high debt-to-equity ratios are most at risk, Clair said, both from the slowing economy and the skittishness of loan officers. Smaller carriers have already taken the blow, with at least 2,500 bankruptcies so far this year.

Truckload carriers also rely more than others on financing from original equipment manufacturers to buy new equipment, Clair said. But the OEMs are as hurt by the economy and the credit markets as anyone: A.C.T. Research said preliminary orders for Class 8 trucks fell 46 percent in November from the same month last year, and estimated North American production of heavy trucks fell 12 percent this year compared with last.

The collapse of airfreight volume signaled by the pullout from North America by DHL in November and deterioration in mainstay ocean shipping, where container cargo volume fell for the 16th straight month in November, are now joined by rail. In Norbridge's annual survey about rail capacity and capital expenditures, "the answers we receive from all of them now is 'we don't know'" what to expect in 2009, Clair said. Even where shippers might hope to see some relief — in inventory-laden warehousing or cost-cutting technology services — the best advice is watchfulness.

Unless your distribution center lease is up for renewal in 2009, you're likely stuck with whatever terms you negotiated in the building boom-time just a few years past, said Richard Armstrong, chief executive at Armstrong & Associates. Third-party logistics providers paying off a 10-year loan to their distribution center builder are unlikely to be soft touches when asked to ease the terms of a shipper's five-year lease.

Technology providers are one of a few sectors holding up relatively well.

Enterprise software specialist i2 expects shippers will continue to seek its inventory planning and optimization software and services even as sourcing and transportation networks shift or shrink, Feuchtwanger said. The flailing price of fuel — which no one believes will stay low longer than the recession lasts — will continue to focus executive interest on logistics costs, he said.

But there are a lucky few who say they haven't experienced a downturn at all.

"We feel somewhat recession-proof," said Nathan Pieri, senior vice president of marketing and product management at global trade software automation provider Management Dynamics. "We have seen great growth in results," he added; revenue is 200 percent above quarterly forecasts.

The outlook for technology companies is good in large part because of supply chain volatility, Gonzalez said.

"I think most technology vendors, transportation management systems vendors, will finish (2008) OK," he said, though "the fourth quarter will be the weakest so far."

Like its Canadian competitor, Descartes Systems Group, Management Dynamics relies for its profits on many of the same travails that vex its customers. Government security

regulation and arcane multilateral free-trade agreement language that frustrates so many new entrants to global markets are the company's bread and butter.

"Regulation is also a good, compelling event for companies to do something differently," Pieri said. "In fact, we thrive on the (trade agreement) complexity," he added.

New regulation is what shippers fear almost as much as the sagging economy.

The Democratic Congress and incoming President Obama should consider cutting corporate taxes and take into account the competitive impact of U.S. environmental regulations on multinational service providers, said Dave Miller, vice president of global policy and economic sustainability at Con-way.

Transportation taxes and fees collected from carriers and shippers for infrastructure projects should be spent only on roads and bridges, not bike paths or even public transit, he said.

Shippers and carriers are mostly resigned to some form of a carbon cap-and-trade system, observers said, even as they fear the impacts on their companies in an already shaky economy.

Freight industry providers should urge government to take a longer-term view of infrastructure, especially given that demand next year will likely be for projects that quickly produce jobs, Gonzalez said. "We need a more holistic approach to solving infrastructure problems; we need to ask, what do we need to have in place in 2018 to be successful and complete globally?"

For many, the big question is whether 2009 will see the worst of the recession or the beginning of its end.

"If 2009 looks like 2008, I think we're OK," said Jordon. But "if we get into a kind of deflationary perspective, that's one that could have much more impact."

Shippers will confront capacity shortages even in a weak 2009 freight environment, and price spikes from tight capacity as the economy recovers, he said.

"I think the government stimulus will be strong and it's going to work" by the second half of 2009, Armstrong said. "Things will snap back pretty quickly once the Obama-ites roll out \$500 billion or \$600 billion to stimulate this thing."

Others aren't so sanguine. "For practically three quarters there will be no improvement in the economy," Jindel said. "If there are little bumps of improvements, they will be short-lived as a result of some stimulus that the federal government does. It won't last."

Yet even as the tumultuous old year gives way to an uncertain new year, optimism retains its allure in many quarters.

“In the business world there’s always a general inclination towards being cautiously optimistic,” Gonzalez said. “There’s a fine line between denial and feeding the flames. And I think that’s what companies try to do. They try to look at the positive things.”