Seeking Opportunities in Logistics

Change is rippling through the supply chain industry as warehousing companies become logistics companies, logistics managers become supply chain professionals and 3PLs become 4PLs.

What will be the next big trend in the supply chain industry? I believe the watchwords will be "supply chain convergence."

Convergence is all about the combination of relevant services to provide customers with a broader set of solutions. In the 1990s, convergence meant the fusion of warehousing, freight forwarding and transportation management to produce lead logistics providers or 4PLs. Companies like Menlo, UPS, Kuehne & Nagel and others developed integrated supply chain solutions and enabled customers to reduce the number of logistics suppliers they used.

Today, companies are increasingly choosing to compete by combining services. For instance, PWC Logistics acquired GeoLogistics, Trans-Link and Transoceanic in order to add freight forwarding, event logistics and project logistics to their arsenal of contract warehousing-based capabilities. Similarly, UTi has acquired Standard Logistics, Unigistix and Market Transport in a bid to add warehousing, reverse/value-added logistics and transportation management to their freight forwarding base. The convergence of logistics services is already well under way.

In the current decade, we are beginning to see the emergence of the next big wave of convergence: the combination of outsourced logistics with other forms of outsourcing. For example, in a recent survey of logistics CEOs at the International Warehousing and Logistics Association, out of five topics the one that generated the highest level of interest was "Where logistics outsourcing converges with other outsourcing." In fact, 100 percent of respondents picked this topic.

Why is convergence so important? First, let's look at the data. Global logistics is a $179 billion market. But contract manufacturing generates $170 billion. And outsourced technology represents a $300 billion market. All of these markets are maturing, as 20 to 30 percent growth rates from the 1990s have fallen to 5 to 15 percent today. Increasingly, as other outsourcing markets mature alongside logistics, we will see convergence.

Consequently, smart logistics executives are watching other outsourcing industries for new ideas.

General Motors, for instance, has just reconfigured its outsourcing of IT. GM awards $15 billion in annual spend on outsourcing contracts. Historically, GM relied on a large number of outsourced IT providers, played a hands-off role, and signed long-term contracts. But today, CIO Ralph Szygenda is leading a new initiative. His objectives are to reduce the set of IT outsourcing candidates to a top-six group, manage the outsourcing contracts more actively, and shorten contracts from 10 years down to five.

This move will have several implications for the logistics industry. First, just as GM's move to dedicated contract carriage with Schneider over 15 years ago ushered in a new era of dedicated contract carriage growth, so GM's moves in IT outsourcing may represent a broader trend. Second, logistics outsourcing contracts are likely to follow the same path as the IT outsourcing route. Third, aggressive IT outsourcers are seeking logistics partners. Some are even pursuing mergers. Companies like EDS, Accenture and other IT firms are looking at logistics acquisitions as a way to extend their outsourcing capabilities.

Meanwhile, logistics companies like New Breed and Menlo are bolstering their IT capabilities in a bid to accomplish a similar goal, but from a different direction.

At the same time, customer demand is also accelerating this trend toward convergence. As Fortune 500 customers have sought to reduce the number of supply

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chain providers they use, companies such Gillette, Kimberly Clark and Nortel in turn prioritized the selection of suppliers that can provide a broader scope of services. Forward-thinking logistics companies are responding by combining new capabilities to provide more integrated services.

A prime example is Power Group, acquired by Exel in September 2002. Exel, a $7 billion global logistics company, transformed itself from value-added warehousing into full-blown supply chain solutions through a targeted acquisition program.

From 1999 to 2001, Exel acquired more than five companies. In 2002, it expanded into contract manufacturing and packaging with the purchase of Power. In turn, Power provided primary packaging of branded products (dry food and beverage) in cartons, bags, sticks, pouches as well as plastics and glass bottles in the United States and Canada. Due to the high level of strategic value in the combination of packaging and logistics, Exel paid a premium price. In a market where valuations are typically four to six times earnings before interest, taxes, depreciation and amortization, according to public sources, Power was valued at approximately nine times EBITDA.

Why was this warehousing-packaging combination such a valuable deal?

In short, it provided the ability to combine manufacturing, packaging and supply chain services into an integrated solution to create value for customers. It also enabled Exel to transfer Power Packaging's core skills and expertise in dry food and beverage to other product categories such as health and beauty aids, pharmaceuticals and medical devices. And it enabled Exel to improve use of existing warehouse facilities, while raising the revenue per square foot the warehouse-based logistics giant could accomplish.

In short, smart logistics companies should respond by evaluating the growth in outsourcing services such as IT, HR, manufacturing, packaging and other new services, and deciding whether acquisitions of new capabilities make sense. As outsourced supply chain services converge, the winners will be those that continue to evolve.

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