

**KPMG ANALYSIS**

## Consumer Products Companies Can't Keep on Truckin'

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By Kathleen Kiley, Managing Editor, Consumer Markets Insider

Truck driver shortages, escalating fuel prices and increasing imports have pushed consumer goods manufacturers and retailers towards long-haul trucking alternatives, including rail and short-haul road freight.

Over the past year, as diesel prices rose manufacturers and retailers began considering how to deal with the trucking crisis, such as alternative distribution, says Chris Caplice, principal research associate at the Massachusetts Institute of Technology's Center for Transportation and Logistics in Boston.

The average price for diesel fuel nationally was \$2.928 per gallon on Sept. 30, compared to \$2.649 a month earlier and \$2.038 a year ago, according to the American Automobile Association. In the four days following the landfall of Hurricane Katrina on August 29, diesel prices rose 35 cents a gallon.

When Hurricanes Katrina and Rita drove up fuel prices to record levels, it accelerated companies' drive to abandon their reliance on trucking. "Shippers have been looking at the trucking crisis for years; now it's worth paying attention to," Caplice says.

Before fuel prices skyrocketed, the industry already suffered a shortage of about 20,000 long-haul drivers, according to the American Trucking Association. In addition, new laws have reduced drivers' time spent on the road, making trips longer and more expensive.

Meanwhile, shipping needs are growing at about 3 percent per year. "The percent of workers willing to do any truck driving is shrinking," says Gary Petty, CEO of the American National Private Truck Counsel in Alexander, Va.

The amount of goods shipped over highways is expected to double over the next 20 years, Petty says; the number of new roads isn't expected to keep pace.

When it comes to trucking costs, consumer products manufacturers and retailers have limited options. Trucks move about 85 percent of goods within the United States. Many communities don't have alternatives like commercial railroads and airports to deliver goods. And Petty says that the past decade's increase of imported goods from China has pushed demand for trucking freight even higher.

Many large retailers such as Wal-Mart Stores and Home Depot have their own trucking fleet, which they supplement with independent drivers who own cabs and trailers. Smaller retailers will hire independent drivers or rely upon manufacturers to deliver goods.

The increase in fuel costs hit manufacturers and independent truck drivers hardest,

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observers say. In the past, manufacturers could push higher transportation costs to truckers, but independent drivers and trucking companies now have leverage due to the driver shortage.

According to the Grocery Manufacturers Association (GMA), the cost of transportation for manufacturers has increased 23 percent over the past three years, to \$1.69 per mile.

What's more, manufacturers can expect increases in surcharges, says MIT's Caplice. Once a week, fuel surcharges -- which truckers levy on shippers -- are adjusted based on the U.S. Department of Energy's national survey price of gas prices reported each Monday afternoon. For instance, for every 6-cent per gallon increase in fuel prices, the trucker can charge shippers, manufacturers or retailers a cent more per mile.

"Instead of weekly, truckers are now assessing surcharges [twice a week] because prices have been so volatile," Caplice adds.

Craig Robins, president of Robins Consulting, a logistics and supply chain search firm in Dallas, says that the driver shortage and rising diesel prices have made it impossible for manufacturers and retailers to resist surcharges. "Fortune 500 companies are all having a difficult time," he says.

As a result, manufacturers are relying upon rail and other alternatives where they once used trucks, especially for imported goods, Caplice says. Rail becomes more appealing the longer the distance. The cost is about 20 percent less than trucking, but delivery usually takes longer.

For its part, the trucking industry is trying to reduce the number of trucks with less than a full load, says Bruce Barren, former CEO of two trucking companies, including Four Winds Enterprises, and current CEO of investment firm EMCOL Hanover.

Trucking organizations now have sophisticated software to track mileage and fuel use, Caplice says. "Truckers are getting better at saying 'no' and not just taking on any load," he says.

Manufacturers and retailers have built additional distribution centers, which has reduced driving distances. Consumer products companies are also using more carriers to increase capacity. Over the past decade, manufacturers had consolidated their shipping with a few companies to generate economies of scale, Barren says.

One issue is that retailers' and consumer product companies' transportation goals aren't always in sync. The transportation cost can comprise a large percentage of making goods, but a small cost for retailers, says Robin Lanier, transportation consultant to the National Retail Federation. Transportation accounts for 62 percent of a manufacturers' logistics costs according to the GMA.

Even more than costs, retailers are concerned with goods getting shelved promptly. "Retailers are concerned about the availability of trucking and that consumers have less disposable income to spend at stores," Lanier says.

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