



## Commercial Insights with Regions Bank

### **Episode 13:** Industry Overview: What's Next For Transportation and Logistics?

The transportation and logistics (T&L) sector has faced both rapid change and unexpected disruptions over the last few years, and there's still more to come. In this episode, we're discussing the factors impacting the T&L industry — from supply chain woes to new technologies to changing legislation — and what transportation companies, manufacturers, and retailers can do to prepare for the road ahead while turning uncertainty into opportunity.

### ***Episode Transcript***

Juan Cazorla:

In this environment, it behooves companies to really be strategic and very precise about inventory planning, and plan for a rainy day, because the reliability of global supply chains is not what it used to be.

Chris Blose:

This tip comes from Juan Cazorla. As Managing Director and Group Head of the Transportation & Logistics Group at Regions Bank, he's witnessed a multitude of factors affect global supply chains over the past few years, from the rise of ecommerce to trade tariffs to port delays. But what comes next?

Welcome to Commercial Insights with Regions Bank. I'm your host, Chris Blose, and today Juan Cazorla is here to walk us through some of the factors that are changing the transportation and logistics industry and how both businesses and consumers might be affected.

Chris Blose:

Right. Welcome, Juan, and thank you so much for joining us today.

Juan Cazorla:

Thank you, Chris.

Chris Blose:

So Juan, you all are working in a field that has seen a lot of growth and a lot of change in the past few years. So people may, when they're thinking about the supply chain, they may not really know exactly what that looks like here in the year 2021. So, at a high level, will you walk us



through, what are the major points along a supply chain, and talk a little bit about where the possible disruptions might be at those points.

Juan Cazorla:

The composition of a supply chain is gonna vary by business type, but it's probably easiest to discuss in the context of say an industrial manufacturer. In a general sense, there's seven points along a supply chain continuum: Purchasing, manufacturing, inventory management, demand planning, warehousing, transportation and customer service. And these processes are highly correlated and often operate simultaneously so there's a lot of inherent complexity in most supply chains. A manufacturer is gonna need to purchase raw materials to make their product and managing the timing availability and amount of these raw materials is critical.

Inventory management is probably one of the most important things along a supply chain. You know, inventory tends to be one of the largest assets on a manufacturer's balance sheet, so monitoring and optimizing inventory days on hand is critical. What I mean by that is, you know, a lot of CFOs want to minimize inventory days on hand, but in today's volatile supply chain environment, going too low on inventory could mean running out of product at an inopportune time. So, maintaining a careful balance I think is really important. Demand planning is, is important. It can be used for things like assessing future capacity requirements or maybe entering a new market or developing a new product.

Warehousing and transportation have really evolved in the e-commerce world in which we now live. Warehouses used to be strictly distribution centers, but as the e-commerce landscape has evolved, value-added warehousing can include things like repackaging, relabeling, or other aspects of the physical conversion of a product. Warehouses can be the last stop for products before they move into the customer's hands. And transportation is really the focus of the group I manage. Transportation commerce really starts with shipping containers which are really the tip of the spear for global, import and export activity, and containers are in voracious demand. But transportation, obviously, can occur through a multitude of avenues, planes, ships, barges, trucks, and products are often delivered to customers via the so-called last mile service, via vans or hired drivers. So those are six of the seven points, and the last one is customer service which, obviously, includes all sale and post-sale activities. One important aspect that's maybe less understood is reverse logistics, which is really when the customers return products and that's also part of ensuring a high quality customer experience.

So, I think it's really important to be proactive and strategic in managing any risks along the supply chain. You know, some of the risks can be controllable and some are not controllable. Examples of uncontrollable risk could include natural disasters, cyberattacks, geopolitical instability, but the bottom line is, all of these potential risks, are negative and often result in lower revenue or increased expenses, and, so, the consequence can be things like productivity losses following a cyberattack. We've seen that with some large multinational companies,



increased labor costs from a service disruption, you know, damage to a company's reputation, product recall, loss of customers. So, again, really important to be strategic and proactive in managing every aspect of a supply chain.

Chris Blose:

So Juan, I've read there are long wait times in a lot of ports right now. So what are some of the factors and dynamics that are contributing to what's happening in our port systems? What is contributing to that high congestion?

Juan Cazorla:

Yeah, great question, and there's certainly been a lot of discussion about what's happening at the domestic ports. You know, the US economy has experienced the confluence of a lot of events over the past few years that have contributed to where we are today. The primary backdrop is, you know, e-commerce now comprises a much larger portion of consumer spending than before the pandemic. You also have pent-up consumer demand following the pandemic and the pace of consumer spending has really accelerated. Just as an example, loaded container imports into the port of New York and New Jersey in June of this year were about 47% higher than at the same time last year.

So, with import shipping at all-time highs, many warehouses and shipping yards are teetering at maximum capacity and really struggling to manage the influx of cargo. So you've seen a bottleneck at ports, lots of delays, just as another example the average shipping container idle time at ports has increased from an average of three days to seven days, so there's a lot of lost productivity and there's a real cost to the economy and the consumers. One such cost is something called demurrage charges which shippers are assessed if the process of unloading a container takes longer than a predetermined time, and that cost is ultimately passed onto the consumer. We've also seen a lot of companies incur real costs as a result of these delays. For example, one large well-known retailer said it spent an extra \$200 million annually to carry an extra seven to 14 days of inventory because of the port congestion. Certainly, COVID was a catalyst, but the face of trade here in the United States really started changing a few years back.

If you recall a couple of years back, the US started assessing tariffs on certain goods, and China retaliated, and companies have tried to move away from China, but the reality is, China still represents a favorable place to manufacture due primarily to lower labor costs. Social distancing mandates certainly loomed large. Worker productivity at the ports is not as high as it used to be. Fewer workers can be on a shift at the same time. And then the other factor's congressional regulations which mandated that operators of commercial motor vehicles limit hours driven, which has impacted truck driver availability at a time when the industry is grappling with overall driver availability. So, in summary I'd say that the shipping landscape is certainly tenuous right now. I think the silver lining, if there is one, is that the situation has the attention of the current



administration. The infrastructure spending bill will see an acceleration in more efficient port operations. But for now, we certainly expect to continue to see disruption at the ports.

Chris Blose:

And if I'm a business owner watching this situation, is there something I can do strategically? You mentioned earlier, maybe rethinking the way you manage inventory, for example.

Juan Cazorla:

In this environment, it behooves companies to really be strategic and very precise about inventory planning, and plan for a rainy day because the reliability of global supply chains is not what it used to be.

I talked about that one retailer that keeps an extra seven to 14 days of inventory on hand. I think that is a good practice. Just plan for the unexpected because the reliability of the system is just not what it used to be.

Chris Blose:

Let's talk about another aspect of transportation, too, which is trucking, which obviously ties into the supply chain. But I know there's some constraint on the side of the trucking industry, too. So can you tell me about what factors are affecting the trucking industry, and sort of what trends you're seeing there, as well?

Juan Cazorla:

Yeah. Great question, Chris. So, you know, the primary issue for the trucking industry, whether you're a provider or user of services, is the absence of qualified drivers which, frankly, was an issue even before the pandemic started. What happened during COVID is that a lot of drivers got sick and a lot of them never came back. A lot of companies furloughed drivers and some of those drivers also didn't return. Some retired or found new career paths. We also saw driver school enrollment plummet, as a result, we've had fewer trainees entering the system.

Regulatory changes have also factored into the mix. Drivers now have to log their hours electronically as Congress has established rules and regulations on how many hours truck drivers can work. These factors have really served to limit what used to be a fairly abundant supply of truck drivers at exactly a time when there's pent-up demand for drivers at all levels, on the roads and on the ports. So, it's an issue for both users of transportation services and providers of such services.

Chris Blose:

And I'm curious, what sort of industry headwinds are you seeing? What changes do you think lie ahead for both the trucking industry, and for our ports?

Juan Cazorla:



Yeah, great question. You know, I think what we've seen in the trucking industry, specifically, is higher wages, higher salaries, and signing bonuses, really across the board, regardless of the type of trucking company that you're talking about. And the consequence of that at the consumer level is that, you know, trucking companies really can't absorb these higher wages, so they're passed on to consumers in the form of higher prices and, you know, certainly, consumer inflation has been in the news of late.

One thing that we think we'll see eventually are driverless trucks for certain routes. It's really not a question of if but it's more of a when. The technology already exists today and is being actually tested at both the manufacture and transportation provider level, and certainly with the infrastructure bill will see an acceleration towards that.

We're also seeing an acceleration towards other forms of powering trucks such as electric or hydrogen, and we'll probably start seeing that with the cargo vans, and certainly all of that is a step in the right direction when we think about ESG considerations. And so, from that perspective, things seem to be moving in the right direction.

Chris Blöse:

You know, we think about air, sea and land, right, in terms of, of shipping. So, let's talk about airfreight just a little bit. Can airfreight take some of the pressure off of sea and road shipping?

Juan Cazorla:

Yeah. Airfreight is certainly part of the transportation continuum, and as we know, there are a lot of well established providers of airfreight services that have their own captive fleets and the demand for their services is at all-time highs. We believe that in the short-term, airfreight may relieve some of the pressure from other forms of transportation out of necessity. But the reality is, all else being equal, air transportation services are more expensive compared to, say, trucking or sea-based transportation. The other dynamic is that, with business travels still way below pre-pandemic highs, many airlines have actually converted passenger planes to cargo planes to replace business travel as a source of revenue. Many cargo carriers have had to shift to airfreight from ocean shipping because of limited vessel space and port congestion. And, if you think back to the e-commerce trends, the expectations for delivery times are quicker. But the reality is that airfreight capacity is very tight right now. For example, global air capacity is about 14 to 18% below pre-crisis levels, because airlines are still not operating a lot of the long-haul wide-body fleets until business travel rebounds. I think the bottom line is that there's not enough extra airfreight capacity to make a meaningful impact unless carriers are willing to bring back some of the furloughed aircraft.

Chris Blöse:

I'm curious, too. You've mentioned a few things. You mentioned higher wages for the trucking industry, for example. Or, you've mentioned potentially having more inventory on hand which



may increase cost. So there are a few things that, if I'm a business owner, I'm gonna look at this and think, "This is probably going to increase the cost along the supply chain in the coming years." So, what is your response to that? And how do you see that cost being passed along to businesses, and then ultimately to consumers, as well?

Juan Cazorla:

Yeah. I would say that, in the near term we should continue to expect price increases as the e-commerce world in which we now live continues to evolve. Again, there are fewer drivers out there. The supply chain is somewhat disrupted as I've talked about. As supply chains adapt and conditions normalize, we do expect price increases will dissipate. We've talked about driverless trucks and delivery vans being developed. That will certainly happen over time and certainly could prove to be more cost effective than the delivery systems that exist today. One interesting development is the executive order that was recently signed, which calls for the sales of electric fuel cell and plug-in hybrids to account for 50% of passenger car and light truck sales by 2030. We believe you could see a parallel mandate for over-the-road trucks. And so, as transportation providers shift from gas power to other forms of energy, that certainly will entail some costs. I believe that some of those costs are likely to be subsidized by the government through tax incentives. But again, any time you're going through such a huge transformation, it's hard to imagine, at some levels, that consumers won't be impacted unless the manufacturers are able to offer incentives. So, the answer is, yes, increased costs in the near term, over the medium to long-term as the disruption subsides, you can see costs normalizing again.

Chris Blöse:

A lot of the things you've mentioned do seem like challenges, but also, possibly, opportunities, right? Whether we're talking about new technology for trucking, new technology for meeting some of these environmental concerns or mandates that are coming forward. So, where are you seeing opportunities to fill unmet market needs?

Juan Cazorla:

Yeah. So, there's certainly an opportunity for the use of technology in the trucking sector. We've certainly seen technology companies enter the trucking landscape that have not historically been in the trucking industry, and frankly they're bringing better technology than a lot of the established players have. What technology's really done is made the system more efficient because when brokers are able to communicate more efficiently with carriers, the efficiency of the overall system increases. You know, trucking historically has been kind of a staid industry, but certainly in the last three to five years we've just seen a big focus on technology-enabled solutions.

Chris Blöse:

I think based on what you said, too, another area of opportunity that comes to mind is for logistics companies, or third party logistics, specifically. So, you mentioned earlier, people, they're doing things maybe that they haven't done before in the area of warehousing, or



thinking about the way they're approaching inventory. So, in your mind, what role will these logistics companies be playing, both in the near and longer term future?

Juan Cazorla:

Third-party logistics providers have really benefited from the current environment, where we're seeing supply chain disruptions, and a lot of the changes that have followed the pandemic. We talked about port delays and some of those complexities. You coupled that with record low inventory levels, which is really manifested in the inventory to sales ratio which is at 1.25 to one, right now, which is the lowest level we've seen since March of 2011. So, these low inventory levels really present an opportunity for third-party logistics providers as companies ramp up these low inventories. And the reality is, very few providers of transportation services have the available capacity to meet all of the needs of shipping clients. Trucking companies are turning away loads because they really just don't have the capacity to meet the demand. And again, this is an opportunity for third-party logistics companies. You know, the rise of e-commerce has really spurred the need for things like brokerage, which is really just managing overload or unexpected demand. And, you know, the way inventory's managed is changed, too. Pre-pandemic people were engaging in just-in-time inventory, with the crisis exposing a lot of the fragility of that inventory method, better practice that we're seeing in today's environment is really stocking up on inventory, not to a level that impacts a company's profitability, but using these 3PL or third-party logistics companies to help with warehousing and procurement, because these companies, that's what they do. So, the current trends certainly bode well for third-party logistics providers.

Chris Blöse:

I'm glad you mentioned e-commerce. I think it's really important to talk about and everything that I'm reading I believe the consumer purchasing patterns that have changed in the last year-and-a-half are likely to be permanent changes. So, in your mind, how have things like e-commerce changed the supply chain dynamics?

Juan Cazorla:

Yes. So, domestic e-commerce sales increased in 2020 to 861 billion, up 44% from 2019. E-commerce now represents about 21% of total retail sales compared to less than 1% in 2000. So, there's been a material shift in buying patterns, and many would say that COVID shifted forward the e-commerce curve by three to five years due to social distancing considerations. There's a view that a lot of this shift is permanent, and I think it certainly manifested itself in consumer buying patterns. The trend is clearly towards e-commerce. So, today goods are increasingly stored in distribution centers for eventual direct distribution to the consumer rather than going to the retail store. So we've witnessed an explosion of warehousing and distribution center developments, so that a lot of the products for these e-tailers can be closer to the population centers and meet customer demand expectations. So, again, we talked about third-party logistic services. E-commerce has really spurred the need for warehousing distribution, and certainly the last mile services which have become fairly routine today.



Chris Blöse:

I think that's an example of massive change in the industry, and I think an example of massive disruption in the industry on the flip side of that would be the semiconductor shortage, and that's something that is constantly being held up as an example of over-reliance on foreign production. But I know the problem is much deeper than that. Any delay there affects manufacturing of our electronics, our cars, you know, maybe even some of the technology that we're talking about from automated trucks to port technology. So, what are you seeing in terms of trends there? What kinds of policy changes are really gonna be necessary to respond to that shortage?

Juan Cazorla:

Yes. So, in the transportation sector, the chip shortage is really impacting the trucking industry. If the chip shortage persists and new trucks aren't coming into the system, that could cause some service issues down the road given the truck companies generally replace their fleets after say three to four years to keep service levels high. And so, COVID has really exposed the global chip manufacturing paradigm, and certainly there will be gradual changes to where we manufacture these key products. But it's a complex topic, because the shortage is not just affecting trucking but things like the manufacturing of refrigerators, washing machines and passenger cars. The reality is that the US today only accounts for about 12.5% of semiconductor manufacturing. A lot of the world's chips are manufactured in places like China and Taiwan. We've seen a lot of the large auto manufacturers publicly note that the shortage is impacting production and causing extended downtimes.

The solution is developing. There's certainly been talk within Congress of the potential consequences of the shortage. President Biden signed an order that includes a review of key products including semiconductors and advanced batteries used in electronic vehicles in a separate, long-term review covering six sectors of the economy. Over time, the long-term review is expected to really strengthen supply chains. But the reality is, there's not an immediate solution, so what we expect is that the industries that are impacted to push for tax incentives to encourage the manufacturing of chips in the US. This will take some time, and certainly the Biden administration has laid the groundwork. But this will take collaboration with countries like Japan, South Korea and certain European countries to be on the same page, and that won't be easy. So, I think that it's a developing situation, but certainly one that has the attention of the current administration.

Chris Blöse:

Well, thank you so much for joining us today. One last question for you. If you're having a conversation with an owner or an entrepreneur right now, and they wanna know kind of what they should be watching of the supply chain, what is the one bit of advice you can give





somebody about either trends or things that you can do to kind of shore up your supply chain right now?

Juan Cazorla:

Yeah, great question. So, I would say, for business owners, as it relates to shipping services, don't play the spot market, meaning, lock down your transportation services. That way you can budget your expenses with the trend of transportation services still being upward sloping, locking those costs down and having a contractual arrangement with the provider, I think, is certainly a prudent strategy.

Right now, the balance of power from a pricing perspective is currently with the providers of transportation services, and what we have seen is that business owners are most concerned about the availability and reliability of services as opposed to necessarily scrutinizing pricing which, obviously, is a consideration, but in this environment where there's more demand for transportation services than supply just not playing the spot market and locking down your transportation services is prudent. On the other hand, if you're an operator of a trucking company, my advice would be, given the chip shortage that we talked about, I would suggest strongly, just focus on securing your fleet availability for the near term, just given the fact that the chip shortage does not appear to be something that's gonna be solved in the near term. So, just making sure you're affecting prudent inventory planning from a fleet perspective is important.

Chris Blöse:

That sounds like good advice. Thank you so much for joining us today. We really do appreciate your perspective.

Juan Cazorla:

Thank you.

Chris Blöse:

If we've learned anything over the past year, it's that planning is key to withstanding disruption. And while some of the disruption we've experienced due to COVID has started to gradually dissipate, both new challenges and new opportunities have begun to arise. As Juan notes, in today's world, it's important to be strategic and precise in your planning.

Thanks to Juan Cazorla for sharing these insights with us, and thanks to you for listening. For more on supply chain management, be sure to check out episode three of this series, Building a Less Vulnerable Supply Chain. You can find this episode and more at [regions.com/commercialpodcast](http://regions.com/commercialpodcast). And be sure to subscribe to this podcast on your favorite podcast service.



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