SUPPLY CHAIN MANAGEMENT PROFESSIONAL

March 2016 | Volume 1- No.11 | Rs.200

LEAD STORY
Impact of Macro-economic and Geopolitical Trends on Supply Chains
12

LEAD STORY
Women in supply chain – Breaking the fortress
18

LEAD STORY
Smart Warehousing - Design Elements of a Warehouse in a Networked World
20

content

March 2016 | Volume 1 | No. 11

SCM News
06 Comments on Global Supply Chain News

Academic Advocacy
36 A Tale of Two Perspectives on an Impending Supply Disruption

Lead Story
08

Lead Story
Challenge of Globalization – Charting our Growth Path
09

Feature
Winners and Losers in the Supply Chain as Oil Prices Tumble
Darryl Judd
34

Feature
To Drive or Not to Drive - Solving the Driver Squeeze
41

Feature
43 Reducing Supply Chain Complexity – the Next Frontier

Opinion
46 Supply Chain and marketing – Some Random Thoughts

SCM Updates
48 SCM news from India

Winners and Losers in the Supply Chain as Oil Prices Tumble

In any volatile market situation, there are going to be winners and losers. The decline in oil prices will have broad implications for transportation and logistics companies - some positive, some negative. Clearly, the impact can vary greatly on a company-to-company basis and the impact of the dramatic price fall in the oil sector will eventually work its way down the supply chain. Darryl Judd writes about the effect of oil price shock on supply chains.

Darryl Judd,
COO, Logistics Executive

At the recent Logisym Singapore 2016 Supply Chain conference, the subject of the boarder impact of the volatile oil prices on our supply chains took centre stage with mixed views of what it meant and just how we will see ourselves through this challenging cycle.

What is clear is that suddenly the world is awash with oil. When oil was trading above US$100 a barrel and new technologies made extraction of shale oil possible at an affordable cost, we saw a rush of new supply onto an already flattening global market. Stockpiles grew well beyond daily demand and yet producers still pumped greater and greater amounts of crude. Oversupply and under demand - The perfect storm?

It is little wonder that a surge in production and weaker than expected global demand for crude has sent oil reserves soaring and prices tumbling. The drop in the oil price over the past 12 months is by far the biggest shock global economy has seen since 2008. Similar episodes in the past tell us the consequences are likely to be both profound and long lasting. Normally, economists would add "positive" to this list, but doubts are surfacing as never before.

A fact underlined by Mr Tony Nash, Managing Director of Complete Intelligence, a specialist economic advisory firm at Logisym. "Global trade in 2015 fell by over 14%. It's therefore no surprise that demand for oil is soft and without output high, this is not about to change anytime soon".

The scale of the current oil shock is difficult to exaggerate. While financial markets and commentators were obsessed by rising geopolitical tensions and the latest twists in central banks' policies in the US, Europe and Japan, even larger forces in oil markets went largely unnoticed. A "key concern" of the International Monetary Fund was the risk of an oil price spike caused by geopolitical tensions. Instead, rising production and weaker demand growth have left suppliers competing to find willing customers.

Yet most economists still agree with Christine Lagarde, IMF managing director, who last month said that "it is good news for the global economy". The positive effect on growth should arise because oil consumers tend to spend more of their gains than oil producers cut their consumption.

What Ms Lagarde failed to mention is that trade is down and the trickle down to consumers is being offset by job losses, lower salaries and markets struggling to maintain

any form of positive growth (when inflation is taken into consideration).

Stephen King, chief economist of HSBC is likely to be closer to the mark when he says that lacklustre demand in China, Japan and Europe over the summer was the primary cause of the collapse in prices so the traditional "lower oil prices good: higher oil prices bad" story is "no longer so obviously true".

He argues that optimism following an oil price fall in economic estimations is based on positive supply-side developments for the western developed world, but "there are plenty of situations where falling oil prices are merely symptoms of a wider malaise".

And so just who are the winners and losers

First, companies that spend a significant part of their resources on transportation benefit from lower oil prices by making considerable savings in the supply chain. So do logistics and shipping companies, because they are able to save directly from lower fuel prices. The airline industry is a winner from the low oil prices with around one third of the industry costs associated with fuel.

The impact on manufacturing businesses is mixed. Sectors that rely on imports (e.g. manufacture of machinery, transport equipment, computer and electronic products) could benefit as transport costs fall and overseas suppliers pass on the savings from lower oil prices. However, exporters could experience stiffer competition from overseas businesses that also become more competitive due to lower production and transport costs. The question being asked in supply chain circles is clear – is the rush to near-shoring now dead?

The financial services sector also benefits from the increased economic activity, as it facilitates the reallocation of capital and other resources to the sectors that want to invest in response to rising levels of demand. Although the other services sectors will benefit through a small increase in demand for their products, the rate of output and employment growth in these sectors will likely be outpaced by growth in the winning sectors.

Net importers of oil, such as European countries, benefit from lower oil prices. Energy imports to the EU cost around $500 billion in 2013 and 75% accounted for oil. With average prices for Brent at around $109/barrel in 2013 compared to the 2015 average of $54/barrel, the EU is experiencing 50% savings. China, the world's second-largest net importer of oil, is an obvious winner despite the slowdown of the economy. Based on 2013 figures, every $1 drop in the oil price saves an annual $2.1 billion, according to the Economist. While Chinese export prices remain at the same level, in the long run low oil prices will benefit the economy on the whole and enable the government to reduce energy subsidies.

Clearly the losers are the oil and gas companies with debt to service. The oil service sector will also likely face a phase of transition, given the reduced amount of capital expenditure invested by oil and gas companies. In the United States, there are now virtually no wells that are profitable to drill.

Chevron, Royal Dutch Shell and BP have all announced cuts to their payrolls to save cash, and they are in far better shape than many smaller independent oil and gas producers. Job losses will impact local economies in the short term.

Electric vehicle manufacturers lose. While the medium-term trend towards the electrification of road transport should continue, cheaper fuel for motorists is likely to slow down the uptake of electric vehicles in the short term. The same applies to alternative fuels such as biofuel.

So how far do we have to go?

With global trade heading downwards and capital drying up, it's clear we may have a way to go before the cycle turns. Adding to that analysts at Deutsche Bank said that "history shows the potential for geopolitical tensions in the Middle East to push oil prices higher", and the possibility of instability in the region could interrupt production. Low prices themselves could provide a catalyst, as cheap oil undermines the outlook of Middle East economies.

According to the International Energy Agency (IEA), "There may be light at the end of what has been a long, dark tunnel" for oil". In its latest monthly market update, the global watchdog speculates prices may indeed have bottomed when international benchmark Brent crude fell to $27 a barrel early last month. Since then, there have been signs of a natural attrition on supply and, crucially, a deal to freeze production at January levels, which could eventually rebalance a heavily oversupplied market.

It pointed to outages in Iraq, Nigeria and the United Arab Emirates that took 350,000 barrels a day off the market in February alone, as was reported in the Financial Times. Iranian production post-sanctions is also rising more gradually than expected, adding 220,000 barrels last month compared to claims it would boost output by 500,000 immediately.

Overall, global supplies eased 180,000 barrels last month – and exports from high-cost exploration areas such as the US and South America could fall more sharply than expected this year. But the IEA also noted that stockpiles are at record levels and that it would take the remainder of this year for supply and demand, currently out of kilter to the tune of two million barrels a day, to reach equilibrium.

In short, prices will be more stable at current levels around $40 a barrel and will not plough depths of $20 or below as some analysts once predicted. But neither will they rise substantially until next year.

While the negative impacts of oil arrive immediately, the positive effects take longer to materialise. While oil might act as a depressant for now, it will become a stimulant later. One thing is clear - It's going a long waiting game.