The Opportunities and Challenges for International Freight Forwarders

Prepared for:
JIFFA Silver Jubilee Symposium 2010
Tokyo 24th November, 2010

By Drewry Supply Chain Advisors
Philip Damas
supplychains@drewry.co.uk
Agenda

1. Long-term trend in the forwarders’ market shares and market position

2. The 2010 transport capacity crunch – exporters and importers needed help

3. Opportunities for forwarders
   Challenges for forwarders

4. Conclusions
1. Long-term trend in the forwarders’ market shares and market position
Long-term trend

- In the past three decades, the freight forwarding sector has secured a large role in global commerce and considerably increased its presence in the market.

- The freight forwarders’ cost structure and their asset-light model have also proved successful and reliable, at a time when the carrier sector has been under financial pressure.

- The need for traditional forwarding services (arranging basic transport services and associated foreign-trade documentation) by sea, air and overland continues.

- Many forwarders now also provide contract logistics and supply-chain management services in addition to traditional forwarding services.

- Overall, the forwarding sector has been significantly more profitable than the ocean carriers and airlines on which forwarders depend.

<table>
<thead>
<tr>
<th>Year</th>
<th>Share of forwarders of the global ocean freight market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>10%</td>
</tr>
<tr>
<td>2007</td>
<td>35%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Share of forwarders of the global air freight market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>76%</td>
</tr>
<tr>
<td>2007</td>
<td>95%</td>
</tr>
</tbody>
</table>
Challenges facing supply chain managers

- On shelf availability
- Increased choice
- Faster range change
- Keeping the product offer fresh
- Fewer markdowns
- Alternative retail formats
- E-retail and reverse logistics
- Faster inventory rotation
- Environmental impacts
- Volatile demand
- Expanding vendor base geographies
- Vendor performance
- Quality management at long distance
- Intellectual property theft
- Extended lead times
- In-market storage costs
- Inventory positioning
- Off-shore DC operations
- International freight capacity and costs
- Distribution network costs

Companies must stay competitive

- Global sourcing is a central strategy for increasing gross margin
- Net margin hinges on the full end to end cost to serve
Long-term trend

- In the past three decades, the freight forwarding sector has secured a large role in global commerce and considerably increased its presence in the market.

- The freight forwarders’ cost structure and their asset-light model have also proved successful and reliable, at a time when the carrier sector has been under financial pressure.

- The need for traditional forwarding services (arranging basic transport services and associated foreign-trade documentation) by sea, air and overland continues.

- Many forwarders now also provide contract logistics and supply-chain management services in addition to traditional forwarding services.

- Overall, the forwarding sector has been significantly more profitable than the ocean carriers and airlines on which forwarders depend.

<table>
<thead>
<tr>
<th>Share of forwarders of the global ocean freight market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
</tr>
<tr>
<td>2007</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Share of forwarders of the global air freight market</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
</tr>
<tr>
<td>2007</td>
</tr>
</tbody>
</table>
Large forwarders get bigger and grow faster than the market

Compound annual growth 2004-2010

- K+N Annual growth: 10.6%
- Panalpina Annual growth: 6.7%
- World container traffic: 5.9%
Four major types of forwarders

- Global forwarders
- Local forwarders
- Regional forwarders
- Specialist forwarders

Local forwarders are facing an uncertain future. Every country has a whole raft of small local forwarders who specialise on a specific locality or customer-based served in a highly personalised way. However, this sector is declining as the importance of networks and freight rate economies of scale are paramount.

Total number of licensed ocean transportation intermediaries and NVOCCs in the US

- 2000 4,019 companies
- 2008 5,304 companies + 32%
2. The 2010 transport capacity crunch – exporters and importers needed help
2009 and 2010 provided a unique business environment for forwarders

- In 2009, up to 600 container ships worldwide were kept “idle” (i.e., parked) as a result of falling demand and deliberate policies by carriers to remove capacity.

- Since early 2010, carriers have brought idle ships back into operation, but only AFTER trade volumes came back.

- Result: not enough capacity, cargo roll-overs.

- Many shippers who bought container shipping services from carriers contacted freight forwarders to ask for help.

- Freight forwarders won shipper business from carriers in 2010 because the carriers’ unfriendly practices.

Question: will forwarders retain this shipper business, or will the shippers go back to the direct carriers?
Carrier practices in 2010

Rebecca Dye, commissioner of the US Federal Maritime Commission:

“[Shippers] believe the carrier practices involved in rolled cargo, cancelled bookings and successive price increases were in conflict with protections in their service contracts.”

House Committee on Transportation hearing of June 30, 2010
3. Opportunities for forwarders
Challenges for forwarders
Opportunities for forwarders

© Drewry 2010
## Opportunities – needs of customers

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers expect logistics providers to develop tailor-made and reliable solutions to manage their complex supply chain</td>
<td>Standardisation and expansion of product offerings</td>
</tr>
<tr>
<td>Sector specific expertise is of more importance than ever before</td>
<td>Streamlining of processes</td>
</tr>
<tr>
<td>Increased need for high transparency and agility of supply chains</td>
<td>“Continuous improvement” and education of employees</td>
</tr>
<tr>
<td>Cost concern – customers heavily and constantly negotiate for lower prices</td>
<td>Indirect costs of major importance</td>
</tr>
<tr>
<td>Flexibility of supply chains is key for customers</td>
<td>Investment in special equipment provided by the logistics company</td>
</tr>
<tr>
<td></td>
<td>Product innovations</td>
</tr>
</tbody>
</table>

Source: DB Schenker
<table>
<thead>
<tr>
<th>When shippers get more value from freight forwarders</th>
<th>When shippers get more value from carriers</th>
</tr>
</thead>
<tbody>
<tr>
<td>The shippers need a package of multi-modal transport services (ocean, air freight etc.), with access to many possible routes and carriers, and customs clearance from one vendor.</td>
<td>The shippers have basic ocean transport requirements and less complex service requirements.</td>
</tr>
<tr>
<td>The shippers need door-to-door delivery (DDP or DDU) to overseas markets, including inland transport and the ability to track shipments from door to door.</td>
<td>In certain cases, to get comprehensive inland transport services and door-to-door delivery (ocean carriers like Maersk and APL provide comprehensive inland services, whereas other carriers do not).</td>
</tr>
<tr>
<td>The shippers require shipment consolidation/LCL.</td>
<td></td>
</tr>
<tr>
<td>The shippers need value-added services beyond basic transport (purchase order management, origin cargo management, warehousing, pick-pack etc....) and the associated purchase order management or logistics IT system.</td>
<td></td>
</tr>
<tr>
<td>Transport volume</td>
<td>The shippers have large volumes, enabling them to secure low freight rates and a more favourable treatment from carriers (peak season capacity, priority discharge).</td>
</tr>
<tr>
<td>The shippers have only low volumes (i.e. no bargaining power with the carriers).</td>
<td></td>
</tr>
<tr>
<td>Sector experience</td>
<td>The shipper is new or inexperienced in international trade.</td>
</tr>
<tr>
<td>-------------------</td>
<td>----------------------------------------------------------</td>
</tr>
<tr>
<td>Contract type and cost volatility</td>
<td>To take advantage of (occasionally) low spot freight rates. This assumes that the shippers are willing to take the risk of more volatile freight rates/shorter periods of validity of rates.</td>
</tr>
<tr>
<td>Vendor relationship</td>
<td>To get more personalised customer service (carriers generally tend to be less good).</td>
</tr>
<tr>
<td>Special handling</td>
<td>The shippers trade in specialised products requiring specific know-how and equipment (wines, project cargo, certain chemicals).</td>
</tr>
<tr>
<td>Internal or external cost preference</td>
<td>The shippers want to outsource certain local administrative processes (documentation, booking and carrier allocation, arranging inland transport) and downsize its internal shipping department.</td>
</tr>
</tbody>
</table>
Opportunities Check List

- Organic Growth
- Regional & Geographic
- Network Growth/Consolidation/Acquisition
- Modal Extension
- Specialism
- Outsourcing
- Contract Logistics
- Primary/Secondary Integration - Total Cost to Serve
- Informational and Optimisation
- Supply Chain Financial Services
Opportunities – Outsourcing

- A common method for exporters and importers to reduce head office costs is to outsource transport and shipping administration and support activities to a freight forwarder. Generally, the outsourcing decision is driven by a comparison of internal and external costs as well as assessing the benefit of turning fixed costs into variable costs. One example was provided when, years ago, a major American chemical importer outsourced its international traffic department: it downsized its traffic department from 70 people to three people by outsourcing its activities to a freight forwarder. Companies such as DuPont and Philip Morris have outsourced their freight forwarding-type activities.

- As intermediaries (or “managers”) of other vendors, freight forwarders are in an ideal situation to monitor the performance of carriers and other sub-contractors. Drewry provides a list of common KPIs. KPIs are an area when operational monitoring is becoming more responsive and more effective. However, this also requires strong IT and clear rules to control performance.

- Origin country value-added services eg consolidation/CFS, vendor management, organisation of origin country inland transport (ex factory)
Supply Chain Primary Secondary Integration
- critical to end customer’s optimising gross and net margin

Traditional Retail Model

<table>
<thead>
<tr>
<th>Origin</th>
<th>Destination</th>
</tr>
</thead>
<tbody>
<tr>
<td>OVERSEAS VENDOR</td>
<td>NATIONAL DISTRIBUTION CENTRE</td>
</tr>
<tr>
<td>ORIGIN CFS</td>
<td>RETAIL STORE</td>
</tr>
</tbody>
</table>

- CY or CFS to NDC
- Single route to market
- Difficult to change pace
- Risks mitigated by costly stock-holding close to consumption market
- Inbound LSP motivated by “OTIF” kpi’s
- Poor alignment of product flows to “new” distribution channels (e.g. multi-channel retailing)
Multiple problems need multiple solutions

Most Supply Chains are a bit like a Blunderbuss!
Shove anything in it, pack it with energy and fire it at the consumer

Ending the Blunderbuss of the Homogenous Supply Chain

- Different consumer behaviours
- Different product values
- Different forecast predictability
- Different ordering criteria and sourcing options
- Different locations for the value adding activity functions

The next generation of supply chains will reduce costs and improve customer satisfaction by much greater logistics differentiation between the SKU
Supply Chain Network Design Opportunity for Forwarders
- what is done where is a critical decision

Active management of Total Cost to Serve through different routes to market
Opportunities Check List

- Organic Growth
- Regional & Geographic
- Network Growth/Consolidation/Acquisition
- Modal Extension
- Specialism
- Outsourcing
- Contract Logistics
- Primary/Secondary Integration - Total Cost to Serve
- Informational and Optimisation
- Supply Chain Financial Services
Opportunities – supply chain finance

- Some cash rich freight forwarders may use their stronger financial position to extend credit to customers with liquidity issues. If the contract includes an element of warehousing it becomes more practical to hedge bad debt against lien on the shipper’s inventory.

- Some have developed niche product offerings in supply chain finance (SCF), which can take many forms from simply extended credit terms to product procurement and trade financing. SCF programmes are now offered by most international banks, providing the buyer with a working capital management facility (effectively extending payment terms) and giving prompt payment to vendors. It is fast becoming an effective means of substituting for lower credit availability during the recession. Some of the large integrators, such as UPS, already offer SCF programmes but smaller forwarders have become increasingly active in this area.
Opportunities – examples

- APL Logistics, Sumitomo form alliance
  APL Logistics formed a strategic alliance with Japan’s Sumitomo Warehouse Co. to jointly market global supply chain services. Under the agreement, Osaka-based Sumitomo will offer its warehousing and other logistics capabilities in Japan to APL Logistics customers, while APL Logistics will make its global services available to Sumitomo customers.

- Davies Turner's sea freight consolidation business grows in China
  UK-based Davies Turner has seen its China-UK consolidation trade grow despite the downturn in the global supply chain industry, following the financial crisis.
  "Over the last few years, we have been ideally placed to win the business of shippers who are switching from FCL to LCL traffic and who are looking to reduce inventory costs and stock holdings."

- Ocean World Lines Introduces Cargo Management Services in Asia
  The cargo management services, including worldwide door-to-door air, ocean and ground transportation, offers a total supply chain service from local oversight of the manufacturing process to securing the best projected booking date for the shipment.
  "We contact our customers' vendors 21 days, 14 days and 7 days prior to the target ship date to secure the best booking. This allows shippers to plan at the factory level and provides line item detail into the supply chain before the manufacturer uploads the purchase order."

- DHL starts Shanghai to Tokyo LCL service
  DHL has started offering a direct service for less-than-container-load (LCL) shipments between Shanghai and Tokyo.
Challenges for forwarders
Challenges – commercial

- Attracting large-shipper customers away from ocean carriers
  Small and medium shippers have always turned to forwarders for their international transport needs for both ocean and air transport. Large shippers have tended to use direct ocean carriers. But this is changing due to the large shippers’ need for:
  - complementary capacity for international ocean freight services
  - support services and value-added services.
  Forwarders may act as the shipping department of certain large shippers, under an outsourcing agreement. The shipper may still have contracts with carriers, but relies on the forwarders to manage the bookings, allocations, documentation etc…

- Management of the supply chain continuity of shippers – Total Cost to Serve

- Room for a fast ocean service at a premium price, whereas most services are now operated by carriers with “slow steaming”

- Strong company policies and internal checks to avoid risks of very large fines from regulators due to anti-price-fixing and anti-bribery legislation.
Challenges - operational

- Service reliability and consistency
- Slow steaming will remain
- More focus on carbon footprint
- Tighter security rules
- Monitoring of shipment visibility and data accuracy
- Will forwarders have “block space agreements” in ocean shipping, as in airfreight?
4. Conclusions
Conclusions

1) The range of value-added services and multimodal transport options of forwarders are attractive to many shippers who now want than just basic transport.

2) Forwarders have gained market share in the last 3 decades, including in 2009-2010.

3) We have seen that forwarders face a number of opportunities and challenges.

4) Small and medium shippers have always turned to forwarders for their international transport needs for both ocean and air transport. More recently, even large shippers have used forwarders either as a complement of capacity for international ocean freight services or as providers of support services and value-added services. Drewry believes that forwarders can position themselves to seize new opportunities.
Opportunities Check List

- Organic Growth
- Regional & Geographic
- Network Growth/Consolidation/Acquisition
- Modal Extension
- Specialism
- Outsourcing
- Contract Logistics
- Primary/Secondary Integration - Total Cost to Serve
- Informational and Optimisation
- Supply Chain Financial Services
Thank you.

Drewry Supply Chains Advisors

A division of Drewry

Philip Damas
Division Director
Drewry Supply Chain Advisors
supplychains@drewry.co.uk
www.drewrysupplychains.com