## Supply Chain Implications of Unrest in the Arab World

# Short and Long-Term Solutions to Fuel Price Volatility

*David Jacoby*

The recent political volatility in the Middle East has caused a surge in oil prices. Supply chain managers must prepare for contingencies and adapt their long-term plans for the possibility of more severe and prolonged supply disruptions. What should you do differently?

The civil war in Libya is having a non-negligible impact on world oil supply. Although the loss has so far been compensated for by production in other OPEC nations, and the other countries experiencing conflicts (Bahrain and Yemen, for example) are not major oil producers, speculation has driven the cost of oil above the $100/barrel mark, and the contagion has the potential to spill into larger oil-producing nations such as Saudi Arabia, Kuwait, or of course Iran. These countries control many times the collective oil production of Egypt and Libya, so the effects would be felt on a much larger scale.

Not only does the conflict raise the risk of affecting major oil-producing countries, but it may also result in a quasi-permanent shift of oil production to countries where the cost of extracting oil is far higher due to lower resource availability and the need to drill offshore, potentially in deep water. The technology required to extract oil in these conditions is much more complex, as are the risks, as BPís deep water Gulf of Mexico experience demonstrates.

If you are a small or medium-sized shipper, you need to make sure your carrier is managing these costs well and being fair about passing them on to you. Make sure your contracts have clear and fair rate escalation clauses. Also, review your logistics network and consider options for lowering the costs of operating the network in a high-fuel-cost environment. You may want to decentralize stock to reduce outbound transport cost, and/or increase cycle stock and order quantities to mitigate the impact of higher transportation costs on total supply chain costs.

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If you are a carrier, you need to get good at hedging fuel prices, or passing them through to your customers via a reliable formula, as the Trans-Pacific Stabilization ocean carriers have learned very well how to do. Longer-term, consider increasing research and development efforts in renewable energy. This includes hybrid and electric vehicles, and could also extend to flex-fuel vehicles. Most companies allocate less than 1% of their budget to alternative energies, compared to a comparatively much higher risk of long-term fuel cost escalation.

If you are a policymaker, you should be evaluating both taxes and tax incentives to encourage investment in renewable energies. If shippers and carriers have a long planning horizon, they can figure out a smart way to embed the costs in their cost structures. For example, the incentive or tax might take place starting in a future period and extending over many years.

In summary, current events have made it essential for supply chain managers to bolster supply chain continuity plans and design carrier agreements to easily handle price volatility. Also, the prospect of long-term higher oil prices should make many carriers and large shippers consider holding more stock in field locations rather than central warehouses, as well as step up efforts on alternative fuel vehicles. D

*Boston Strategies International is the world leader in supply chain management for the oil & gas, power generation, and renewable energy industries. To contact Mr. Jacoby or the firm, please call (1) (781) 250-8150 or e-mail info@bostonstrategies.com.*