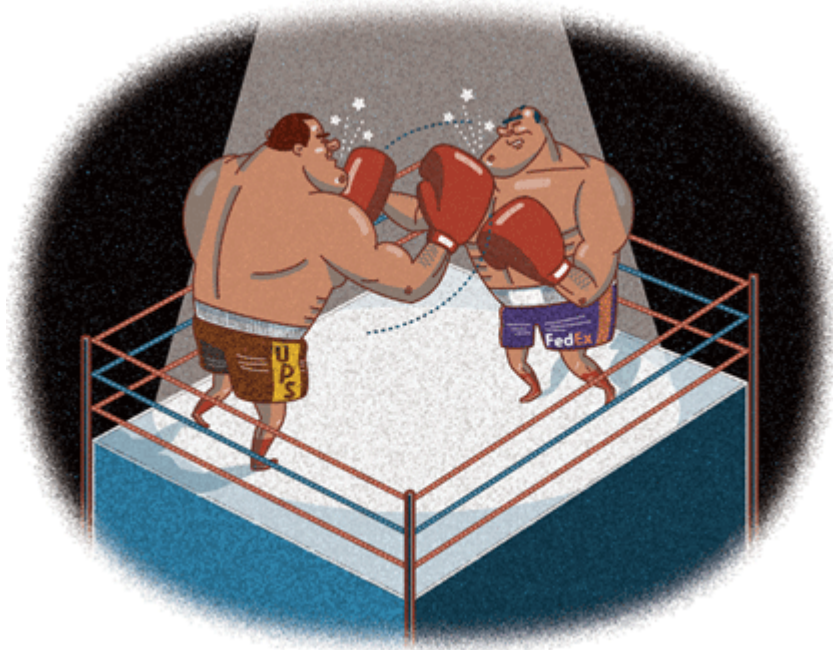


January 2009

Transportation Trends: Parcel express roundtable: Slugfest

With DHL knocked out of the domestic picture, it appears that the two remaining heavyweights will be slugging it out for market share. Industry analysts suggest, however, that a wily contender may be looming at ringside.

By Patrick Burnson



Shipping, like nature, hates a void, and industry analysts are hoping that DHL's departure from the U.S. market will not place duopolistic pressure on those shippers already operating under severe economic strain. In an effort to determine what may lay in wait for parcel express shippers this year, *Logistics Management* convened a roundtable comprising four of the industry's leading experts.

We're joined by Gerard (Jerry) Hempstead, a former DHL executive who brings tremendous insider perspective to the discussion; Doug Caldwell, who, as vice president of ParcelPool, delivers the viewpoint of the consolidator; consulting expertise comes from Rob Martinez, president of Navigo Consulting Group; and David Ross, vice president and transportation analyst with the Stifel Nicolaus research team rounds out the panel. Together they arrived at incisive and often startling conclusions that may force many parcel shippers to pause and consider the effect the new landscape will have on their logistics operations.

***Logistics Management:* How would you best define the current parcel express market for shippers?**

Doug Caldwell: The overnight express market is in rapid decline right now, and international—which in recent years has been the growth leader—is having the same kinds of issues that were being seen on the domestic side.

We're observing that all the carriers are facing rising costs, in part due to the lack of shipments. So in turn, the carriers need to pass on those rising costs. It's a vicious circle.

Rob Martinez: I would have to agree that the express segment of the parcel industry has been in free fall in recent years, primarily due to higher express costs, including high base freight tariffs, fuel surcharges, and accessorial charges.

David Ross: Both Doug and Rob pretty much sum it up; but I would like to point out that shippers will see limited options with complicated pricing about to come into play due to DHL pulling out of the U.S. mix.

Shippers would like simpler pricing (i.e., fewer surcharges) and more carrier options, but given the extremely high barriers to entry in the small package market, we see this as unlikely. Still, the carriers do continue to advance their technology and improve service.

Jerry Hempstead: DHL had to be the "everyday low price" carrier that, for all intents and purposes, set the threshold for the bottom of the pricing market.

But DHL did not know how to manage its culture and endured tremendous operating losses. For shippers in early 2009, it's still a buyer's market due to excess capacity among competitors. But rates will have to get higher.

LM: What will be the fallout of DHL's departure?

Ross: First of all, we should see the removal of the pricing anchor from the market. This should also help mitigate the volume decline and margin contraction that FedEx and UPS have seen as a result of the slowing global economy. Less competition means FedEx and UPS—unless they want a price war—should be able to pass along annual rate increases with little resistance.

We should see USPS becoming, slowly but surely, more competitive on ground parcel but not on the express side since they don't have the infrastructure or technology and systems to compete on tracking and tracing and other services needed for most next-day shipments. Ground parcel is less time-sensitive, and the USPS has a fleet on the ground that is best suited for B2C shipments. The USPS also recently began negotiating rates for shippers with significant volume, as the retail rate base can't compete with FedEx and UPS prices on most business.

Martinez: I agree. Pricing discipline will be difficult to maintain. Other factors include the reliability and price advantages of less time specific—yet time definite—services like ground. Not only are base charges, fuel surcharges, and many accessorial charges lower than express, but delivery performance is the same or better than Express for many ZIP code pairings.

LM: Where will DHL fit in?

Hempstead: They will retain a small presence here with about 100 terminals and a small driver force dedicated to the pick up and delivery of the international express packages, which by the way includes Canada, Mexico, and Puerto Rico. It remains to be seen if DHL in fact cuts a deal with UPS to fly its packages on the UPS air network. Many industry observers now believe that there is no valid business reason for UPS to enable its largest global competitor to reduce its costs or be successful here in the U.S. Many would be surprised to see a deal actually consummated.

Martinez: I agree with Jerry, DHL's customers abandoned ship in mass exodus from its remaining domestic operations. As such, DHL will remain competitive internationally.

LM: We mentioned how the USPS may benefit by the DHL move a little earlier. In your estimation, what will be their new role?

Caldwell: The USPS is really going after the current DHL shippers, and it's my understanding that they are having some success. This month, the Postal Service is rolling out some new, volume based discounts for both Priority Mail and Express mail shipments. The discounts range up to 15 percent, and start at about 25 shipments a day.

USPS has stepped up to the plate in the tracking and tracing area in the last few months, and is now very close to their commercial competitors in this area. All in all, the Postal Service is starting to look very entrepreneurial, at least when it comes to packages. They've put together a really innovative team focused on shipping—Bob Bernstock, Jerry Whelan, Gary Reblin, and Jim Cochrane. These guys know the small parcel market, and they know the competition. I guess you could say that it's not your Father's post office anymore.

Hempstead: Doug makes a terrific point, but I don't agree with all of it. The USPS has new latitude in pricing, true, but they are just getting their feet wet in learning how to use this freedom. Coming out of a regulated world they have a big learning curve. USPS sales force never had the tools to sell before the way UPS, FedEx, Airborne, and DHL did.

They don't have complete freedom but they also need to get beyond their current cost theories because incremental volume does not have the same associated cost as transactions currently within the network. Over time they will come out with some very competitively priced options. It's important that shippers open a dialogue with the USPS representative and keep pressing that rep for a proposal for a discount.

Ross: I'd like to add one more caveat to that, Jerry. Let's remember that USPS will now be the third biggest player in the U.S. parcel market but a distant third to FedEx and UPS.

The USPS has recently focused on becoming more competitive on price and looking to improve technology and service as well. Since it's essentially a government entity, though, change does not happen fast; and while the USPS would like to move into DHL's spot as a viable third option for most parcel shippers, we think they're years away from that actually happening.

LM: What does this all mean for service levels and rates heading into 2009?

Ross: Service levels should improve as the company that had arguably the worst service is leaving and the remaining players are getting significant incremental density. Rates would have been under a lot of pressure in 2009 due to the weak economy; however, it looks like with capacity falling more than demand, FedEx and UPS should realize a higher percentage of their annual rate increases than originally thought.

Caldwell: As Jerry stated earlier, until economic stability and pricing discipline is restored, all bets are off, even on improved service. But rate hikes will be a reality.

LM: Given all we discussed, can you give parcel shippers one or two recommendations for managing their parcel spending for the coming year?

Ross: Ground service is improving for all carriers, so we recommend using as much ground as possible. Second-day air is better than next-day air, if a shipper can plan accordingly, and only ship it next-day early a.m. if it's absolutely critical. The few hours earlier it may arrive usually just translates into wasted dollars. Also, know your freight. If shippers just guess what their freight volumes and characteristics are without data or specifics, FedEx and UPS will likely build a "cushion" into the rate to account for the shippers' fuzzy math. Knowing your freight helps the shipper and the carrier.

Martinez: Fuel surcharges have gone from a very significant amount of the total express shipping cost this summer to now just a significant part of overall shipping cost. We don't know where fuel surcharges will be in 6-12 months, but we do believe fuel costs should stay relatively high and rise over time, so shippers should get used to budgeting for fuel surcharges.

Caldwell: Be creative, and look under every rock for potential cost savings. If you're like a lot of shippers, you've already picked most of the low hanging fruit. So explore all the options including FedEx, UPS, the regional carriers, and the USPS as well. And look at what you can do, as a shipper. It might be a bunch of seemingly small things—cleaning up shipping addresses, looking at cube issues, and dynamically routing shipments based on costs—but those little things can add up, and add up fast.

Hempstead: Doug has it down. I'd like to add that the carriers don't want to give up traffic they have in hand and will fight to retain you—and they will price to attract business currently handled by the other guy. They are banking on the fact that most shippers will not be bothered to take advantage of the current economic situation. So use an industry expert to help you negotiate your new deal.

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