



A Sea Change in the Logistics Industry

There are three trends that are causing a sea change in the logistics industry today:

- environmental regulations
- security requirements, and
- transportation costs.

All three are reshaping global trade. And all three are forcing companies to re-evaluate their strategies. As deadlines approach, they are scrambling to comply and questioning the conventional wisdom. They're also searching for experts who can help them profit in this brave new world.

These trends can be traced directly to three recent events: new regulations in Europe, tighter cargo security in the United States, and skyrocketing fuel costs that threaten to flatten global trade.

All three will have a dramatic effect on the supply chain.

REACH

The first trend—tighter environmental laws—is best illustrated by new regulations called REACH. Last summer the European Union began requiring all exporters of chemicals, components, and products containing chemicals to begin registering those substances. The regulation is called REACH, which stands for the Registration, Evaluation, Authorization, and Restriction of Chemicals.

REACH is the world's most ambitious law on public health and environmental protection. It replaces some 40 individual pieces of legislation with what the EU hopes will be a more streamlined system. It is designed to consolidate prior laws and regulations to create a single system for tracking chemicals manufactured in and imported into the EU.

With REACH the EU is trying to minimize the potential health and environmental impact of those substances by sharing information among its member states. That means registering some 30,000 chemicals over the next 11 years. It also means additional reporting requirements for a broad range of industry sectors, such as pharmaceuticals, industrial chemicals, cosmetics, and cleaning products. The new policy covers a number of businesses, from

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producers of substances and end-products to exporters, importers, distributors, and downstream users.

REACH is far-reaching. It applies to all chemicals, from substances used in industrial processes to those used in everyday life. It includes paints, clothes, furniture, electrical appliances, and others. It applies to chemicals themselves, chemicals used in preparations, and chemicals that are intentionally released from products. All of these must be registered with the European Chemicals Agency.

REACH places the onus on manufacturers and importers to collect data and share information about the chemicals used in their respective products, plus any risks they may pose. These regulations present a significant challenge to exporters, who must now master the intricacies of the new law or lose the ability to do business in this important market.

For exporters to Europe, REACH is a game-changer. If a company cannot comply, it won't be able to sell products in one of the world's biggest markets. The EU's 27 member countries and 500 million citizens make it the largest economy in the world by nominal GDP. Lack of compliance could jeopardize the business.

Yet compliance itself holds considerable risk as producers and importers face the possibility of having to share proprietary information. They may also have to test their chemicals if the data is deemed incomplete. Companies must submit information on the physico-chemical, health, and environmental properties of their substances to determine how they can be safely used. Each manufacturer and importer must submit the data and assessments to the European Chemicals Agency in a registration dossier. The potential for divulgence of trade secrets is very real, so it is critical that REACH compliance be handled extremely carefully.

Compliance is complex. There are multiple definitions of products and multiple deadlines, plus restrictions on who can register these products. Companies should take all of this into consideration when developing a strategy for complying with REACH.

Under the regulations, two broad categories of chemicals must be registered: those already being manufactured or imported into EU countries (called *phase-in substances*) and those that are new to the EU (called *non-phase-in substances*).

For phase-in substances there is a pre-registration period and final registration period ranging from 3 to 11 years. Phase-in substances are ones that were already being manufactured or imported into the EU before the implementation of REACH on June 1, 2007. They faced staggered registration deadlines based on how many tonnes an exporter is bringing into the EU. For non-phase-in substances there is simply a registration period and no staggered deadlines. In almost all cases, these substances must be registered before they can be manufactured or imported into the EU.

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To further complicate matters, foreign nationals cannot register their own substances. Under REACH, only a natural or legal person established in the EU can be a registrant. Exporters that do not have a subsidiary in the EU have three basic routes to compliance. They can:

- establish a subsidiary in the EU
- allow the importer to register their products, or
- outsource the process to a legal representative familiar with REACH, the EU regulatory climate, and the chemicals industry in general.

Let's look at those three in more detail.

Establishing a subsidiary can be costly and onerous in terms of maintenance and management. Abdicating the process to an importer runs the risk that confidential information could be compromised by disclosure or reverse engineering. If the registrant is an importer or distributor, that entity technically owns the registration and is responsible for communicating with the European Chemicals Agency. The agency will require detailed disclosure of the composition of chemicals and other products. In addition, working through an importer or distributor may make it difficult to alter future distribution channels in the EU. In fact, changing partners in Europe may cost an exporter access to the EU market.

The process of establishing an internal team to gather data, test substances, file reports, and interface with the EU can tax the resources of even the largest companies. The REACH deadlines point up the need to act quickly to ensure uninterrupted access to the EU market. Within this context, outsourcing REACH compliance to an expert familiar with the regulations may prove to be a viable alternative.

Outsourcing can be accomplished through what REACH calls an *Only Representative*, an agent that can register the substances of non-EU members. An Only Representative must be both a legal entity established in the EU and have, quote, sufficient background in the practical handling of substances and the information related to them, closed quote. As such, the representative can serve as a valuable adviser for developing a global REACH strategy. That strategy can complement internal compliance programs through transaction auditing, training, and the formulation of appropriate policies for present and future filings.

An Only Representative can provide an exporter with greater control over the entire registration process, including critical aspects of reporting and testing. This should minimize the potential for disclosure of proprietary information. In addition, experts on REACH can help meet and maintain the rigorous and ongoing compliance schedule, allowing exporters to focus on their core business.

A final word on REACH. The key challenge to compliance is remaining viable in this crucial market while protecting trade secrets. Outsourcing this process can provide a logical solution for exporters looking to maintain their

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competitive edge. It allows companies to retain control over the entire process, including ownership of the registration data. But whatever a company decides, it should start now to study the far-reaching implications of REACH.

10+2

Exporters to the EU aren't the only ones affected by new rules. U.S. importers are struggling to understand the impact on their supply chains of proposed regulations called 10+2.

Created by U.S. Customs and Border Protection as part of the SAFE Port Act of 2006, 10+2 would require carriers to submit additional pieces of information to Customs officials 24 hours before a container is shipped. 10+2 is designed to improve the government's knowledge about the content, origin, and destination of international containers. Its purpose is to identify potential high-risk shipments before the cargo reaches American shores.

The 10+2 rule will require importers to provide 10 data elements for security screening that do not appear on a cargo manifest, with an additional two from ocean carriers. Importers also will have to report the existing seven data elements much earlier in the supply chain. The new information includes the name of the companies that both manufactured the goods and stuffed the container. Some of that information may be hard to obtain and require enterprise-wide systems that are beyond the capabilities of current in-house networks.

The proposed regulation—the final rule has yet to be published—poses a number of problems for U.S. importers, as highlighted in a recent survey done by BDP International. Executives questioned about 10+2 were largely unclear about the requirements—only 17% of them had a very clear understanding of the proposed regulations. Executives were equally concerned about how they will obtain this new data before their cargo ships. They were unsure whether their IT systems can handle the additional information. And they were equally unclear about how they will recover the costs of compliance.

The pressure to obtain new data elements from new partners is one of the biggest challenges an importer will face in dealing with this program. That's why more than 90% of the companies we surveyed are looking to U.S. brokers to develop the right solution at the right price to deal with the additional requirements.

As with REACH, the issue of confidentiality further complicates the situation. U.S. importers will need to report exactly where that ocean container is being loaded, or stuffed, in 10+2 parlance. That can pose a problem. Sometimes the exporter is not the manufacturer. Often there are middlemen who have multiple countries of origin for these products. The exporter may want to keep that information confidential. And that could affect an importer's ability to comply.

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Further muddying the waters is the fact that ocean vessels are sometimes redirected en route for commercial purposes, long after the importer would have to file its 10+2 data.

Fuel

The third major trend that is reshaping global trade involves the persistently volatility in the cost of fuel and its pass-through effect in the economy. According to CIBC World Markets, the cost of shipping a 40-foot container from Asia to the east coast of the United States has tripled in the past eight years. The cost to fill an average tractor-trailer has increased by 116 percent over the past five years—and trucks carry 70% of U.S. freight. Those numbers are from the American Trucking Associations. They and others believe the cost of fuel is perilously close to surpassing the cost of labor as a trucking company's biggest expense.

The airlines provide another example of the negative effects of rising fuel costs. Stories about the trials of U.S. carriers are in the news daily but even companies in higher-demand areas like Asia are struggling. The International Air Transport Association says that a toxic combination of high fuel costs and falling demand will see airlines post losses of \$9.3 billion over the next two years.

All this is starting to work its way through the supply chain. And it is posing a strategic as well as a financial challenge to everyone in the global logistics industry.

One casualty, although this might be temporary, is the rush to offshore manufacturing. Higher transportation costs could eventually wipe out any cost advantage to outsourcing to countries with cheaper labor rates. Add to that recent concerns about product quality and rising labor costs abroad and it's no wonder some companies are re-evaluating their decisions on where to manufacture and source their products.

But as fuel prices remain persistently high and as countries introduce new environmental and security regulations, the real question is how companies will adapt to this sea change. The answer is *awareness*. Constant monitoring of the global supply chain and the cost of inputs is a must. But so is an understanding of the complex systems and regulations that affect our business—and the expertise to deal with these changes. It's only through awareness that we can prepare for the unexpected . . . and keep our heads above water.