Reading the Runes – The Key Issues that Will Affect the Logistics Industry in 2011 and 2012

Almost all analysts confirm that the outlook for the UK economy is uncertain, with significant downside risk of a double dip recession in 2011. While uncertainty pervades, and business confidence wanes, logistics organisations will be tightening their belts, conserving their cash and sweating their assets.

We analyse the factors that will affect costs in 2011 and 2012 and how the adoption of good technology can help offset pending cost increases.

Major Trends

Certain events and trends are already inevitable:

- **All operators will face cost increases caused by the VAT hike announced in this year's budget.**
- **Energy costs will continue to rise in 2011 due to the government's obligations under the Carbon Reduction Commitment.**
- **Potential increases in commodity prices and the cost of oil (if the US economy recovers and the Far East economies surge ahead).**
- **Customers will increase demands to improve service levels – as they in turn, compete for market share in tough conditions.**
- **3PL's are accelerating the adoption of IT to streamline costs and meet these demands to 1. improve SLA standards, and 2. generate end-to-end cost savings.**
- **IT suppliers are expected to help their customers by proving capability to support end to end processes, generate fast ROI (12-18 months), provide an installment based payments option in line with generated savings, and sustain low ongoing system running costs.**

The UK Economic Outlook

According to forecast by the UK Treasury, analysts and market watchers, the run up to next year it looks very much like the economy will be at best sluggish in 2011, and incur the downside risk of a double-dip recession. Overall the economic growth figure average issued by the Treasury predicts a modest recovery (av 2.4% GDP) – although barely enough growth to cover inflation but at least better than the Eurozone (1.4%), which provides little room for market expansion.

Bright Spots Waning?

Some bright spots unveil a recent predicted downgrading of the price of oil ($70 a barrel from $90 by JP Morgan) and reveal a higher than UK average increase in annual consumer spending in London (10.8%) – although there is little improvement elsewhere. Many analysts expect the impending public sector job cuts and the rise in VAT to subdue demand as we move into 2011.

Supermarkets, who rode the recession well through 2008/9, are now finding trading conditions tough as they move into the Autumn of 2010. Sainsbury recorded its worst trading performance for five years in June 2010 while Tesco could only manage a 0.1% increase in sales year on year for that period.

Tel: +44 (0)121 717 7474
Contacts: Linda Rodway, Peter Lombardelli
E:moreinfo@proteussoftware.com
www.supply-chain-optimisation.com

3PL's Face Increased Customer Expectations and Energy Price Squeeze

Retail customers are demanding increased services from their 3PL's to support higher service levels as they turn up the competitive heat on their High St and Internet rivals.

The increased funding of the Government's green energy agenda will translate to the consumer in the form of higher energy prices which will be further threatened by increases in the oil price or deterioration in the dollar exchange rate, and by planned rises in VAT (up 2.5% in 2011).

3PL's Must Now Prove Sustainability and Energy Efficiency

Large businesses expect their supply chain to support them by, not only meeting tighter turnaround times and eliminating errors, but also provide them with evidence of commitment to the green agenda and demonstrate that they are managing and minimizing energy use.

The Challenge for 3PL's

One of the biggest issues for logistics organisations remains the cost of maintaining their vehicle fleet. Many operators have extended the vehicle replacement cycle from 3 to 5 years. The success of this proposition is dependant on lowering the vehicle maintenance and repair cost by optimizing routes and encouraging driver care, while finding the optimum vehicle speed and negotiating delivery and pick up times accordingly.

3PL's are increasingly being judged (by both their customers and their investors) on their capability to sustain end-to-end operational excellence, incorporating energy use and transport efficiency, as well as the overall commitment of streamlining costs and processes.

The challenge for 3 PLs is to implement controls and improvements rapidly – as the impact of these issues increase cost pressures as we move through 2011 into 2012.

The Fastest Way to Reduce Costs is to Implement Technology

Many large players have paid millions for IT systems that underpin their cost reduction programmes and have taken several years to refine and optimise them. They also have dedicated in house teams to find new methods of increasing efficiency.

Medium and small logistics companies simply cannot afford this level of capital spend, or the overhead, time and skill-sets to implement such automation. Equally, packaged cheaper systems ('a quick fix') may never provide a viable technological platform which will help them compete against their better automated rivals, as they may have limited functionality and prove difficult to integrate with other systems.

A Look at 2012

No analyst would like to predict into 2012, this makes growth planning for CEO's somewhat of a problem, so they will be inclined to 'hunker down', cut costs and preserve cash until the recovery comes.

We can expect continued cost pressure to persist as the market shake-up continues through 2011 into 2012. Larger 3PLS's will seek to expand by becoming more efficient, modernizing, and growing their facilities near key port and transport gateways, to create better access to markets and leverage improved transport links.

This general upsizing leaves room for well run medium sized organisations to acquire and operate in niche markets and presents opportunities to fulfill spaces vacated by inefficient players who will at best, remain marginal and, at worst, simply cease to exist.

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Good Technology is Available at a Price Easily Justified by the ROI

Fortunately time has allowed incumbent IT suppliers to develop and refine products which help small and medium sized 3PL's implement feature-rich systems; comparable or better than that of their larger peers, for a fraction of the cost.

Moreover IT suppliers have developed ways of integrating their products to provide end-to-end information systems that can be implemented quickly and generate an ROI in 6-18 months while costs can be profiled to coincide with generated savings.

The Choice of IT Supplier is a Multi-million Pound Decision

The choice of IT supplier now becomes 'a multi-million pound decision' as those who get it right can generate higher margins and true competitive advantage, while those who get it wrong face an agonizing and irreversible trek on a journey of wasted time, high costs that are unlikely to be recovered and irreversible business impairment.

***Foot Notes – The Carbon Reduction Commitment**

Summary

Under the Kyoto Agreement the government is committed to reduce the UK's output of greenhouse gases by 80% by 2050. To enable this reduction the government has introduced the Carbon Reduction Commitment scheme which places a tariff on the use of 'black' energy (oil, and gas).

The CRC scheme is currently is targeted at high energy users consuming more than 6,000 kw.hours (roughly equivalent to an annual electricity bill of approx £500,000) of energy. It covers over 20,000 businesses in the public and private sector including retailers, banks, and manufacturers as well as local authorities, municipalities, universities and hospitals.

Transportation organisations and those providing dwellings are currently excluded – although there is speculation that transport will eventually be affected – and the haulage industry is in consultation with the government at this time.

*Participants must register with the environment agency and measure and monitor their organisations carbon emissions from **all parts of their business**. They must process reports for assessment and purchase carbon allowances (for each tonne of C02) they emit – currently pegged at £12. Sales begin in April 2011.*

They will be entered as part of a national league tables which will monitor their performance and fine those who are deemed to be wasteful or submit late reports. These companies will also loose important credibility and possibly fail to qualify for contracts with major customers – particularly government agencies.

It is speculated that ceilings will be gradually lowered as those currently affected produce only 16% of the total UK carbon emissions.