Europe’s 3PL Industry Consolidates on the Road to Pan-European Services

The growth of the European freight industry in the 1990s has offered a lesson that the country-by-country model for logistics is no longer valid; companies have begun to reorganize themselves into continental operations based on integration and rationalization. The pace of change, however, has been slow. The introduction of the Euro as common European currency has made the need to restructure logistics systems greater than ever. The years to come will bring about a rationalization and consolidation of European third-party logistics systems, followed by globalization.

In 1991, my colleagues and I expressed the following view:

“Several key developments provide the foundation for the proposition that the 1990s will be the era of the freight mega-carrier, with the future European freight industry coming to be dominated by a few, very large companies.”

Perhaps we were presumptuous. The proposition was, and still is, based on two key developments. First, activity within the logistics services market has been stimulated by events outside it. The globalization of business, coupled with increasing competitive pressures, has led many manufacturers and retailers to assess their core competencies and as a consequence has provided new opportunities for third party logistics (3PL) service companies. In some cases, this has led to the demand for one single pan-European 3PL service provider, yet this remains very much the exception at present. Exploiting this latent demand will necessitate an increasing concentration in the industry, either through acquisitions, mergers, or alliances. Second, the deregulation of the freight markets in Europe coupled with the completion of the single European market has released new logistics operators into the field.

By 1993 our enthusiasm had heightened. Work on “Reconfiguring European Logistics Systems” in conjunction with Andersen Consulting confirmed our view that the country-by-country model was no longer valid and companies had set about reorganizing themselves into regional (European) operations. The emphasis was very much on integration and rationalization. The motivation was clear: to cut out layers of cost resulting from excessive levels of administrative and inventory duplication, none of which was providing appropriate customer service levels. Critically, companies recognized the need to separate their sales function from that of physical fulfillment.

Yet the pace of change in Europe has been slow. While companies are aware of the logistics opportunities presented by a single European market, many struggle to implement their strategies effectively. Translating vision into reality presents major challenges in which the management of people and information are paramount. With the introduction of the Euro in January 1999, the need to restructure has never been greater:

“Simplification and standardization are having a profound effect on our business - we still have miles to go in realizing this but the Euro will accelerate it - and will bring increasing transparency in pricing across the continent - but any price reductions triggered by an increase in transparency could be offset in part by lower distribution costs and greater operational efficiencies.

- John Pepper, Chairman, Procter & Gamble, June 1998 in The Financial Times

Additionally, the dearth of pan-European logistics service providers has been a significant barrier to European restructuring. So what has hap-
pened to our proposition that “mega-
freight” carriers will emerge in Europe? And what are the trends in Europe’s 3PL market?

3PL European Market Size
Total logistics expenditures in Europe amounts to approximately $129 billion, of which $31.6 billion (24%) is contracted out. The 3PL industry is set for continued levels of growth with one forecast indicating that total European logistics expenditures will reach $155 billion in 2002, and that 3PL will increase its share of this expenditure to 28%, representing revenues of $44 billion. Despite this, the 3PL market in Europe is characterized by a fragmented set of players, although there are signs of consolidation. An example from Germany is Deutsche Post’s unprecedented acquisition spree to consolidate its position in the express parcels market and to develop wider logistics service skills.

Europe’s Leading 3PL Companies
The financial figures in Figure 1.0 inflate somewhat the market share of the leading 3PL players as they include incomes generated outside of Europe and some non-logistics-related income. Europe’s leading 3PL companies achieve logistics revenues that equate with a market share ranging between 0.5% and 6.0%.

Cranfield Survey Work
To monitor the development of 3PL outsourcing, Cranfield has been involved in a number of studies. Most recently this has involved collaborative work with Northeastern University, and Mercer Management Consulting, Inc. The Mercer surveys are designed to gauge the current status and future prospects of 3PL services in Europe and North America as perceived by their CEOs. The survey covers issues related to geographical scope, alliance building, industry service offerings, selling of third-party services, and the dynamics impacting on the 3PL industry. In all, 18 European CEOs, representing the largest European 3PL companies, responded to the latest survey in 1998.

EUROPE’S LEADING 3PL COMPANIES

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Revenue ( Millions)</th>
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</thead>
<tbody>
<tr>
<td>Deutsche Post</td>
<td>D</td>
<td>15,840 – 98</td>
</tr>
<tr>
<td>TPGroup (TNT only)</td>
<td>NL</td>
<td>1,103 – 98</td>
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<tr>
<td>Stinnes Logistics</td>
<td>D</td>
<td>7,700 (Schenker + BTL) 98</td>
</tr>
<tr>
<td>Gefco KN</td>
<td>F/D</td>
<td>5,800 (1.5 + 4.3) 98</td>
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<tr>
<td>GEODIS</td>
<td>F</td>
<td>2,952 – 98</td>
</tr>
<tr>
<td>NFC (Exel)</td>
<td>UK</td>
<td>2,584 – 98</td>
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<tr>
<td>Panalpina</td>
<td>CH</td>
<td>2,946 – 97</td>
</tr>
<tr>
<td>Ocean Group</td>
<td>UK</td>
<td>1,908 – 97</td>
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<tr>
<td>Thyssen Haniel Log</td>
<td>D</td>
<td>1,744 – 97</td>
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<tr>
<td>Tibbett &amp; Britten</td>
<td>UK</td>
<td>1,500 – 97</td>
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<td>POTE</td>
<td>UK</td>
<td>1,421 – 98</td>
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<tr>
<td>Hays plc</td>
<td>UK</td>
<td>1,360 – 97</td>
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<tr>
<td>Fiege Logistik</td>
<td>D</td>
<td>1,300 – 96</td>
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Those CEOs predict a stable growth rate of between 10% and 15% per annum over the next three years. However, this growth rate hides the continuing decline in basic service margins and is one of the underlying causes leading to the industry consolidation we are witnessing. Some of the key findings are:

- Although the market for contract logistics will continue to grow, the loss of control and service quality issues are the primary constraints to increased 3PL usage.
- The emphasis on Europeanization picked up in earlier surveys has been replaced by a drive towards globalization.
- The offering of Value-Added Services and Information Management may be the keys to differentiation, but 3PL revenues continue to be largely generated by basic services.
- The price of services offered is an important issue in the choice of 3PL providers; lower cost is still the main driver for outsourcing.
- As users retain fewer 3PL providers, 3PL service offerings will need to expand – either directly or through alliances.
- Supply chain integration, globalization, and logistics information systems represent the biggest opportunities for growth as users focus more and more on core business processes.

The Key Revenue Generators
The top two revenue generators for 3PL providers, though not necessarily profits, remain basic services: warehouse management/services and transport services. Revenues from value-added services seem to be stable at around 30% in both Europe and North America, but growth seems illusory.

While it is possible to identify examples of successful value-added services for almost all of the survey respondents, these are often customized solutions, and as such the providers find it difficult to replicate easily the service with other customers.

Some shippers use an increasing scope strategy explicitly to test and develop 3PL relationships with providers. The relationship starts with letting the provider manage transportation, progresses to minor warehousing activities, and is followed by all warehousing (inventory management not included). The next step is to
add different value-adding services, e.g., packaging and light assembly. This approach to outsourcing enables the shipper to evaluate the provider on different levels of complexity, and ultimately whether to continue or terminate the relationship, through a phased introduction. Such an approach is an alternative to the full-scale evaluation of multiple providers for complex multiple activities. This phased approach is attractive to companies who lack the resources to evaluate and implement 3PL solutions and who feel no need to outsource immediately all 3PL activities. At a European level, however, it does rely on the selected 3PL provider having adequate Pan-European capability.

American CEOs appear to attach greater importance to value-added services than their European counterparts, perhaps hoping that value-added services will enhance the complexity of their service offerings and in so doing improve the margin they are able to achieve. However, basic service provision remains critical in Europe and North America. 3PL providers must provide high-quality and cost-competitive basic services if they are to retain customers. Providers who demonstrate an ability to drive down user-basic logistics costs will be rewarded with additional business.

Growing service complexity will encourage some 3PL companies to move away from an asset-based to a more management/information-based service portfolio, acting as first tier service providers.

Opportunities for 3PLs
The outsourcing market remains strong. This is reflected in CEO comments about new markets emerging in Eastern Europe and Asia. The emphasis is shifting to globalization, as 80% of the European 3PL companies are already present in eight or more Western European countries. At the global level, the opportunities for 3PL companies stem from global sourcing and the rise of consumerism in Eastern Europe and Asia. Fears surrounding the impact of the Asian crisis appear to have been tempered by the realization that economic recessions often have a positive effect on the outsourcing market.

The pace of change associated with globalization and Europeanization forces companies to concentrate on their core competencies; geographical separation places new strains on supply chain activities with the need for integration. This provides new opportunities for 3PL companies. However, 3PL companies are themselves finding it difficult to integrate their activities across borders. 3PL CEOs have indicated that there are opportunities to increase operational efficiency. In part this will need to come not only from a more realistic approach to contract development more in line with true geographical capabilities and a greater use of alliances to provide wider service offerings but also from better asset utilization of shared resources through operational networks.

In a follow up to the 1998 survey we have established a greater IT emphasis, in part stimulated by e-commerce developments. Yet this is at variance with the low level of alliances reported by CEOs with information technology companies. Geographical scope appears to be driving the 3PL industry at present.

The most frequently cited problems faced by the industry are downward pressure on prices and margins, the availability of qualified personnel, and the problems of IT development. This is the same as in the previous survey. However, new problems this year are the Pan-European and regional management stresses. As 3PL companies Europeanize/globalize their operations, they begin to encounter management problems associated with mixed business cultures, management reporting structures/communications, and the management of alliance partners. The development of conjoint strategies between users and 3PL service providers seems to rely on compatible cultures.

Geographic Expansion and Alliances
The past decade has seen moves toward centralization of European (and in some industries global) logistics. Multi-nationals are changing their concepts from decentralized to centralized sourcing and distribution, and shippers are tending to rationalize their service providers in line with their network needs. This is reflected in the CEO responses to questions on the primary reason for entering new markets. The vast majority of answers focused on the need to internationalize operations, but, interestingly, many CEOs felt compelled to enter new markets because of their customers' drive for Europeanization and globalization.

While in agreement on the importance of globalization, user plans and provider strategies are not always in sync.
While North American users are focusing more on outsourcing of European and Asian logistics, providers are focusing on NAFTA, with U.S. providers consolidating their position in their own region.

The overall preferred entry strategy was direct investment and alliances with foreign companies. There was no significant difference in the entry strategy used according to region although restrictions on foreign ownership in certain parts of Asia would mitigate toward alliances with local partners.

Over two-thirds of the companies have established alliances with other providers of 3PL services primarily to increase their geographical networks and extend their portfolio of services. When compared with findings in the U.S. survey, it appears that alliances are more often by European companies. It would appear that the pace of change, with respect to shipper demands for geographical and service scope, often as part of a 3PL rationalization process, has favored alliance building. Some CEOs clearly stated that one of the significant events impacting their industry was the development of more alliances.

CEOs identified a range of factors important in making alliances work. Not surprisingly, common culture tops the list, but issues related to information technology and communications have become more important as customers demand more seamless services irrespective of the players involved.

**Comparison: U.S. versus Europe**

Comparisons with the North American providers revealed that European companies are more advanced in the internationalization of their operations. Half of European companies described themselves as operating worldwide (i.e., in three continents or more). European companies have quickly exploited the opportunities arising in Eastern Europe with a number of CEOs describing the region as offering significant growth. Perhaps more surprisingly, European companies have a greater presence in Asia. This is perhaps a legacy of colonial trade and the freight-forwarding origins of many of Europe’s leading third-party logistics players. North American companies, by contrast, have concentrated on consolidating their position in NAFTA and developing their presence in the European market. The entry of North American providers into Europe is in its first wave and has taken place largely at the request of existing North American clients. Whether these new entrants can consolidate their longer-term position ultimately relies on their ability to attract and retain indigenous European customers.

**Summary**

**Rationalization First, Globalization Later**

Despite investment abroad, revenues for both European and North American providers are substantially weighted to their domestic markets (less than 80% of revenues for the majority of companies) with only moderate increases over the next three years. The globalization of these companies will be a slow process. As European CEOs are confident that the third-party market will remain strong, Europeanization of third-party logistics remains important, in order to provide a more complete set of services. Consolidation within Europe will continue, but for some the emphasis is already shifting toward globalization.

We can conclude that European 3PL industry restructuring is symptomatic of the drive to provide increasing geographical and service scope. This is being achieved through the glut of acquisitions, mergers, and alliances. However, the slow rate at which value-added services are being taken up by shippers indicates that 3PL providers have not been successful in claiming a more prominent position in Supply Chain Management activities. Whether true Pan-European 3PL logistics providers will emerge is still questionable, but the building blocks are being put in place.