The World Turned Upside Down: The Year in Review, and the State of the Logistics Industry in 2006

By Benjamin Gordon

When American Revolutionary troops defeated the British in 1783, Lord Cornwallis marched to surrender to the tune of *The World Turned Upside Down*. Today, 223 years later, this tune seems like an apt metaphor for the warehouse logistics market in 2006.

Who would have predicted that, in an era increasingly dominated by large, asset-light logistics giants such as Menlo, Kuehne + Nagel and UPS Supply Chain Solutions, we would witness the first Class 1 railroad startup in over 100 years? Or that a little-known public warehousing company from Kuwait would conduct a three-company acquisition binge and emerge as an $8 billion global leader? Or that Wal-Mart would make a bid to convert Houston into a port competitive with Long Beach? What do all these surprises mean, and how will they affect IWLA members?

If 2005 was a year of dramatic change, 2006 promises to pose even greater challenges to warehouse logistics companies and users as they seek steps to ensure solid footing for the future. These three major changes – related to assets, consolidation and infrastructure – are analyzed below.

Are Assets Still an Albatross?
Ever since President Carter ushered in a wave of deregulation of the transportation industry in the late 1970s, the asset-light logistics sector has experienced enormous growth. Firms such as Expeditors, UTi and Landstar were all founded in the last 25 years and skyrocketed to become multi-billion-dollar giants. Meanwhile, logistics outsourcing grew exponentially, expanding from under $10 billion in 1990 to a $90 billion industry in 2005.

However, last year everything changed. 2005 was a good year to own assets. For instance, the railroad industry, long derided by analysts as a hidebound bastion of slow growth and poor service, emerged as a top performer in 2005. The basket of Class I railroad stocks achieved growth of 29 percent, outpacing the basket of asset-light freight forwarders (which returned 24 percent) for the first time in three years.

What happened?

First, a chronic shortage of capacity drove demand for truck drivers to new heights. According to the American Trucking Associations (ATA), we are experiencing a shortage of 20,000 truck drivers today. If nothing is done, ATA predicts this shortage to spike to 111,000 by 2013. As a result, driver pay is expected to grow more than 10 percent this year, and trucking rates are expected to follow suit.

Second, the same capacity crunch has driven steamship rates up. For instance, Neptune Orient Lines has achieved a 16 percent jump in year-over-year profits.

Third, several key asset owners made decisions to reduce their asset intensity. For example, in a major announcement in April 2005, BNSF Railway, Norfolk Southern, Union Pacific Railroad and Kansas City Southern all declared plans to exit the trailer/container market. This initiative put pressure on shippers to find alternative methods of securing capacity.

As a result, smart companies stepped into the breach and sought opportunities to add assets in select markets. For instance, we witnessed the first Class I railroad startup in over 100 years. The Dakota, Minnesota & Eastern Railroad launched a bold initiative to secure $2.5 billion in federal funding, wading into new waters to compete against the BNSF Railway and Union Pacific. The Railroad Rehabilitation Infrastructure Financing loan, if successful, will create new choices for shippers, and will enable new business models for logistics companies.

INFRASTRUCTURE: CAN THE U.S. KEEP UP?
2005 was also a year when the U.S. appeared to fall behind in transportation infrastructure.

In August, President Bush signed SAFETEA-LU, a $286.4 billion, six-year spending plan for transportation infrastructure. Many criticized the bill as a pork-laden entitlement, full of wasteful spending such as the “Alaskan bridge to nowhere.” Others predicted that the lack of smart infrastructure investments would doom the U.S. to second-run status in the global logistics marketplace.

Meanwhile, the booming economies of Asia fueled growth by targeting infrastructure investments. India, for instance, with a logistics market of just $15 billion – approximately 0.7 percent of the U.S. logistics market – announced plans for $17 billion in transport infrastructure investment between the years of 2006 and 2010. Thus, on a per-year basis, while the U.S. is investing 5 percent of its annual logistics spend on infrastructure, India is investing more than four times as much, or 23 percent. Can the U.S. compete?

As a result, local markets and companies took matters into their own hands. In Los Angeles and Long Beach, marine terminal operators launched PierPass. This initiative was intended to improve efficiency at the country’s leading ports, employing a combination of technology, use fees and extended hours.

However, the biggest news came from Houston. Wal-Mart announced plans in August to shift major volumes of inbound freight from California to Houston, and began construction on a 4 million sq. ft. facility. The ripple effects of this move could be enormous, as other retailers and importers follow suit. This shift may also pose challenges for freight forwarders, who move to adopt new strategies to serve emerging port markets.

WILL ACQUISITIONS RESHAPE THE LOGISTICS LANDSCAPE?
2005 was also a year of tumultuous change on the acquisition front.

The Dutch-based global giant TNT has been in the news for its acquisition plans. TNT has announced plans to sell its logistics division. Just recently, TNT announced its plan to sell its French subsidiary Logistiques Nicolas to the French cargo transport operator Malherbe. Malherbe, of course, is French for “bad grass.” So the Dutch are selling bad grass to the French. What would Cornwallis say about that?

In other news from the more serious parts of the world, German-based Deutsche Post purchased Exel for $6.7 billion, establishing a record-breaking $72 billion company as a result. Deutsche Bahn targeted the U.S. for growth, purchasing BAX Global for $1.17 billion. And A.P. Moller-Maersk purchased Royal P&O Nedlloyd for $2.95 billion, cementing its position as the world's largest steamship by a factor of two.

But perhaps the biggest stories of the year developed below the surface. In 2005, a little-known Kuwait-based logistics firm, PWC Logistics, developed an ambitious plan to expand beyond the Middle East into Asia and the U.S. They acquired three companies – Trans-Link, TransOceanic, and GeoLogistics – in the process transforming the business into a global leader with over 450 offices spread over 100 countries and a market value of more than $7 billion. Measured in market value, PWC Logistics is now larger than Exel at the time of its sale to DHL. In short, PWC has successfully transitioned from a small niche player to a large global power, in a move that will have implications for its competitors in Asia, the U.S., and worldwide.

In another little-covered story, JP Morgan Chase purchased supply chain software provider Vastera for $129 million. If PWC demonstrated the threat of global competition from previously-unexpected sources, JP Morgan Chase highlighted the convergence of logistics with financial services. By purchasing Vastera, JP Morgan Chase signaled its intent to provide new bundles of services, combining international trade compliance and forwarding capabilities with trade financing. The result may take another two to three years to play out, but is likely to create new opportunities for cross-border shippers, and put pressure on traditional freight forwarders.

WHAT WILL THE FUTURE HOLD?
Will assets be an albatross, or a strategic advantage? Will infrastructure shortages force companies to seek new markets? Will consolidation create larger competitors who pressure the mid-market?

Most importantly for IWLA members, how should small/mid-sized logistics firms respond? Some logistics providers are exploring the sale or merger of their business. Taking advantage of record valuation levels and strong buyer interest, more than 20 companies took this route and completed a transaction in 2005. Other logistics companies are choosing to draw on aggressive financial markets by raising capital to pursue acquisitions. Still others are seeking new markets for growth, targeting China, India and other overseas opportunities.

If Cornwallis' *The World Turned Upside Down* is any indication, the only constant for the logistics market will be continued change. Smart logistics providers will develop strategies and invest resources to ensure their success across all of these scenarios.

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