Fuel: the weak link in the chain?

The cost of fuel is taking the headlines, but it masks many other inefficiencies in the air freight sector, argues **Larry Woelk**

Fuel

To certain destinations, some airlines will not apply a freight rate but only the fuel charge – which begs the question of whether the fuel surcharge is just a surcharge and not just a way of increasing margins.

The increase in air freight costs as a result of the surcharges comes as shippers are already wondering if the speed gained by air freight is worth the cost.

Most industry sectors have been experiencing reduced margins for their products. Many hi-tech companies have had to change their attitude about logistics and transport since the dotcom bust. Before the bust, their margins were high and they could afford to use expensive modes of transport like air freight and express. The dotcom margin squeeze revealed that their supply chains were inefficient. In order to reduce costs, many hi-tech companies have reviewed their supply chains and realised that, with better planning and forecasting, they could use cheaper forms of transport such as sea freight and trucking.

Sea freight operators are reporting significant increases in containers full of products, among them hi-tech and pharmaceuticals, that traditionally flew by air.

Some industry pundits claim that the demise in air cargo may be accelerated by the cost of fuel but that the decline had already begun for traditional air freight – shipments handled by freight forwarders and carried by the airlines.

Traditional air freight is adversely affected by the pricing dynamics between shippers, forwarders and airlines.

Pricing pressure starts with the shippers, historically aggressive price negotiators. Freight forwarders, keen to build tonnage, offered very competitive – low – often unprofitable rates. Once the traffic was “won”, the forwarder would beat up the airlines to get lower carriage rates. Many forwarders also used, and still do, their massive global tonnage to negotiate rebates, further reducing the airline’s profitability.

In the last 10 years, new procurement processes introduced by shippers have exacerbated the pressure on rates. Most major air freight tenders are now managed by purchasing and not logistics professionals. These purchasing professionals are very good at getting lower prices, even from quality providers. E-tendering on the internet is another initiative that drives rates down. Participating in an e-tender requires the freight forwarder to bid on millions of dollars, euros or pounds of business in real time. It is a challenge to respond to a competitor who has just undercut your latest bid while trying to understand your own cost base and only having minutes, or even seconds to respond.

Lower and lower prices for the shipper puts considerable pressure on air freight services. The freight forwarders don’t have sufficient margins to add a lot of value to their services and neither do the airlines.

Additionally, the air freight paper trail has not gotten any smaller. In fact, one industry executive, with more than 30 years’ experience, says more paper is travelling through the air freight chain than ever before. The paper orientation has persevered after 40 years of the integrators offering an electronic, virtually paperless process. Furthermore, the airlines and freight forwarders do not have transparent connectivity for tracking and tracing, air waybills, customs and so on. There have been improvements; but the paper flowing though the air freight chain is considerable and the processes inefficient when compared with the integrators.

The integrators have a “closed” system physically and electronically. The air freight chain of the freight forwarders and airlines is very, very “open”, with as many as 15 parties involved in a single shipment. Ironically, because of its many participants, the air freight chain should have comprehensive connectivity – physically and electronically – to monitor the movement from one chain member to the other.

Because of their “closed loop” approach, the integrators provide a better service and charge accordingly, making healthy margins. What’s more, they continue to move down the food chain, handling heavier and heavier consignments.

Granted, there are many freight forwarders who know how to add value to their services, but there will continue to be downward pressure on rates as long as there are freight forwarders out there, and there are many, whose primary sales strategy is to undercut rates.

At the end of the day, the network offered by the airlines and forwarders far exceeds that of any one integrator. If only they could connect the chain.

The rise in fuel costs may be straining the air freight chain, but maybe the air freight chain has always been broken.