# Seven Mega-Trends That Will Reshape Logistics

by Benjamin Gordon

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It's a good time to be a third-party logistics company. The mood of the logistics industry has improved considerably since early last year.

First and foremost, growth is back — the 3PL market in 2004 grew 6 percent to an estimated $76 billion. The industry is achieving record profits.

The stock market reflects the renewed vigor. For 2004, the Standard & Poor's 500 index increased 9 percent. At the same time, the basket of asset-light logistics companies soared 75 percent. (Hub Group went up 141 percent; Landstar 93 percent, and UTi Worldwide 75 percent, among others.) Clearly Wall Street believes these companies are poised for future growth.

What is driving this growth and opportunity? Part of the answer is a reviving economy and continued expansion of logistics outsourcing. But there are substantive changes occurring below the radar. Here are seven mega-trends manufacturers, retailers and others who buy 3PL services should consider as they construct global supply chains.

## 1 Lean logistics is reducing inventory

One key metric of logistics efficiency is inventory/sales ratio, which measures the level of inventory companies need to support their annual revenues. The U.S. inventory/sales ratio has fallen to a historic low of 1.32 by recent measures.

Since 1981, inventory carrying costs have fallen nearly 60 percent and transportation costs declined 20 percent from 1981 to 2003. 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 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 such as 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 shipping customers.

## 2 New technologies such as RFID are finally happening

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 happening. The U.S. Defense Department has been using RFID since 1991 and the first Persian Gulf War.

In the past year, several initiatives have come to fruition. Shippers are working under RFID mandates from retailers Wal-Mart, Target, Metro AG and the Department of Defense. Wal-Mart has successfully launched a pilot project, with eight major suppliers and one Texas distribution center serving seven stores. Meanwhile, leading supply chain software provider Manhattan Associates generated 4 percent 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 United Kingdom and China, and Trenstar for Coors. Although format wars will complicate adoption, there is no question RFID technology is taking root, and it will open doors for smart 3PLs.

## 3 China is revolutionizing global logistics

The explosion in the Chinese manufacturing market has major implications for the global logistics arena. As China grows some 10 percent annually — official estimates are slightly lower, but construction in Shanghai alone is up 40

**New services include the convergence of warehousing with packaging and the convergence of financial services with logistics.**

percent over last year — the ripple effects are being felt worldwide. Chinese exports are up 35 percent annually, and imports are up 40 percent.

As a result, cargo volumes for Asia-California shipping lanes have risen 8 percent. However, with capacity short, ocean rates have soared more than 40 percent. 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 percent of the global steel market.

The China phenomenon will have massive implications for 3PLs that are focused on manufacturing and industrial sectors.

Most 3PLs already are scrambling to ensure a foothold in this market, either through acquisitions, start-ups or joint ventures. This pressure will only increase in coming years.

## 4 NAFTA remains a high-growth market

Although China has captured the headlines, the convergence of markets under the North American Free Trade Agreement has created significant opportunities for logistics providers in both Canada and Mexico.

Over the past decade, U.S. exports to Canada have grown 10 percent a year. Last year, more than 10 million trucks crossed the U.S.-Canada border, as the United States imported $211 billion in goods and services from Canada and sent $161 billion in trade north. 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 compliance complexity, cross-border services will provide expanding opportunities for innovative logistics companies.

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

## 5 Security requirements make logistics more complex

Regulatory change at the federal level is creating two sets of dynamics. On the one hand, economic deregulation is promoting simplification and competition. Remember the Interstate Commerce Commission? In 1981, the ICC had 11 members. It was eliminated in 1995 and replaced by a much weaker Surface Transportation Board, which today has only three members. Ongoing deregulation will continue to facilitate competition.

Yet security regulations instituted following the September 11 terrorist attacks are making the logistics world increasingly complex. As a result, 3PLs 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 1980.

## 6 The consolidation of logistics companies 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 a flurry of deals:

PBB's acquisition of Unicity Integrated Logistics for $45 million to solidify their Canadian/cross-border position.

UPS's acquisition of Menlo Forwarding for $260 million to add to their Fritz-based global freight forwarding network.

JP Morgan's acquisition of Vastera for $129 million to make a bigger play for global trade financing.

This wave of consolidation will continue, fueled by growing customer demand for one-stop shopping, 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 that capital seeks a home, we may see $12 billion invested in the supply chain sector over the next five years. Meanwhile, UPS is sketching plans to deploy a significant portion of its $2 billion in annual free cash flow in 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 Mid-market companies offer niche services to compete against global giants

The most successful mid-market 3PLs are developing successful strategies to dominate attractive niche markets.

For instance, reverse logistics is a $35 billion market. Mass merchandisers see typical return rates of 4 to 15 percent, while cataloguers see 18 percent returns.

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 Logistics built a service parts logistics capability for Sun Microsystems in the late 1990s, ultimately driving from break-even 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's expansion of trade financing capabilities).

Ultimately, the smartest 3PLs will seek out new niche markets to dominate in the coming years.