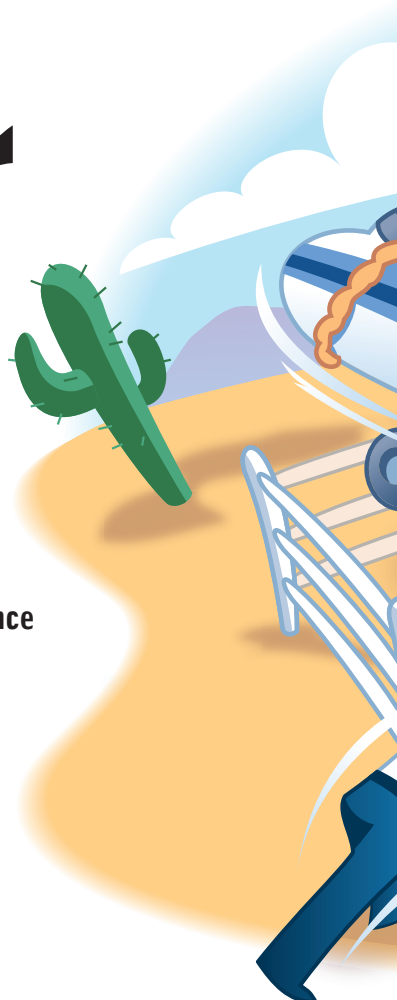
Corralling air cargo costs



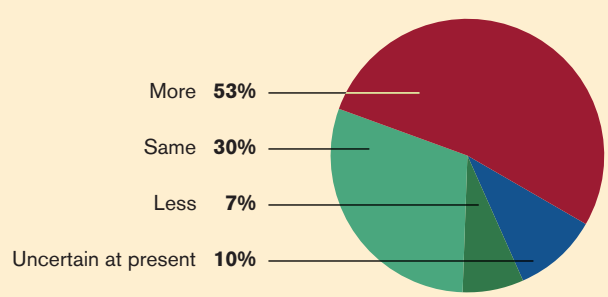
Although the fluctuation of jet fuel surcharges and the supply/demand balance of air cargo capacity are elements that air shippers can't control, there are several steps they can take to better manage the related, volatile costs.

BY **KAREN E. THUERMER,** CONTRIBUTING EDITOR

The global economic downturn that hit markets hard in 2009 has had an enormous impact on the international freight business. But perhaps nowhere has it been felt as much as in the air cargo segment. Here, as most logistics managers are well aware, losses were huge.

However, the uptick in the global economy, led by South America and Asia, and a slow but steady rebound across North America and Europe in 2010 has helped the sector recover some of those losses. Lower and stable fuel costs throughout last year also enabled carriers to post solid gains against 2009.

2011 vs. 2010: Spending on international freight



Source: Peerless Media Research Group

"But the carriers and airfreight forwarders, quite honestly, took a beating as shippers had no freight to move and demanded lower rates to move what they had," says Greg Andrews, EMIL managing director, Georgia Institute of Technology Supply Chain and Logistics Institute.

While shippers took advantage of the market dynamics in 2009 and 2010 and jumped on some of the cheapest rates they had seen in decades, carriers and forwarders learned who their good customers were.

"Most important, carriers and forwarders learned the value of capacity management," says Andrews. Even as freight demand began to grow again, carriers managed capacity by being slow to return parked planes into service. "And now, instead of capacity chasing rates and freight, freight and rates are chasing capacity," Andrews adds.

Brandon Fried, executive director of the Airforwarders Association (AFA), points out that while freight companies are now seeing increased volume, low margins continue to be a significant obstacle to their growth and expansion.

"Consequently, rates have doubled and, in some lanes, tripled over the last year—quickly returning them to pre-recession levels," he says.

Add to this skyrocketing fuel costs that are passed along to the shipper as fuel surcharges. "The most significant driver of rate pressure today is certainly the rising cost of fuel," remarks Fried. "Airlines and forwarders face a continuing uphill battle in covering constantly changing fuel costs. Incorrect planning or erroneous assumptions could spell economic disaster for carriers trying to solve this issue."

Consequently, shippers find themselves facing an influx of changeable rates and hidden surcharges, inefficient shipping routes, missed delivery-to-transit commitments, lengthy timelines, capacity constraints along with size and weight factors, and safety and security issues.

"It's enough to keep transportation and logistics managers awake at night trying to find ways to hold off air freight increases," says Andrews.

ROUNDING UP RATES

A recent survey conducted by *Logistics Management* on behalf of Management Dynamics revealed that nearly one out of four companies spends in excess of 15 percent of their overall revenues on international and domestic freight services. Most notably, the survey found, one out of four organizations spent upwards of $50 million on shipping in 2010. For 2011, all indications lean towards an increase in spending on international freight.

While the survey discovered that shippers acknowledge that they need enhanced methods for securing better rates and routes, few reported that they are now running highly developed solutions to achieve those objectives. Some 66 percent of the shippers surveyed also indicated that over the next 12 months to 18 months, rate negotiations would be the predominant action they will undertake to control their global freight costs.

Although the fluctuation of jet fuel surcharges and the supply/demand balance of air cargo capacity are elements that they can't control, shippers can take a few steps when negotiating rates.

The first, says Dr. Paul Dittman, director of the Office of Corporate Partnership at the University of Tennessee, is to come to the table with your carriers armed specifically with your air freight needs. Shippers can do this by closely examining their company's business supply chain model and understanding why they use air freight. He suggests implementing a

Illustration by Dave Joly

forecasting tool or matrix to understand supply chain trends and when air freight demand changes might occur.

"This way companies can understand when air cargo offers the optimal use so they don't have to suddenly react," Ditmann says.

Another step forward, says Andrews, is to focus on your company's market strategy: Is it to be the first on the shelf or is it seasonal? Is your product high value, build-to-order, with short lead times? "Once you answer these questions, then you need to work with your carrier or forwarder to flat-line your rate impact," he says. "This may be a two-tiered rate program, one where rates are lower out of season and higher in peak demand; but known for the duration of the year, budgeted, planned, and passed along in the price of your product."

Also, according to Fried, air shippers need to discuss specific needs with a freight forwarder. "For example, the forwarder may be interested in shipments destined for specific geographic areas and, therefore, may offer lower prices for those consignments," he says.

According to Brian Clancy, managing director of Logistics Capital & Strategy, LLC, an advisory firm serving management, private equity, and key stakeholders in the global transportation and logistics industries, such seasonal capacity purchasing, or forward purchasing of block space, can save up to 10 percent to 15 percent on airport-to-airport shipment costs. Moreover, agreeing to specific costs beforehand such as document preparation, freight rates, and fuel surcharges also helps avoid costly surprises in the long run.

THINK OUTSIDE THE CORRAL

Whereas many carriers use spoke and wheel networks where their aircraft fly to a central hub location, some are finding that direct routings that use the appropriate aircraft for the service needed are more cost effective. For example, Clancy suggests flying Shanghai to Port Columbus International Airport via Louisville International Airport using UPS instead of using main carriers via Chicago O'Hare (ORD). "In this routing, a 10 percent to 15 percent savings can be realized airport-to-airport," Clancy says.

The best source for determining the most cost effective routings is the air freight forwarder. Through his or her carrier relationships and knowledge of the market, the forwarder can also marry air cargo with ground services.

For the ground portion of the air shipment, Clancy recommends using private, dedicated contract carriers (DCC) capacity versus forwarder or airline controlled road feeder services (RFS). "This can save as much as 10 percent to 60 percent on RFS delivery costs, depending on the empty capacity available," says Clancy.

If a shipment is not time critical, there's also the option to switch to two-or three-day air-freight delivery versus next day. "While next-day serves as the cornerstone of the air freight shipping business, customers should continuously evaluate

its needs versus more economical air transportation alternatives," Fried suggests. "These options often save significant costs while delivering similar value."

A more drastic alternative: Challenge the reason for being in a specific geography. Are you there to serve the local market, or are you there for what used to be cheap labor? "Pull out the total landed costs models and crunch through them again, with higher labor and soaring fuel costs," Andrews recommends. "You might be surprised at the bottom line answer. Perhaps Mexico, Canada, or the U.S. makes better sense."

By near scouring products, companies are also able to enable surface modal substation options such as intermodal. And if certain global markets are critical, then alternative transportation modes might be a solution.

"Get off the plane and onto a ship, truck, or train," says Andrews. Sea/air services in specific lanes can often strike a balance between price and total transit time. In fact, according to Clancy, savings here can result in 50 percent to 60 percent over airport-to-airport shipments.

An example might be shipping by ocean from China to Seattle, then air freight to Chicago. Even better, Clancy suggests, is expedited less-than container load (LCL) sea freight options like APL/Conway ocean guaranteed for shipments that are less urgent, but still need time-definite delivery. "Expedited LCL sea freight offers 65 percent to 75 percent savings," Clancy estimates.

GAIN VISIBILITY

If the corporate business model dictates that shipments must move by air, it's critical that all variables be removed within your network to save on air freight costs, Andrews insists.

"Improve your forecast accuracy," says Andrews, "and hold your planning department accountable. Schedule exactly what space you'll need, when you will need it, and hit the target," he says. "Your carrier and forwarder will reward you with stable rates; and, in some cases, may even lower rates."

"You can find a treasure chest of market intelligence buried in the reams of freight invoices these guys pay on behalf of their clients."

—Greg Andrews, Georgia Institute of Technology Supply Chain and Logistics Institute

Additionally, says Andrews, pay that transport provider on time. "Get creative and pay ahead of time. Cash flow is equally important for the carrier and forwarder."

Another important consideration might be benchmarking with your third party freight payment company. By finding out how your air cargo service rates stack up against others will provide a wealth of ammunition for negotiating rates.

"You can find a treasure chest of market intelligence buried in the reams of freight invoices these guys pay on behalf of their clients," Andrews says. "Obviously, they do not give out confidential client rate information, but they are smart enough to offer this as a value add service—and the costs certainly are worth the investment."

In doing so, shippers can at least determine if they are above or below their industry curve in vertical and specific lanes.

Karen E. Thuermer is a frequent contributor to Logistics Management

Not to be overlooked: Packaging, product design

If turning every stone to find cost savings in air freight is your mantra, don't forget packaging and product design.

Dr. Paul Dittman, director of the Office of Corporate Partnership at the University of Tennessee, recommends keeping the variety and number of product stock keeping units (SKUs) to a minimum, especially for international shipments.

"Most companies have more SKUs than they need," says Dittman. "For every company, 20 percent do not sell."

Proper packaging is also essential to saving air freight charges because rates are based not only on weight, but volume as well. That's because boxes containing air inside are usually charged for their cubic displacement or the amount of space they'll occupy on the aircraft.

"Simply put, a box of lampshades could actually cost more to ship than a smaller box of heavier books," says Brandon Fried, executive director of the Airforwarders Association (AFA).

Therefore, it's always wise to use conservative packing practices; and when in doubt, ask for advice from your airfreight forwarder.

Finally, with the air cargo security landscape constantly changing, shippers should be prepared for new requirements that may include furnishing essential and significant shipment information before departure and increased screening.

"Because most of the new security laws are unfunded mandates, the industry is responsible for its own cost recovery, so expect to pay more for screening on your shipments," Fried remarks.

One way to decrease such costs, he suggests, is to screen goods as they are packed in boxes. "Shippers can get certified to perform such screening by simply joining TSA's Certified Cargo Screening Program," adds Fried. "The initiative was started in response to the 100 percent screening mandate here in the U.S. and has so far been tremendously successful in increasing cargo security and saving shippers a significant amount of money."

—Karen E. Thuermer