

# ***Asian Emergence: The Brave New World of Logistics***

*By Benjamin Gordon*



Innovation was once viewed as the bastion of the United States. In 1790, George Washington authorized the first U.S. patent, granting Samuel Hopkins the right to a new manufacturing method for potash. Today, 216 years later, both manufacturing and innovation have gone west, from the United States to Asia. As a result, we are in the midst of a sea change that is revolutionizing not just the global economy, but also the logistics world.

This article will highlight the global changes Asia is driving, and the resulting winners and losers in logistics.

## *India and China: Getting Big Fast*

To understand the changes in Asia, it is instructive to start with China, since the US and China represent a combined 60% of global trade.

Today, along with India, China stands at the epicenter of the fastest-growing region of the world, otherwise known as the “Asian miracle.” The two countries represent a population of 2.2 billion. In addition, both are attracting foreign direct investment, with China attracting \$60 billion, and India drawing \$3 billion. Overseas firms like Yellow Roadway (YRC), DHL, and GeoLogistics are attracted by the high growth potential in India and China. The Indian logistics market represents \$15 billion, according to Frost & Sullivan, and is growing at 7% annually. Meanwhile, China weighs in at \$250 billion of logistics spend according to UPS, and is growing at 16% annually.

An important engine of growth is China’s 2001 acceptance by the World Trade Organization (WTO). As a result, China must now adhere to WTO’s rules, and is liberalizing rapidly. In the past four years, China has reduced tariffs from 25% to less than 10%. Continued legal changes will attract more overseas investment and fuel accelerated expansion.

Another key driver of Asian logistics growth is the low level of logistics outsourcing. Both China and India have under-penetrated third-party logistics (3PL) markets. India’s 3PL sector represents 3% of the country’s total logistics spend. China’s 3PL sector represents just 2% of the country’s total spend. In contrast, the United States’ 3PL sector is much more penetrated, at approximately 10%. Europe is even higher, at 25%. Clearly the 3PL sector has a lot of room to grow.

A core reason for this low penetration in Asia is the low efficiency in these markets. In the United States, over the past 25 years, logistics costs as a percentage of GDP dropped from 17% down to 9% due to a combination of government infrastructure investments and high-growth, asset-light outsourcing logistics companies. In China, logistics costs today represent 21% of GDP. Today, in China and India, both of these dominant trends in the US are also underway.

The governments of India and China are investing aggressively to fuel accelerated growth. India, for instance, whose logistics market is approximately 0.7% of the US logistics market, announced plans for \$17 billion in transport infrastructure investment between the years of 2006 and 2010. In contrast, the US just signed into law SAFETEA-LU, a \$286.4 billion, six-year spending plan for transportation infrastructure that translates into 5% of its annual logistics market. Thus, on a per-year basis, while the U.S. is investing 5% of its annual logistics spend on infrastructure, India is investing over 4 times as much, or 23%.

Asian business leaders see these trends and are responding by seeking outsourcing solutions. A survey by Harris Interactive and sponsored by UPS showed that Asian executives are seeking to outsource at a rate three times faster than that of their US and European counterparts. When asked whether they are moving “very extensively” or “completely” to outsourcing, 29% of Asian executives said yes. In contrast, just 11% of US and European executives agreed with this assertion. As a result, logistics markets are opening up and growing rapidly throughout China, India, and indeed much of Asia.

### *Impact on U.S. Logistics Markets*

The impact of Asia’s ascendance on US logistics markets has been swift.

First, manufacturing has shifted from the US to Asia. In November 2005, GM declared plans to slash 30,000 jobs in Canada and the United States. Days later, GM announced plans to add 450 workers in India, and 200 staff in China. In the next 3 years, GM intends to raise auto parts sourcing in India from \$120 million today to \$1 billion, and up to \$80 billion in China.

Second, carriers and freight forwarders have gained significant benefits. In November 2005, three North American carriers – American, Continental, and Air Canada – initiated service to Delhi.

Third, the West Coast of the US has continued to register record levels of demand. As Asian-based manufacturing is shipped to the US for consumption, the ports of Los Angeles and Long Beach are achieving record volumes. Los Angeles, for instance, handled over 700,000 TEUs in the month of October alone. In the coming year, China will originate over 48% of all import freight into the United States, much of it via the West Coast. California-based firms have grown correspondingly. For instance, California-based freight forwarders GeoLogistics and BAX Global have both completed successful turnarounds in the past five years, expanding from unprofitable operations in 2000-2001 to over \$50 and \$100 million in operating profit, respectively, on the basis of dramatic Asia-US freight forwarding growth.

### *Consolidation is Coming, in China and throughout Asia*

The rapid ascent of China has caught the attention of global logistics leaders.

In India, DHL purchased a 68% stake in Blue Dart, establishing a foothold in the domestic courier and express marketplace. FedEx and UPS are also strengthening their positions in the country, and recently increased the number of flights in and out of China. UPS also entered into an agreement whereby it would acquire the express delivery agency business from Sinotrans.

In China, over 150 M&A transactions have taken place with US companies over the past decade. Companies like GeoLogistics, Yellow Roadway (YRC), and others have forged deals to enter China. Historically, US companies seeking growth in Asia have targeted the Western-friendly markets of Hong Kong and Singapore. Mainland China, after all, didn't even have a stock market until 1990, and many of the core assets of the country remain under government ownership. In the case of Yellow Roadway, the company entered into an agreement with Shanghai Jin Jiang International Industrial Investment Co., Ltd. for the formation of a China-based transportation joint venture. Jin Jiang is a publicly-traded company based in Shanghai.

However, this acquisition approach is changing rapidly, as companies target mainland China as well as neighboring markets. According to MidMarket Capital Advisors, two-thirds of Chinese companies' acquisitions of targets in the US have been conducted as 100% transactions through Hong Kong entities. In contrast, two-thirds of US companies' acquisitions of targets in China have involved majority investments in mainland China. This activity is expected to continue to surge.

### *Implications for US Companies*

For US-based companies, the implications are monumental.

On the one hand, companies that gain a successful foothold in Asia can expect to see significant growth. US-based companies like Expeditors, BAX Global and GeoLogistics now derive a majority of their profits from Asia. In a market where logistics companies were historically valued at 5-7 times operating profit, or EBITDA, the high valuations (Expeditors trades at close to 20 times EBITDA, BAX sold for 11 times EBITDA, and GeoLogistics sold for 14 times EBITDA) reflect the premium that markets and investors place on Asian growth opportunities. Similarly, when PWC Logistics announced a string of three acquisitions to strengthen its presence in Asia in 2005, its market valuation skyrocketed from less than \$2 billion to over \$8 billion, in large part due to the premium that investors placed on the company's Asian expansion.

On the other hand, companies that overlook Asia do so at their peril. Much like the European manufacturers of the 1800s, who found themselves supplanted by Samuel Hopkins and other leaders of the US manufacturing golden era, US companies today who fail to invest in Asia will eventually slip behind. For example, Expeditors grew its market value by 20.3% over the past five years. In contrast, EGL, a firm with a weaker Asian presence, grew its market value at half that rate, or 9.5%. Smaller firms face an even more dramatic impact, as freight forwarders with a subscale presence in Asia-US trade lanes are finding themselves increasingly shut out of lucrative markets by larger competitors.

Smart logistics companies have several options for responding. Some, like BAX and GeoLogistics, sought mergers with the global firms of Deutsche Bahn and PWC Logistics, respectively, gaining resources to fund accelerated growth in Asia. Others are raising capital in a bid to fund acquisition-led growth while maintaining independence. What is clear is that every US logistics firm needs a strategy for growth in what may be known as the Asian century.

### *Implications for Asian Companies*

For Asian companies, the choices are even more dramatic. Most Asian logistics firms are at a crossroads.

Those that develop winning niche leadership strategies are pursuing rapid growth, and in turn are attracting significant interest from outside parties. Trans-Link, for instance, established a dominant position in the event logistics and specialty freight forwarding sector. With a commanding market share of 80% in its target markets, Trans-Link drew the attention of PWC Logistics, who bought the business and promoted its senior management team into a more prominent role with a multi-billion-dollar giant.

On the other hand, firms that fail to achieve meaningful differentiation are at risk of falling behind. As global competitors pour capital and resources into the Asian region, mid-sized companies will enjoy growth in the short-term but risk obsolescence in the long-term.

As a result, the smartest Asian logistics companies are preparing for the coming wave of consolidation. Whether as buyers or sellers, the leaders are getting ready to stake out their position in a rapidly-changing marketplace.

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