Supply Chain Metrics That Matter: Third Party Logistics Providers

Using Financial Data from Corporate Annual Reports to Better Understand Third Party Logistics Providers

12/10/2013

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Research

Supply Chain Metrics That Matter is a series of reports published throughout the year by Supply Chain Insights LLC. They are a deep focus on a specific industry.

These reports are based on data collected from financial balance sheets and income statements over the period of 2000-2012. In these reports, we analyze how companies made trade-offs over the course of the last decade in balancing growth, profitability, cycles and complexity.

Within the world of Supply Chain Management (SCM), each industry is unique. We believe that it is dangerous to list all industries in a spreadsheet and declare a supply chain leader. Instead, we believe that we have to evaluate change over time by peer group. In this series of reports, we analyze the potential of each supply chain peer group, share insights from industry leaders from each industry, and give recommendations based on general market trends.

Disclosure

Your trust is important to us. As such, we are open and transparent about our financial relationships and our research process. This independent research is 100% funded by Supply Chain Insights.

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Research Methodology

The basis of this report is publicly available information from corporate annual reports from the period of 2000-2012 for publicly-owned companies involved in the third party logistics (3PL) industry.

In picking companies for the *Supply Chain Metrics That Matter* report, we traditionally rely on companies recently listed in the Fortune Global 500. For the 3PL industry, we identified three pure play 3PL companies using both the Fortune Global 500 and the Morningstar Integrated Shipping & Logistics peer group to inform our decision.

The financial ratios used enable supply chain leaders to better understand where the industry is on the Supply Chain Effective Frontier. In this report, we share a framework for supply chain excellence that balances growth, profitability, cycles and complexity metrics. In each *Supply Chain Metrics That Matter* report, we share insights from each of these metrics categories. Due to the fact that the supply chain is a complex system that must be managed holistically, we share the trends on each of these dimensions over the course of the last decade.

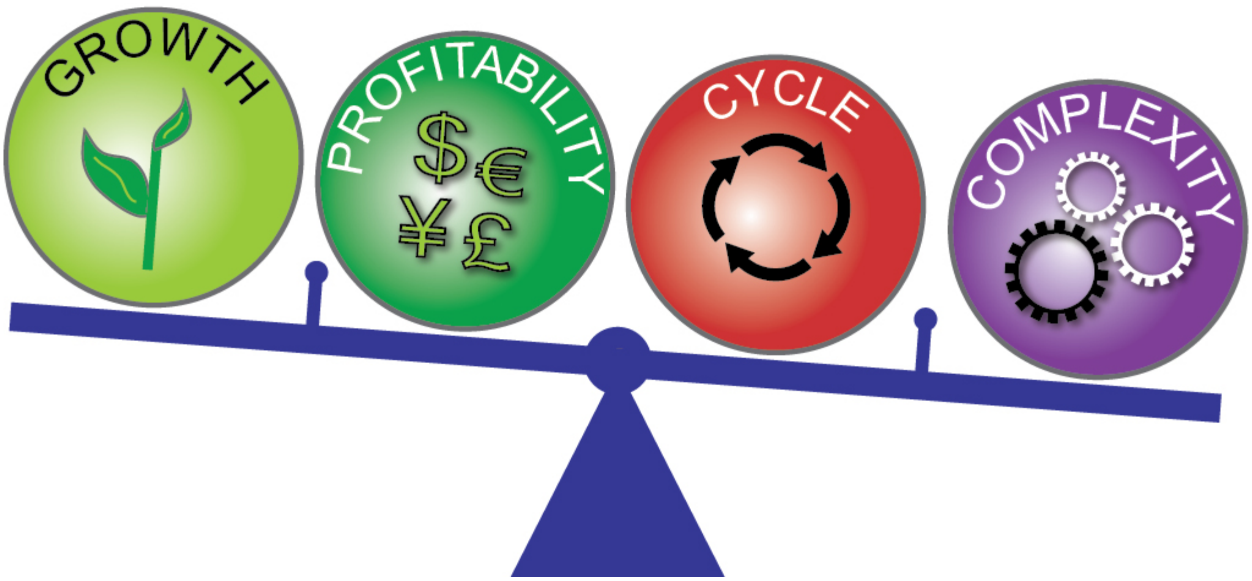
We use the financial data to help readers learn from past trends, to better understand current operating environments, and we provide recommendations for the future. We augment the financial data analysis with information from our quantitative and qualitative research studies as well as our work with clients operating within the industry.

Executive Overview

Third party logistics (3PL) providers fill a critical role in today's global supply chains. With the rise in e-commerce, the growth of global markets, and the reshaping of the retail market, dependency on 3PLs is rising. It is an industry with fierce competition. Despite the promises of technology-driven differentiation, as of yet, no 3PL has successfully been able to differentiate and create significant brand loyalty. This is the market opportunity moving forward.

Today, companies on average send 30% of goods through third party logistics (3PL) providers. The 3PL market is now $148 billion in size with single-digit annual growth.[1] Hit hard by the Great Recession, the industry is still in recovery. The 3PL industry has matured over the last 50 years; but it operates at a low margin, struggling to balance what we term The Effective Frontier.

Figure 1. The Effective Frontier



The ongoing inability to drive resiliency on The Effective Frontier by managing tradeoffs of growth, profitability, cycle and complexity should be a concern for those working in, or working with, the 3PL industry. Comparable results from ten industries are shown in Table 1, ranked by average operating margin. 3PLs not only occupy the second lowest ranking, they have also seen the most significant drop in operating margin as a percentage since 2000. In this report, we look more closely at the current state of the industry.

[1] Armstrong & Associates, Inc. Slow Dance-2012 3PL Market Analysis and 2013 Predictions Report is Released. http://www.3plogistics.com/PR_3PL_Financial-2013.htm

Table 1. A Review of Industry Progress from 2000-2012

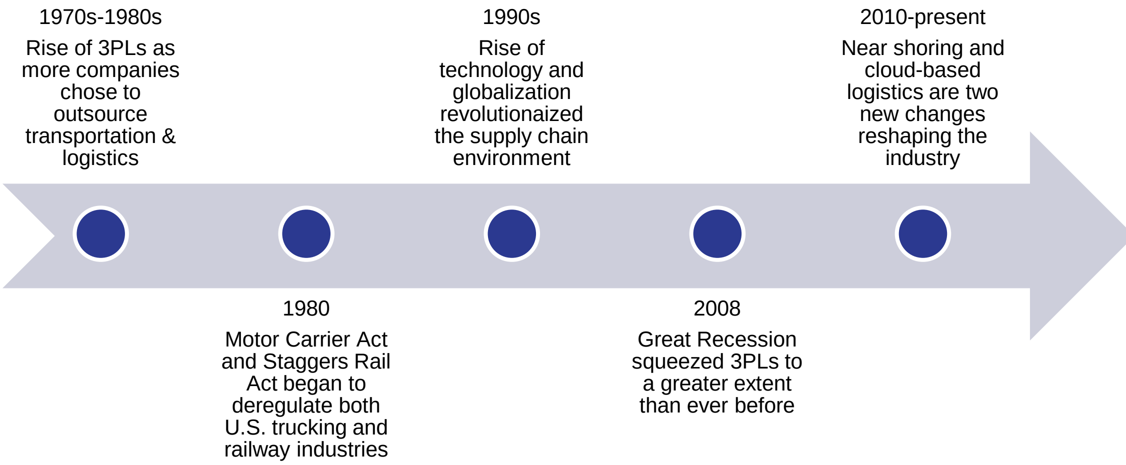
Industry	Average Operating Margin	Operating Margin Percentage Change (2000-2012)	Average Cash-to-Cash Cycle	Cash-to-Cash Cycle Percentage Change (2000-2012)	Average Inventory Turns	Inventory Turns Percentage Change (2000-2012)
Pharmaceutical	0.25	-22%	190.3	25%	2.0	47%
Medical Device Manufacturers	0.18	-84%	211.6	7%	2.2	6%
Consumer Packaged Goods	0.17	27%	28.3	-68%	5.6	9%
Food	0.16	-30%	38.1	-17%	6.4	16%
Consumer Electronics	0.12	74%	9.3	-45%	43.8	-35%
Apparel	0.10	-9%	127.7	3%	3.2	-4%
Chemical	0.09	-25%	78.1	-12%	5.3	5%
Automotive	0.04	-92%	75.9	-28%	9.9	-16%
Third Party Logistics	0.03	-104%	27.5	52%	36.6	76%
Contract Manufacturing	0.02	-43%	38.8	-44%	8.0	38%

Source: Supply Chain Insights LLC, Corporate Annual Reports 2000-2012
Apparel: American Apparel, Inc., Columbia Sportswear Co., Hanesbrands, Inc., PVH Corp, Ralph Lauren Corp., VF Corp.
Automotive:: Daimler AG, Ford Motor Co., General Motors Co., Honda Motor Co., Ltd., Toyota Motor Corp., Volkswagen AG
Chemical: BASF SE, E. I. du Pont de Nemours and Co., The Dow Chemical Co.
Consumer Electronics: Apple Inc., Dell Inc., Intel Corp., Motorola, Inc. (now Motorola Solutions, Inc.)
Consumer Packaged Goods: Colgate-Palmolive Co., The Procter & Gamble Co., Unilever N.V./PLC
Contract Manufacturing: Benchmark Electronics, Inc., Celestica Inc., Kimball International
Food:: Campbell Soup Co., General Mills, Inc., Kellogg Co.
Medical Device Manufacturers: Boston Scientific Corp., Medtronic, Inc., St. Jude Medical, Inc., Zimmer Holdings Inc.
Pharmaceutical: Eli Lilly and Co., Merck & Co., Inc., Pfizer, Inc.
Third Party Logistics: Kuehne + Nagel International AG, Panalpina Welttransport Holdings AG, R.R. Donnelley & Sons Company

History of the Third Party Logistics Industry

The third party logistics industry is evolving and is very different by geography. Although some companies date back hundreds of years with their involvement in international trade, the business model for 3PLs is less than 50 years old. Figure 2 is a timeline of several critical dates and developments over the past half-century outlining how the industry evolved and coalesced into what it is today.

Figure 2. Historical Timeline of the 3PL Industry



The 3PL landscape is complex with 3PLs, freight forwarders, consolidators, and shippers focused on truck, air, sea and train modes as well as new fourth party logistics (4PL) providers. There is a lot of overlap in services and offerings resulting in buyer confusion. Competition is intense.

Growth: Slowing With Age

As the 3PL industry has matured, growth has slowed. The business is cut-throat. Current year-over-year growth from 2000-2012 for the peer group is shown in Table 2.

Table 2. Year-Over-Year Sales Growth (2000-2012)

Year-over-Year Sales Growth (2000-2012)			
Company	**2000-2006**	**2007-2009**	**2010-2012**
Kuehne + Nagel International AG	22%	5%	12%
Panalpina Welttransport Holding AG	17%	-1%	9%
R.R. Donnelley & Sons Company	12%	3%	1%
AVERAGE	17%	3%	7%

Source: Supply Chain Insights LLC, Corporate Annual Reports 2000-2012

Profitability: Tight Margins

Table 3 illustrates that operating margin is very low for 3PLs. They share these extremely low margins with contract manufacturers as seen in Table 1. Both industries operate in a part of the global supply chain with tight margins and low resiliency.

Table 3. Operating Margin (2000-2012)

Operating Margin (2000-2012)			
Company	**2000-2006**	**2007-2009**	**2010-2012**
Kuehne + Nagel International AG	0.03	0.04	0.04
Panalpina Welttransport Holding AG	0.03	0.02	0.01
R.R. Donnelley & Sons Company	0.06	0.02	0.01
AVERAGE	0.04	0.03	0.02

Source: Supply Chain Insights LLC, Corporate Annual Reports 2000-2012

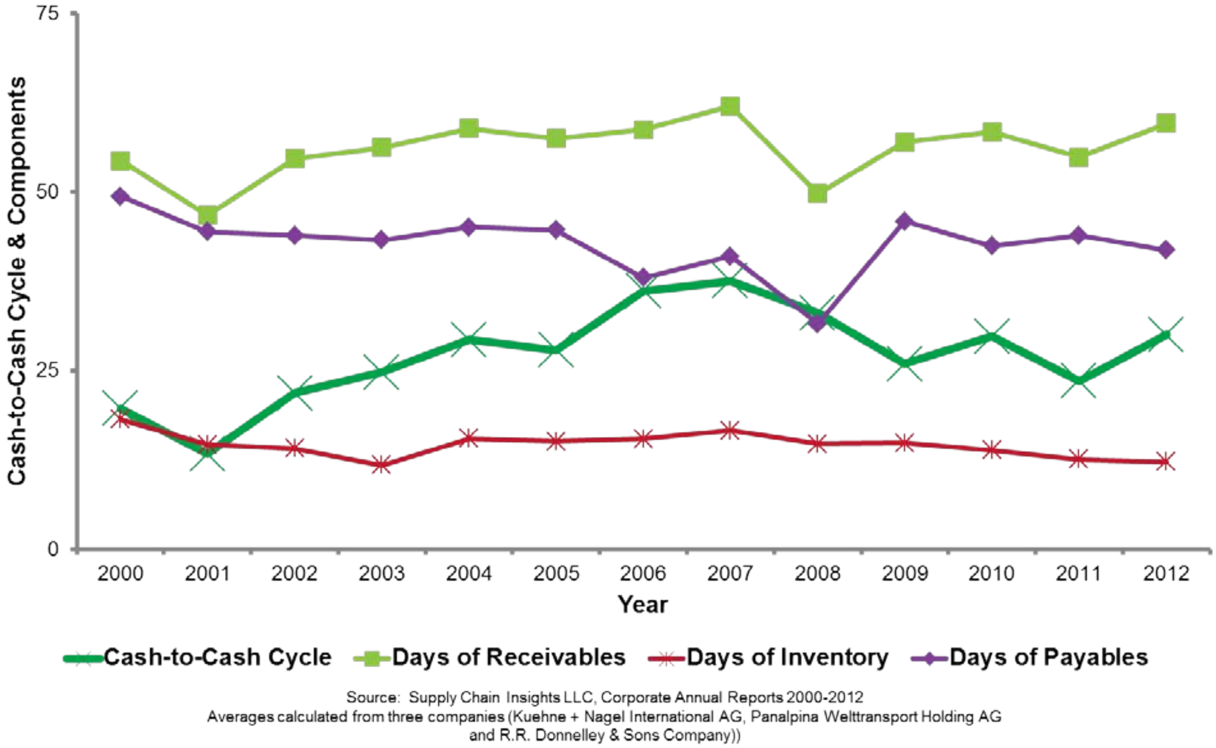
Operating margin is low across all three companies regardless of revenue base or geographical location. It is just a stark reality of the business. Just as in the situation of slowing growth, an improved focus on strategic offerings and collaborative relationships offer a goal for 3PLs to shoot for. Moving beyond the transactional operations focus is challenging, but necessary to maintain and even improve operating margin in the future.

Cycle: Cash Flow Management

Cycle metrics are challenging to analyze when it comes to 3PLs because of the role of client inventory. Different companies may define their inventory stores differently which will impact common measures such as days of inventory or the cash-to-cash cycle. For this reason, our analysis focuses on the cash-to-cash cycle to get a holistic understanding of cash flow within the organization with an especial focus on management of the two non-inventory measures: days of payables and days of receivables. The peer groups' average performance over the time period is shown in Figure 3.

The cash-to-cash cycle in forest green has risen since 2000 but this is not driven by days of inventory which has remained flat across the peer group. Instead, a slight decrease in days of payables (DOP) with an increase in days of receivables (DOR) have cooperated to raise the cash-to-cash cycle from 20 days in 2000 to just under 30 days in 2012.

Figure 3. Cash-to-Cash Cycle & Components (2000-2012)



A decrease in DOP means 3PLs are paying their bills more quickly, but the rise in DOR means this gain is nearly negated by a slower collection of monies owed to them by clients. More focused management of DOR is a possible avenue to consider in an effort to decrease the cash-to-cash cycle and improve the general cash flow management through the firms.

Complexity: Adding Strategy to the Equation

Revenue per employee is our preferred measure of complexity as it distills the business into a simple measure of the monetary value each employee provides to the business. The performance of the 3PL peer group on revenue per employee is shown in Table 4.

Two of the three companies have lost ground on revenue per employee in the latest period (2010-2012) compared to where they started the century. Again, the critical piece here is not a question of operations and efficiency, but rather, the need to redesign the business model. Getting the right talent in place (talent has been a sticky problem for 3PLs for much longer than the larger supply chain talent crisis) and creating an environment of innovative thinking and strategic relationships with clients are critical. Getting this right can significantly improve revenue without requiring excessive payroll investments.

Table 4. Revenue Per Employee (2000-2012)

Revenue per Employee (K$) (2000-2012)			
Company	2000-2006	2007-2009	2010-2012
Kuehne + Nagel International AG	299.5	257.5	250.4
Panalpina Welttransport Holding AG	384.3	476.2	460.2
R.R. Donnelley & Sons Company	158.4	179.5	177.7
AVERAGE	273.3	304.4	296.1

Source: Supply Chain Insights LLC, Corporate Annual Reports 2000-2012

Recommendations

The 3PL industry is still young and maturing. The turmoil of the Great Recession and its lingering effects has challenged the industry significantly. Here are our recommendations:

- **Focus on a Resilient Business Model.** The 3PL business model is not static. Companies in the space offer a variety of services that are constantly evolving. By focusing on building a strong and resilient business model, 3PLs will set themselves up for stability when the next recession strikes.
- **Differentiate.** Today, there is low brand loyalty. E-commerce and the rise of collaborative logistics create an opportunity to build new and differentiated business models.
- **Build Strategy into the Relationship.** The ever-growing complexity of operating a global supply chain requires not only operational expertise, but strategic vision. That is the next step in the evolution of many 3PLs, and those who take steps now will lead the evolution.
- **Margins Are Critical.** In an environment of low margins, supply chain efficiency is paramount. By working with clients to establish stronger and more collaborative relationships, 3PLs must do what they can to protect their ever-slim margins.

Conclusion

Is the 3PL model viable? We believe we do not yet have the answer. Today, third party logistics providers play a key role in the global supply chain. Their role is especially critical for small shippers and companies expanding into new, untested geographies. It is a relatively young business model with a variety of companies offering comparable, but not identical, solutions to clients. By focusing on strategy and differentiated service offerings, 3PLs can strengthen their own financial health while also providing a more resilient partner for their clients. Until this happens, shippers should be cautious. The 3PL industry needs to improve resiliency to evolve into the valuable partner it wishes to be.

Company Profiles

Company	Stock Exchange: Ticker Symbol	2012 Revenue (billions USD)	2012 Global Employees (thousands)	Country Where Based
Kuehne + Nagel International AG	SIX: KNIN	18.3	72.4	Switzerland
Panalpina Welttransport Holding AG	SIX: PWTN	7.1	15.6	Switzerland
R.R. Donnelley & Sons Company	NASDAQ: RRD	10.2	57.0	USA (Illinois)

Source: Supply Chain Insights LLC, Corporate Annual Reports 2012

Other Reports in This Series:

Supply Chain Metrics That Matter: A Focus on Retail
Published by Supply Chain Insights in August 2012.

Supply Chain Metrics That Matter: A Focus on Consumer Products
Published by Supply Chain Insights in September 2012.

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Supply Chain Metrics That Matter: A Closer Look at the Cash-To-Cash Cycle (2000-2012)
Published by Supply Chain Insights in November 2013

About Supply Chain Insights LLC

Founded in February, 2012 by Lora Cecere, Supply Chain Insights LLC is focused on delivering **independent, actionable and objective advice for supply chain leaders**. If you need to know which practices and technologies make the biggest difference to corporate performance, turn to us. We are a company dedicated to this research. We help you understand supply chain trends, evolving technologies and which metrics matter.

About Abby Mayer

Abby Mayer (twitter ID @indexgirl), Research Associate, is one of the original members of the Supply Chain Insights LLC team. She is also the author of the newly-founded blog, Supply Chain Index. Her supply chain interests include connecting financial performance and supply chain excellence, as well as talent management issues and emerging markets.

Abby has a B.A. in International Politics and Economics from Middlebury College and a M.S. in International Supply Chain Management from Plymouth University in the United Kingdom. She has also completed a thru-hike of Vermont's 280 mile Long Trail, the oldest long distance hiking trail in the United States. As part of the planning and food prep process, she became interested in supply chain management when she was asked to predict hunger pangs for the entire three-week trip before departure. If that isn't advanced demand planning, what is?!?!