ready for crude oil at $200 a barrel?

Here's what shippers can do to shield their operations against fuel price shocks

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Jeff Rubin, a respected CIBC World Markets economist has predicted that crude oil will hit (US) $150 a barrel by 2010 and $200 a barrel by 2012. This would translate into $7 a gallon in the US or (Cdn)$2.25 a litre, twice current levels. His arguments are that world oil production has stagnated at 85 million barrels a day over the past two years. Even with the possible reduction in demand in the western world, the growing demand in China, Russia, India and the Middle East will more than offset these declines over the next five years.

The opposing view offered by Dina Cover, a commodity economist at Toronto-Dominion Bank, is that the growth in the supply of crude oil will outpace demand over the next two years bringing oil prices down to (US)$85 a barrel next year before a rebound in growth sends them back into triple digits.

While I am not an expert in this area, history would seem to support Rubin's forecast. There has been little evidence in recent years that shows a major upswing in production. When you look at the possible success of the $2,500 Tata Nano car and the potential market there is in China and India for a gas burning vehicle at this price point, it makes you think that there will likely be a significant increase in fuel consumption in future years. The middle classes in these countries are anxious to enjoy a higher standard of living and switch from bicycle and motorbike to a passenger car.

What does this all mean for shippers? Even if Rubin's predictions are unduly pessimistic, they suggest that fuel surcharges are likely to increase significantly in future years and possibly approach the cost of freight. While shippers cannot directly reduce the costs of fuel, their freight transportation programs can certainly have an impact on fuel consumption and on their freight costs. Here is a list of things that shippers should be looking at as we move toward fuel at $150 and $200 a barrel:

1. Improve your Shipment Packaging

Companies that ship consumer goods whether dry, temperature-controlled or frozen will have to revisit their packaging. There are companies that provide consulting services in this specific space and can save shippers millions of dollars in freight costs through either reductions in the use of corrugated paper or reductions in cubic space occupied – the key variable in freight costs. There are still many shippers that have not fully grasped the potential cost savings that can be achieved in this area.

2. Reassess your Modal Choices

Shipping LTL and small parcel freight via air, expedited road or even regular over-the-road service is going to be an increasingly costly proposition. Shippers are going to have to take a harder look at production schedules, customer locations and their network design. The cost/service trade-offs of shipping full loads via intermodal or over-the-road to local distribution facilities will need to be re-evaluated.

3. Optimize the Size of your Shipments

There are an array of high quality Transportation Management Systems (TMS) that are available on a purchase or pay-as-you-go basis. The algorithms in these programs can take vast amounts of data and optimize shipment loadings to various locations to reduce freight costs. For those companies that have not taken a hard look at TMS systems, now is the time. It may be the resource you need to keep your company in business.

4. Benchmark your Fuel Surcharges

Not all fuel surcharges are created equal. As a shipper, you owe it to yourself to benchmark your fuel surcharge template against those of other shippers and carriers. This data is available from companies that specialize in the freight rate benchmarking space. Also, keep in mind that even if your company is using an industry standard (e.g. FCA) fuel surcharge template, shippers discount these tariffs at various levels. Many shippers are operating under the misunderstanding that they are paying industry levels when in fact their companies are paying higher than the norm.

5. Negotiate your Fuel Surcharges

Fuel surcharges are negotiable. While recovery of fuel costs is a requirement of every trucker, there is a cost recovery and profit component built into fuel surcharges. You owe it to your company to be paying market rates and no more. Otherwise you are not doing your job and adversely affecting the financial position of your company.

Clearly the management of fuel costs and fuel surcharges is now an important component of every transportation manager's job in North America. Adopting the five best practices outlined above can help your company differentiate itself from its competitors and survive in the era of high fuel costs that is now upon us. **CT&L**

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