

Seven Mega-Trends Shaping Modern Logistics

Growth in the 3PL Marketplace is back. In this article we highlight seven trends that show the industry is poised for more expansion and will likely yield significant benefits for logisticians engaged in global practices.

By Benjamin Gordon

FIRST AND FOREMOST, growth is back – the 3PL market is up 6%, to an estimated \$80 billion. The industry is achieving record profits. For instance, UTi in the last quarter saw gross revenues up 50%, net revenues up 29%, and profits up over 50%. The stock market reflects this renewed vigor. For the last 12 months, the S&P is up 14%, and the DJ Transports are up 17%. In contrast, the basket of logistics companies is up 84%! Highlights include Hub Group, which is up 280%; Target, up 74%; TLC, up 85% (and fueled by a name change from C2 to Total Logistics Corporation). Eagle Global Logistics is up 57%, and Expeditors is up 33%. Clearly the market believes these companies are poised for future growth.

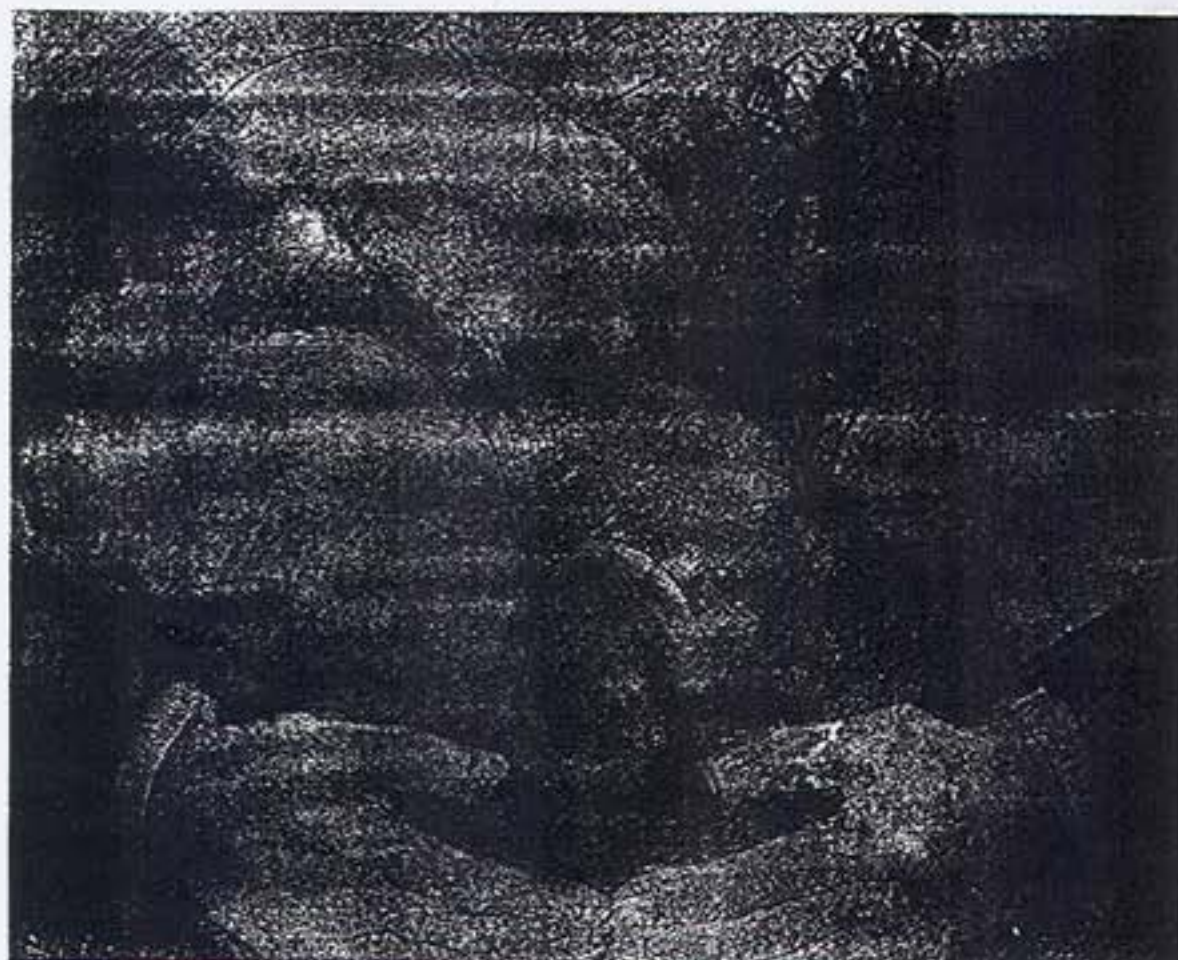
What is driving this growth and opportunity in the 3PL marketplace? In addition to the continued expansion of logistics outsourcing, I would like to highlight seven mega-trends in particular.

1. Lean logistics: continued reduction in inventory levels

One key metric of logistics efficiency is the inventory/sales ratio, which measures the level of inventory companies require to support their annual revenues. Last year, the U.S. inventory/sales ratio fell to a record low of 1.38. This year, the number has dropped even further, down to 1.32!

Over the longer term, logistics spend as a percentage of GDP has dropped even more significantly. In 1981, this metric stood at 16.2%. Today, it has fallen nearly 50%, down to 8.5%. Over the same time period, inventory carrying costs have dropped 60%, versus a 20% decrease in transportation costs. The key driver has been the reduction in inventory levels.

Who are the 3PL beneficiaries of this



mega-trend? Those companies that help their customers to operate with lower warehousing, inventory, and supply chain systems costs are all emerging as big winners. For instance, KN Lead Logistics won the Nortel outsourcing contract by promising major reductions in the cash-to-cash cycle and other balance sheet improvements. Similarly, Unicity has delivered significant value for companies like Maytag by developing and executing supply chain strategies to reduce the number of warehousing locations for Fortune 500 companies in Canada. These "lean logistics" leaders will continue to drive supply chain value for their customers.

2. New technologies – RFID is finally happening

The conventional wisdom about logistics technology falls into one of two camps: it's revolutionary or it's over-

hyped. The reality is that moderate adoption is indeed happening. The U.S. Defense Department has been using RFID since 1991, with the first Gulf War. I just returned from Kuwait, and saw one of the warehouses where RFID is being used for military logistics. This new technology is indeed being deployed.

In the past year, several initiatives have come to fruition. Just last June, Wal-Mart announced the top-100 mandate for January 2005, followed by full adoption for Wal-Mart's 10,000 and the Defense Department's 43,000 suppliers. Today, Wal-Mart has successfully launched an April pilot project, with eight major suppliers and one Texas distribution center serving seven stores. Meanwhile, leading supply chain software provider Manhattan Associates generated 4% of its last quarter's sales from RFID, based on five new customers. With a sales pipeline of 50

prospects for its RFID applications, Manhattan Associates expects to see significant growth in this category.

Innovative 3PLs are leading the way. 3PL pilot projects have emerged in several areas – DHL for Metro in Germany, Exel for the House of Fraser in UK and China, and Trenstar for Coors. While it is undoubtedly true that format wars will complicate adoption – e.g. ambiguity

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between class 0, class 1, and Gen 2 – there is no question that RFID is happening, and will open doors for smart 3PLs.

3. China – growing at least 10% annually and revolutionizing global logistics

The explosion in the Chinese manufacturing market has major implications for the global logistics arena. As China grows some 10% annually – official estimates are slightly lower, but construction in Shanghai alone is up 40% over last year – the ripple effects are being felt worldwide. Chinese exports are up 35% annually, and imports are up 40%. As a result, cargo volumes for the Asia-California shipping lanes have risen 8%. However, due to a shortage of capacity, ocean rates have soared by over 40%. This impact is being felt more dramatically in certain sectors. For instance, steel mill spending tripled in the last year! As a consequence, China now consumes 30% of the market.

The China phenomenon will have massive implications for 3PLs who are focused on manufacturing and industrial sectors. Already, most 3PLs are scrambling to ensure a major foothold in this market, either through acquisitions, start-ups, or joint ventures. This pressure will only increase in the coming years.

4. NAFTA – another high-growth market, closer to home

While China has captured the headlines, the convergence of NAFTA markets has created significant opportunities for North American logistics providers in both Canada and Mexico.

Over the past decade, US exports to Canada have grown at 10% annually. Last year, over 10 million trucks crossed US-Canada borders, as the U.S. imported \$211 billion from Canada and exported \$161 billion. Similarly, truck crossings on the U.S.-Mexico border grew from 2.8 million in 1995 to 4.4 million in 2002, as both exports to and imports from Mexico more than doubled over the same time period. As U.S. companies continue to expand trade with NAFTA neighbors, and as security regulations create increased complexity in terms of compliance, cross-border services will provide expanding opportunities for innovative logistics companies.

Logistics companies who are particularly well-positioned are those focused on lean logistics. As cross-border transit times become more reliable, logistics firms that eliminate excess inventory and provide high-velocity logistics solutions will become increasingly valuable.

5. Regulatory changes – simplification and complexity

Regulatory changes are creating two sets of dynamics. On the one hand, deregulation initiatives are promoting simplification. President Ronald Reagan's death reminds us of the history of deregulation. In 1981, the Interstate Commerce Commission stood at 11. This entity was eventually eliminated by Reagan, and replaced by a much weaker Surface Transportation Board. Ongoing deregulation will continue to facilitate competition.

On the other hand, the regulatory environment is also marked by expanded complexity. Supply chains are only beginning to adapt to the 24-hour rule for trucks, and its equivalents for other modes. Security mandates will add to the regulatory requirements companies will need to meet. As a result, regulatory changes will ultimately fall on the shoulders of 3PLs, who will become security partners as well as supply chain partners for their customers. 3PLs that can adapt to this regulatory environment will succeed, just as innovative trucking

firms prospered in the years following motor carrier deregulation in the 1980s.

6. Consolidation – the wave continues

The logistics market witnessed a massive wave of consolidation in 2000-2001. Mega-mergers combined the firms of Deutsche Post-AEI-Danzas, UPS-Fritz, Kuehne & Nagel-USCO, and Exel-Mark VII. After a brief pause in 2002-2003, the pace has quickened. In the past few months, we have witnessed the following:

- Ozburn-Hessey's acquisition of Lanter Logistics – to consolidate the warehousing marketplace
- PBB's acquisition of Clarke Logistics – to solidify their Canadian/cross-border position
- Reliant Equity's acquisition of Air-Road – to build on the company's leadership position in the U.S.-Mexico transportation management marketplace
- DHL's acquisition of SmartMail – providing a high-growth, North American post office logistics service offering for the German logistics giant
- TPG's acquisition of Wilson for over \$200 million – adding a Scandinavian freight forwarding base to TPG's global logistics operations
- Exel's acquisition of Fujitsu's logistics arm for \$46 million – providing Exel with a strong beachhead for Japanese market expansion
- Exel's acquisition of Tibbett & Britten for over \$600 million – consolidating Exel's contract warehousing and logistics leadership within both North America and the UK

This wave of consolidation will continue. It will be fueled by growing customer demand for one-stop-shop solutions, new technologies, and deep-pocketed buyers. The private equity marketplace stands at a record level of capital, with \$120 billion in money on the sidelines. As this capital seeks a home, we may well see \$12 billion invested in the supply chain sector over the coming five years. Meanwhile, strategic buyers like UPS are sketching plans to deploy a significant portion of their \$2 billion in annual free cash flow within the logistics sector.

The implications for logistics companies are significant. As smart money flows into the most successful sectors, it

will become harder for most independent 3PLs to succeed without aligning with a partner.

7. Niche services – required for mid-market companies to compete successfully against global giants

While the preceding trends may appear to pose challenges to mid-market logistics firms, plenty of opportunities still exist. The most successful mid-market 3PLs are developing successful strategies to dominate attractive niche markets.

For instance, reverse logistics is a \$35 billion annual market. This service involves the management of reverse flows of product throughout the supply chain. Mass merchandisers see typical return rates of 4-15%, while cataloguers see 18% returns. Privately-held Genco has built an extremely successful leadership position within the reverse logistics niche.

Similarly, service parts logistics has become an important part of the supply chain for high-technology and telecommunications companies. This service revolves around rapid fulfillment of high-value parts, typically through critical parts warehousing located near airport facilities for next-flight-out execution capabilities. USCO built a service parts logistics capability for Sun Microsystems in the late 1990s, ultimately driving from breakeven to \$40 million of EBITDA in less than five years on the basis of these and other differentiated services.

Other niche services include the convergence of warehousing with packaging (as represented by Power Logistics, which Exel recently purchased) and the convergence of financial services with logistics (embodied by UPS' expansion of trade financing capabilities). Ultimately, the smartest 3PLs will seek out new niche markets to dominate in the coming years.

In conclusion, the logistics marketplace will continue to be a source of growth and opportunity for the innovators. Logistics companies that anticipate and respond to these seven mega-trends will be winners well into the future.

This article was derived from Mr. Gordon's speech at a 3PL Summit, partly sponsored by LQ, on June 28, 2004 in Chicago, where he served as Conference Chairman.



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