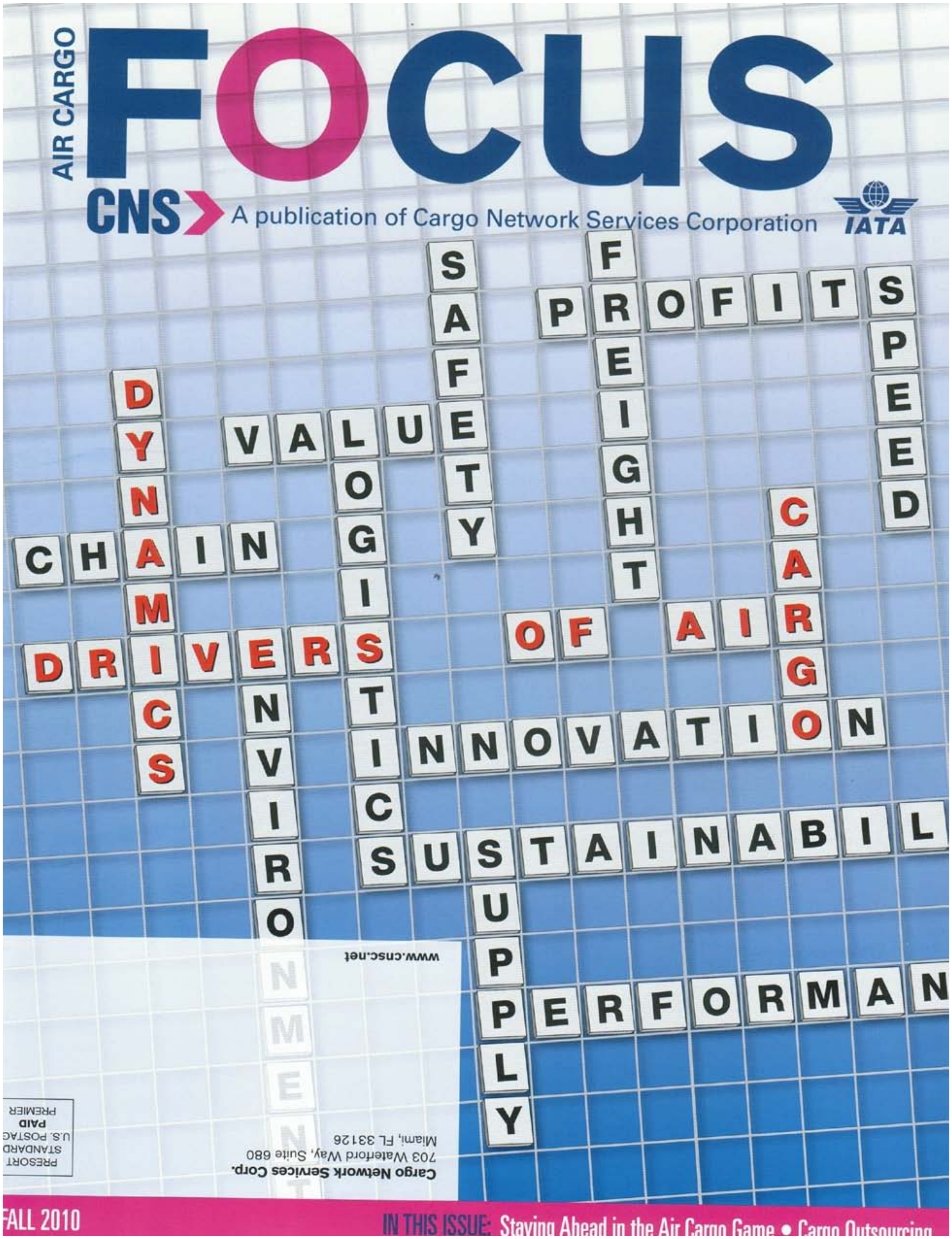
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IN THIS ISSUE: Staying Ahead in the Air Cargo Game • Cargo Outsourcing

Time to (Re-)Think

Why Corporate Footprint Plays a Decisive Role in the Airfreight Industry

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TOPICS SUCH AS MERGERS AND ACQUISITION, equipment groundings, and price-earnings ratios have never held a more important place in weekly management meetings of the airfreight industry than today. Reports about takeovers and bankruptcies are practically common place in today's daily news. The big names in the industry selectively augment their portfolios in growth markets such as Asia or Latin America, but also in those modes of transport where they are not (yet) among the top players worldwide.

The target group for such takeovers, mostly leading companies at a local or regional level, is diminishing. In most cases several potential buyers are bidding for one and the same (still available) company. Inevitably, this leads to rather high-priced takeovers, which effectively eliminates less financially potent mid-sized buyers who simply cannot afford to compete with their larger, cash-rich competitors. Therefore, more than ever, the question for those smaller companies is how to position themselves against the "big guys" in the future.

Large companies announce record results

In the past, for instance, the shares of Kuehne+Nagel have been repeatedly recommended as an investment vehicle by Züricher Kantonalbank. A few days ago, Kuehne+Nagel was even rated "overweight" by the analysts of Morgan Stanley, which is not surprising considering their results of the first six months of 2010. According to those analysts, Kuehne+Nagel's growth perspectives are above average. Their growth in airfreight has significantly contributed to this situation.

K+N's competitor Panalpina has also increased profits, and their stock market valuation has improved by 50%. Again, airfreight has contributed the lion's share of this success. This also applies to other companies such as Schenker and DHL, whose airfreight division has been the main contributor to their bottom line. According to research conducted by the German company Aviainform, the ten biggest airfreight forwarders were able to improve their airfreight results in the double-digit-percentage range during the first half of this year over 2009.

Among these airlines, Lufthansa Cargo has achieved the best half-year result in its entire company history after intensive measures had been taken to improve performance. The logistics affiliate of the German airline generated an operating profit of EUR144 million (USD192 million) in the first half of this year, an improvement of EUR278 million (USD371 million) over the same period last year.

Europe's biggest airline, Air France/KLM, also reported an increase in revenue, particularly in the airfreight division. For the first quarter (April to June), the carrier posted an 11% increase in overall sales, with an increase of 44% in airfreight!

Despite all this, the Lufthansa Group suffered an operating loss of EUR171 million (USD228 million) in the first half of 2010, and British Airways experienced an operating loss of GBP231 million (approx. USD362 million) in the past fiscal year. Air France-KLM had an operating loss amounting to EUR1.3 billion. In other parts of the word, particularly the Middle East and Asia, the airlines are generating profits. US airlines also expect rising profits due to an increase in their passenger business and a reduced capacity in the market.

IATA remains optimistic

According to estimates by the International Air Transport Association (IATA), the airlines are expected to generate profits more than three times higher than previously anticipated. IATA, which represents approximately 230 airlines worldwide, forecasts a total net surplus of USD8.9 billion (EUR6.8 billion) for 2010, a drastic improvement over the estimates of USD2.5 billion from last June. However, it is uncertain how long the economic recovery will continue. "It is clear that there will be a slowdown in the fourth quarter, and 2011 will be a much tougher year," IATA warns.

What this means for small and medium-sized forwarders

When looking at the annual reports of forwarders in comparison to the business results of the airlines, one could get the impression that the "asset-free" policy of the forwarders has had an essential and positive impact on their business results while the "asset-intensive" policy of the airlines (purchase and maintenance of aircraft) shows negative trends. But a closer look reveals that this impression is not entirely true. Assets are also increasing among the worldwide leading forwarders, and there is a principle understanding of the increased risks resulting from that. This also results in different methods of space acquisition, which is essentially based on mutual success factors and cooperation. Airlines are still the line-haul provider between the airports of departure and destina-

When it comes to the small and niche forwarders, however, airline loyalty is increasing.

tion, but to be included in the large forwarder's list of preferred partners, other criteria than just price play a key role. Both businesses are much more closely linked by a shared vision and requirements such as quality, reliability, flexibility, and predictability.

This philosophy does not hold true for mid-sized market players. Many medium-sized forwarders are able to achieve rather low purchase prices from the airlines, even though their volumes are far less than those of the top players. However, driven by their market demands and other factors, those forwarders are forced/more willing to re-book their freight if they are able to achieve lower buy rates. It seems that due to the lack of freight for consolidations, this practice continues to thrive.

When it comes to the small and niche forwarders, however, airline loyalty is increasing. Quite often a forwarder is controlling a certain business (niche) and thus depends on maximum reliability of its airline partner. Frequently, this leaves hardly any room for "price hopping". Instead, both providers, the forwarder and the airline, are much more likely to use this as a chance for mutual future growth.

Concentration and innovation —guaranties for growth?

For quite a long period of time, we have observed top providers consistently expanding their market shares. The top 20 forwarders and airlines control more than two-thirds of the market while several thousand other forwarders and a few hundred more airlines split the remaining segments among themselves.

This is why there is an ever increasing number of agency agreements between smaller forwarders around the globe. Expansion into new markets (e.g., investments in a network in China, India, or Russia) is simply not feasible for them and carries too much risk. Investing in a unified IT system is also too expensive for many of these enterprises. Even smaller investments such as advanced training of employees are often impossible. Yet this is exactly what shipping agents continually require from their logistics partners and what gains more and more importance in tenders.

While the freight forwarder is increasingly forced to deal with augmenting requirements, the rules for successful airlines are different. Flexibility, a far-reaching network with high and regular frequencies, and maximum reliability of the fleet are the basic requirements for each airline. Uniform quality standards worldwide, environmental responsibility, and profitability as security for staff and shareholders are more advanced needs. Particularly in times of peak prices for kerosene, unbalanced commodity flows, and discussions on emissions, a modern, fuel-efficient fleet is the basis for any provider's success in today's market. In addition, regular investments toward most modern IT systems (e.g., IATA's e-freight and electronic booking) are as necessary as those in the latest safety technologies and ongoing staff training.

Corporate footprint to remain a success factor

Global markets require global providers – size alone is not a guaranty for continued growth and sustainable success. What counts is specialized knowledge of existing and new markets and putting it to good use. An essential contributor to the future success of small to mid-sized forwarders is the partnership-like cooperation with segmented customers. Risks will have to be managed by all parties involved, and this, more than ever, will require the exchange of timely and correct information, as well as effective planning.

The fact that small/medium-sized companies and global footprint are not mutually exclusive is evident in the German Market where three shipper associations have consistently ranked among the top 10 providers, competing quite successfully with the multinational giants of the business. So far this recipe for success has been mostly ignored in other markets, including the US. Such associations could very well position themselves as a "third power," particularly in the American market. Small and medium-sized companies frequently demonstrate higher flexibility than, for example, a Schenker/BAX or Expeditors ever could, as companies of that size have system-inherent inhibitors. Additionally, smaller cooperating specialists could expand from within their niches when operating in a truly global fashion and fill a void that larger forwarders and integrators cannot service. In the case of appropriately bundled volumes, these niches promise better access to capacities (particularly in critical times and markets), as well as higher profits, without a considerably higher risk.

It would certainly be healthy for competition overall if regional forwarders would position themselves "globally." Most supply-chain participants would potentially draw benefits from such a scenario. Shippers would have more qualified vendors to choose from and possibly obtain better service and prices, regional forwarders would be able to compete for business they currently cannot touch, carriers would have an improved customer mix, and the airfreight industry overall could experience an improved receptiveness to innovation, decreasing costs, and more stable profits.