Your Supply Chain Costs will increase by 5% in 2010

David Jacoby

There is more good news than bad for the economy, and that will translate to a 5% increase in supply chain costs for shippers in 2010. Volume and rates declined so much in 2008 and 2009 that the carriers' and service providers' only survival strategy was to remove unprecedented amounts of capacity - which for some companies meant equipment and people and for others meant selling or liquidating their businesses. But now the supply cuts are meeting or exceeding the drop in demand, so as demand picks up rates will rise.

Ocean rates will stay low, almost flat, due to the massive new capacity that was ordered during the boom.

After a long slumber, demand appears to be rising. Asia continues to grow. The Chinese economy will have grown 8% in 2009, and Indonesia by 4.1%, Vietnam by 4.2%, according to projections by IHS and The Economist. Brazil will exit 2009 with fairly flat growth (-1%) and grow in 2010. And while the US will take several years to recover, it is possible to see an end to the gloom. The country's deficit will return to "normal" (-3.5% of GDP) by 2013, and macroeconomists generally think the risk of hyperinflation that might be caused by the government bailouts will be mitigated by slow growth. IHS puts US inflation at 1.3-2.3% through 2015. Because inflation will stay low, they say, the US dollar won't fall apart. This scenario puts US on a positive growth path in 2010 and beyond, with only a slight dip in 2011 after the stimulus money wears off, and it puts trade (at least trade into and out of the US) at a 4.4-7.7% growth rate starting in 2010, they say.

Assuming this is all true, what will happen to your supply chain costs in 2010?

- Sourcing costs will rise by about 1% during the year. While some sectors will still be experiencing decreasing prices, most industries have rebalanced and are seeing slight inflation.
- Freight rates will increase by less than a percent overall, if you use all modes equally (this is admittedly based mostly on trucking and the situation in the US). Truckload rates will rise by several percent from their current depressed levels, but we won't see a driver shortage again. Air and rail traffic and rates will stay down as air shippers remain cost-conscious and ship via lower-cost modes where possible. In recognition of sluggish demand in air transport, Airbus is cutting its production back by 15% or more from today's reduced levels. Rail carriers have been unable to rationalize as flexibly as trucking companies, so excess capacity will remain through 2010, keeping rates low. Ocean rates will stay low, almost flat, due to the massive new capacity that was ordered during the boom.
- Warehouse and logistics labor will increase by 1-2%. Like most industries, wages will continue to increase even while the unemployment rate stays high, as most people work harder and some get marginalized due to age or skill deficiencies.
- Inventory carrying costs will rise slightly - less than 1% - as monetary authorities err on the side of keeping interest rates low rather than stifle the budding economic recovery.
- Production costs will rise 0.9% on rising energy costs.

The bottom line: if supply chain costs represent 20% of your costs, and they rise by 5%, your company's total cost base will increase by 1%. Assuming you have a 20% margin before supply chain costs, this means you will need 4% (80/20 * 1%) more top-line revenue to cover that 1% cost increase. So whatever target your company has for 2010 revenue, you better figure on increasing it to cover these rising supply chain costs.

David Jacoby is the President of Boston Strategies International Inc, a consulting firm that provides market data, cost and pricing benchmarks, and contracting advice to manufacturers and their supply chain partners. To contact Mr. Jacoby or the firm, please call (1) (781) 250-8150 or e-mail info@bostonstrategies.com.