Consolidation at fever pitch

Merger and acquisition activity is radically changing the face of logistics across the globe. The subject was the focus of the recent Supply Chain Asia conference in Bangkok, where delegates discussed the drivers of the trend; steps for merger success and implications for Asian logistics companies. *Lloyd's FTB Asia* editor Turloch Mooney attended

The reasons behind the frantic M&A activity in the global logistics industry are well documented. Customers are looking for one-stop shop intermodal solutions; service providers are looking to build market share in a highly fragmented but equally promising industry; and new technologies are being developed that allow for the creation of more complex, integrated supply chains.

Added to this in Asia, there are large logistics and supply chain efficiency gaps left in the wake of the region's rapid economic development, heady growth in logistics demand as the region evolves into the world's manufacturing centre and the generally higher valuations enjoyed by logistics companies operating in the region.

"There is intense interest in Asia right now. Companies see growth opportunities, and high-cost supply chains are ripe for a new wave of efficiencies and consolidation," said Benjamin Gordon, MD of BG Strategic Advisors, a US-based company that has advised on a series of major global logistics M&A deals.

"The massive wave of consolidation, particularly in forwarding and warehousing, taking place in the US is now hitting Asia."

Gordon's firm worked on 12 deals in 2005, totalling more than $2bn in transaction value. As a result, the firm has opened an office in Singapore.

Not surprisingly, China is the market with the most potential for logistics development, and so the Asian market experiencing the most merger and acquisition activity. (see *Lloyd's FTB Asia* Jan/Feb for a review of M&A deals in the China logistics market in 2005)

Economic reform and thunderous growth are underpinning predications of expansion in the $12bn 3PL market of up to 25% a year, with the general logistics market expected to grow by some 10% a year and be worth some $50bn by 2010.

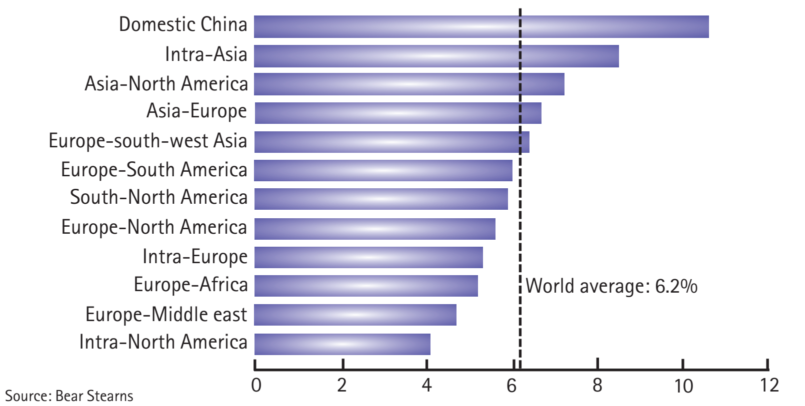
The logistics market in China is highly fragmented and inefficient. According to the powerful National Development and Reform Commission (NDRC), the central government body that dictates the country's economic strategy, the industry is currently served by some 2.5m trucking companies, 7,000 barge operators and 2,000 major freight forwarders in the private sector alone. Average expenditure on goods flow in China is up to 30% of the aggregate cost of goods – three times higher than that in developed countries – while total expenditure on logistics in China accounts for 21% of GDP, close to double the average in developed economies.

Opportunities abound in other Asian markets too. Outside of China, BG identified the logistics industries of India and South Korea as particularly attractive prospects for development. Analysis by the company highlighted these markets as significantly ahead of other Asian markets, based on growth, efficiency, gains to pursue and size of their logistics sectors.

Impact of M&A on Asian logistics companies

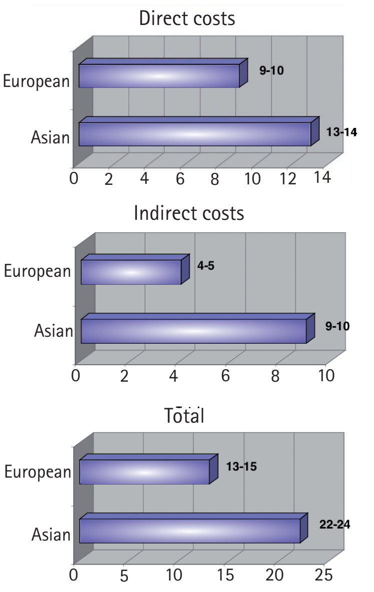
Delegates at the Supply Chain Asia forum discussed the potential impact of consolidation in the industry in Asia, mainly in terms of the prospects for homegrown Asian

Percentage growth of global logistics markets



Source: Bear Stearns

Estimated logistics supply chain costs as a percentage of GDP



Source: McKinsey Quarterly 2005

logistics companies in the face of the trend.

Most agreed that the current penchant in Beijing for the creation of Chinese companies with global reach in a number of strategic industries – Lenovo in computers, Haier in white goods, SAIC in automotives – would result in the emergence of at least one major global logistics player out of the domestic market.

Another heavily discussed issue at the forum was whether mid-sized Asian logistics companies would be able to survive on their own in an era of rampant consolidation.

"Big companies with big volumes can be more flexible with costs, while there will also be a lot going on for smaller niche players," said Paul Bradley, president of Arshhiya Technologies, a Mumbai-listed software and logistics outfit.

He said the market was set for an extended period of radical change that would ultimately put pressure on mid-sized companies which, to survive, would need to focus on using technology to integrate much better with partners and customers.

"Scale adds advantage by lowering cost structure, while smaller companies have flexibility, agility and speed," agreed Essa Al-Saleh, MD – corporate development with PWC Logistics, the Dubai-based company that has been aggressively acquiring logistics outfits.

"Our M&A driver is the need to provide solutions from origin to destination. Size is important for business development, but what really matters is the solutions you can deliver to your clients," he added.

For the Singapore-based chairman of YCH Group, Dr Robert Yap, customer service and partnering would be the most important factors in determining the success of Asian logistics companies in the face of global industry consolidation.

"If you grow with your customer and manage to create real partnerships, you will survive, no matter what size your company is," he said.

One thing for certain, given the very dynamic nature of the industry in Asia at the moment, Asian logistics companies are at a point where they need to clearly define where their businesses are going.

According to Ben Gordon, the number of choices most companies face is limited. You can either decide to sell to a large competitor, bulk yourself up through organic growth and your own acquisitions, consolidate with respected competitors or stand still but recognise that the gains you are enjoying at the moment will shrink over time.

"The most important thing is to control your destiny," he said. "Pick a strategy by choice, not default, and make the investments to ensure you'll be a winner."

In search of the successful merger

While acquisitions are plentiful, successful mergers are harder to come by in the industry. A recent BG study, Mergers that Worked: Lessons from the Logistics Leaders, points out that as many as 60% of all acquisitions in the logistics sector fail to create value in excess of the purchase price.

The study notes that companies which engage in a consistent pattern of multiple acquisitions through both good and bad times have a better success rate.

The success of the "serial acquirers" is believed to be due to their having developed "a disciplined and well-developed set of rigorous acquisition criteria, consistent processes, a focus on both financial and cultural metrics, standalone M&A staff and a feedback loop enabling them to learn from both wins and losses".

The study examines the acquisition strategies of two companies, UPS and UTi, both of which made frequent acquisitions in the past 15 years and achieved high market capitalisation growth during times of decline in the S&P 500.

Interviews with UTi CEO Roger McFarlane and UPS reveal common steps that can assist in the achievement of successful logistics M&A.

McFarlane said the first issue when looking at a merger was to ensure you were buying the right business: "There has to be a good cultural fit in terms of ethical standards of behavior, customer-centric values, and other soft criteria, in addition to the hard ones."

UPS "rejected companies that didn't fit the cultural model. Companies that weren't operations-driven were dropped. Those that didn't share the same values and attitude in terms of customer commitment, quality, and importance of information technology were not going to fit", it said.

Both companies also worked hard to retain the management of the acquired outfits in order to "strengthen their bench", as McFarlane put it. "We are particularly keen on retaining and developing management," he said. "We treat them as if we've just hired them. So we lay out very clearly what their responsibilities are going to be and how they will interact with our team."

Finally, and perhaps most important, both companies have well-developed strategies to counter the possibility that customers might be vulnerable after an acquisition, mainly involving demonstrating the advantages and benefits of deals to key customers as quickly as possible.

Turloch Mooney