

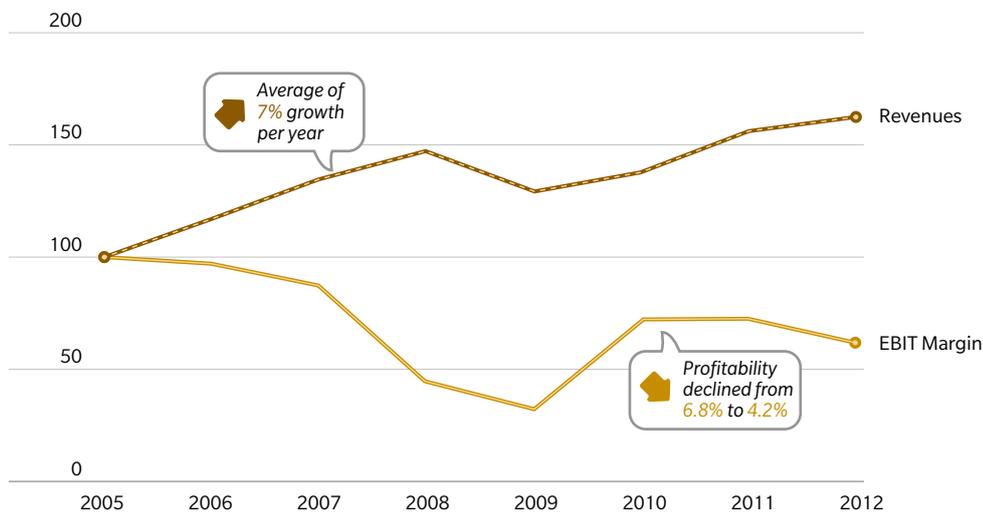
# INCREASING THE PROFITABILITY OF LOGISTICS



Despite increasing revenues, only a small number of logistics services providers are seeing increased profitability. Companies that want to grow their logistics businesses profitably must do more than just adjust a few small cost levers and hope to achieve scale or synergy effects by way of acquisitions. They must be willing to pursue fundamental change and challenge the way things have been done in the past. Oliver Wyman has identified six levers that can help logistics services providers unlock greater profits in a growth market.

An analysis of 100 leading global logistics companies – which has been ongoing since 2005 – found that these companies are achieving impressive revenue growth of 7 percent per year on average (Exhibit 1). At the same time, however, their profitability has significantly declined, from 6.8 to 4.2 percent EBIT during the 2005–2012 period. Thirty-seven of the 100 companies surveyed were able to maintain or increase their profitability, but only 35 enterprises managed to both grow and become more profitable. That general economic conditions were unfavorable over part of this period does not fully account for these numbers. Often, a company’s growth (or lack of it) can be traced back to opportunity-driven activities that, in the long term, failed to achieve the desired effect on profits.

EXHIBIT 1: INDEXED AGGREGATE REVENUES AND EBIT MARGIN FOR THE TOP 100 GLOBAL LOGISTICS PROVIDERS



Source Oliver Wyman analysis

## MARGIN PRESSURE DESPITE GROWTH

A good example for margin pressure despite growth is European road transportation. This market segment is highly fragmented, and even leading players can only claim a market share in the range of 0.5 to 2.5 percent. Increasingly, financiers and parent companies are asking themselves whether it still makes sense for them to invest their money in European road transportation, or whether it might not be better to channel funds into more attractive logistics segments, such as contract logistics, or into emerging markets, such as Brazil, Central Asia, India, and China (BRIC markets).

Since 2005, many logistics services providers have built up extensive geographic coverage in Europe's core countries by means of organic growth and acquisitions, and now call themselves "network services providers." But a closer look reveals that they are not so much road transportation networks as independently operated subsidiaries that seek to realize synergies within the group and jointly develop individual customer solutions. Network thinking is often not well developed: Traditional mindsets with a focus on legacy business and "silo" thinking at the regional management level are more typical.

What's more, the fact that profit and loss are usually measured at the local subsidiary level means that, in day-to-day business, every subsidiary in the network will strive to optimize itself at the expense of the others. In these cases, the oft-praised "local entrepreneur" philosophy may actually have a detrimental effect on the organization as a whole. More often than not, it prevents companies from realizing scale effects, professionalizing their core functions, subcontracting appropriately, and optimizing their networks. In addition, complex matrix structures, which complicate decision-making, as well as the duplication of functions and responsibilities, will amplify these effects.

## MORE PROFIT IN GROWING MARKETS

In recent years, the logistics industry has optimized existing business models down to the smallest cost lever. As a result, in road transportation, logistics services providers are increasingly using route optimization systems, relocating truck fleets to regions with lower labor costs, selecting network-compatible shipment typologies, implementing the latest technological innovations, and extending their truck capacity utilization rates. There's a little room left in terms of the potential of traditional cost levers – such as implementing lightweight construction, improving aerodynamics, and increasing the efficiency of engines – but not much. The situation in other logistics segments is more or less the same.

Achieving profitable growth in the future will thus require logistics services providers to undertake a thorough overhaul of their traditional business designs. Oliver Wyman has identified six levers that can help them to achieve this goal.

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ONLY 35%

of the top global 100  
logistics companies  
have grown profitably  
since 2005

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## 1. BALANCING THE BUSINESS PORTFOLIO

The activities of logistics services providers today often encompass a broad combination of transportation, forwarding, and supply chain management, while at the same time these firms are becoming more international. Market and profit potential and risk profiles diverge considerably, depending on an individual company's lines of business, products/solutions, and geographic coverage. For example, spare parts logistics for industrial goods generates higher returns than many businesses in the automotive industry, but has less market potential. When developing a growth strategy, it is thus important to use targeted investments and activities to create a portfolio that balances profitability and risk.



## 2. SPECIALIZING AND STANDARDIZING SOLUTIONS

In recent years, customers' logistics requirements have undergone substantial change. Customers are prepared to pay more and commit themselves longer to one supplier if that supplier can offer innovative, industry-specific solutions that can have a major impact on final product costs. Solutions development should be backed, however, by standardized processes and systems, including a modular approach to existing assets and networks and elimination of multiple types of solution components, such as warehouse management systems.



## 3. PROFESSIONALIZING TENDER MANAGEMENT

In recent years, shippers have considerably improved the professionalism of their logistics purchasing, and the cost structures, prices, and services of individual logistics services providers have become much more transparent. But many logistics services providers have no clear view of what it costs them to render their services at the subsidiary or dispatcher level, and tender management is often a last-minute affair. Professional tender management, on the other hand, comes into play right after an inquiry is received, is closely integrated into key accounting and solutions deployment, and is grounded on deep industry expertise and sophisticated IT tools.



## 4. THINKING AND ACTING “NETWORKS”

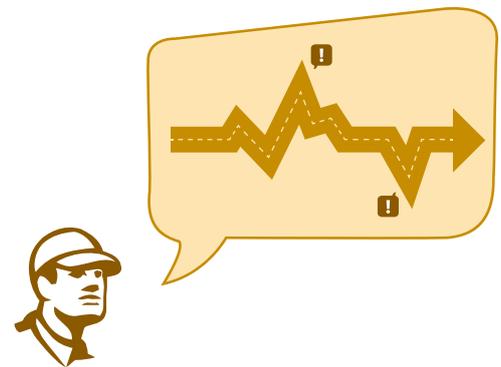
Currently, it is typical in the logistics industry for individual subsidiaries to dispatch and control traffic. As a result, it is impossible to optimize the utilization of the entire network, and parts of the network often become destabilized. The aim of “thinking and acting networks” is to significantly increase both network efficiency and productivity, thus delivering high levels of service quality and customer satisfaction. To meet this goal, logistics services providers must, above all, install centralized network management, including corridor and trade lane management, and define a core network with fixed routes and timetables, whereby line planning can be adapted on a rolling basis to account for market and origin/destination changes.



## 5. IMPLEMENTING DYNAMIC CAPACITY MANAGEMENT

In the face of rising volatility among customers and capacity providers, it is becoming increasingly difficult for logistics companies to assess capacity needs. They often lack a detailed understanding of the economic drivers of traffic volumes or an early warning system that could enable them to spot market changes. Simulation-based optimization models that explicitly incorporate economic drivers, such as demand-based capacity growth or cargo rates, enable estimation of basic capacity and peak ranges. These estimates can then be used to plan capacities on a rolling basis and redefine capacity needs accordingly. The logistics services provider can then choose a suitable combination of different contract durations and define the appropriate hedging strategy, e.g., for cargo rates.

In addition, employees of logistics services providers are widely scattered, meaning that they interact closely with diverse individual markets. This access to market information is a hidden asset that can be systematically exploited as an early warning system for market changes and as input for capacity planning.



## 6. STREAMLINING THE ORGANIZATION AND GOVERNANCE

Processes and structures across subsidiaries often are not harmonized – a situation that can be improved through the sharing of best practices. In addition, logistics companies should determine if there are functions/activities (e.g., accounting, customer service, IT, HR) that could be aggregated at some level – whether at headquarters, by country/region, or through shared services centers.

It is also important for providers to seek ways to simplify and speed up decision making, in order to respond more quickly to customer demands or market changes. Too many input levels or committee rounds can greatly slow down time-to-market – particularly at large logistics services providers. At the same time, industrializing and standardizing production can improve transparency and serve as a basis for establishing a governance system that measures the performance of individual locations using comparable key performance indicators (KPIs). This opens up the opportunity to install professional, cross-regional benchmarking and subsidiary optimization teams, for example, which can be an effective tool for ensuring continuous improvement.



## RECALIBRATING THE VALUE COMPASS

Standardizing and streamlining structures and processes, developing an industry and innovation orientation, thinking and acting in terms of networks, as well as professionalizing certain functions are all means to one end: improving future logistics services business designs. The traditional “local entrepreneur” culture, i.e., of focusing on transactions and making “gut decisions,” will no longer suffice to produce profitable growth. While strong, vital subsidiaries are important, there also must be an overall perspective on the business, greater systematization, and a stronger team orientation. Last but not least, it is important for logistics companies to align their individual employees’ value systems and targets with this perspective.

## ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across 25 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,000 professionals help clients optimize their business, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC], a global team of professional services companies offering clients advice and solutions in the areas of risk, strategy and human capital. With 52,000 employees worldwide and annual revenue exceeding \$10 billion, Marsh & McLennan Companies is also the parent company of Marsh, a global leader in insurance broking and risk management; Guy Carpenter, a global leader in risk and reinsurance intermediary services; and Mercer, a global leader in human resource consulting and related services. For more information, visit [www.oliverwyman.com](http://www.oliverwyman.com). Follow Oliver Wyman on Twitter @OliverWyman.

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