

Where will the latest business cycle take freight forwarders?

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The business cycle is one of the certainties of the world's economy. It comes in a number of forms but everyone is subject to it. The logistics sector is particularly prone to cyclicality. Indeed, the success of big providers of air and sea freight transport is defined by the dynamics of their cycle.

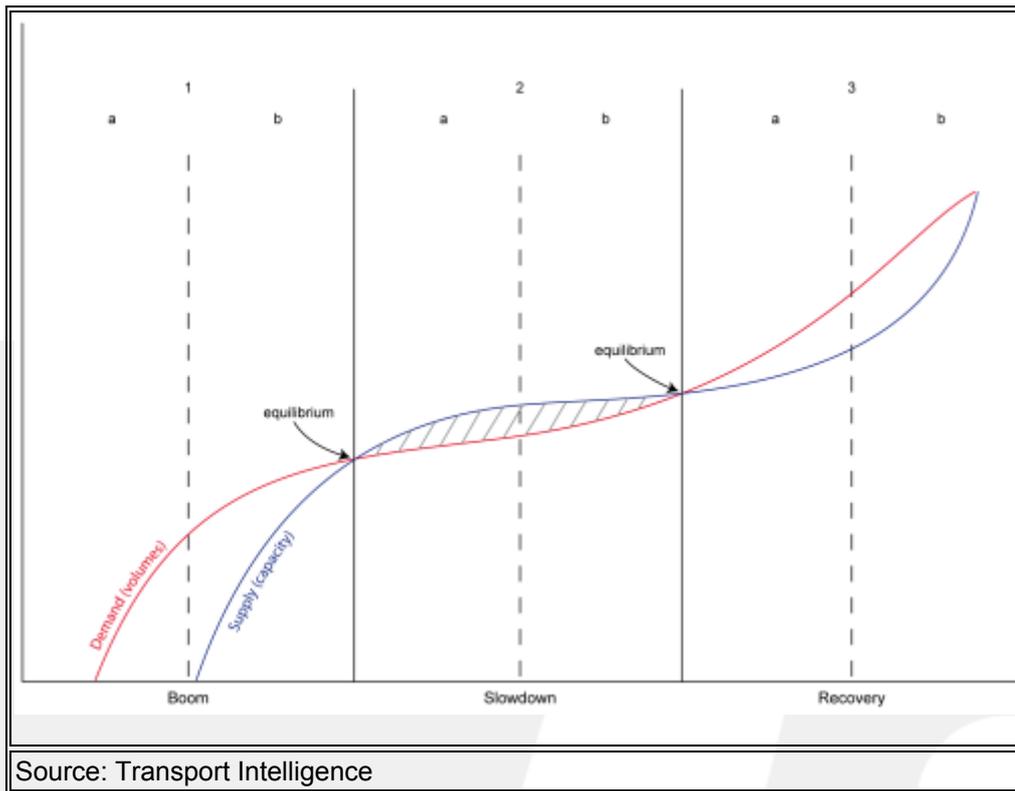
In air freight, but even more so in sea freight, the business cycle is defined both by variations in demand, which is driven by the wider economy, and a characteristic pattern of supply. Aircraft and vessel owners find the economics of market share irresistible and have an apparent addiction to buying too many aircraft and ships in periods of market growth, only to find they have excess capacity in a downturn. That condition is amplified by the lead time of buying and building aircraft and ships. The success of, say, a shipping company is therefore defined by its ability to manage through the whole cycle, not just the good times.

So the dynamics of both air and sea freight usually follow a predictable pattern, what might tendentiously be called 'boom and bust'. But are all logistics businesses like that? Surely those that buy and sell air and sea freight capacity should be driven by the same imperatives? The answer is an emphatic 'no'.

Over the past decade, the companies still, rather anachronistically, called freight forwarders have tightened their grip on air and sea freight. The biggest operators in that sector such as DHL, Panalpina, Kuehne + Nagel and Schenker have not only gained market share but have also tilted the balance of power between them and the companies whose services they buy. That can be measured by the quantity of freight moved by major forwarders compared with the rest of the market. The most high-profile example in that context is Kuehne + Nagel, which has been expanding its market share, with its sea freight forwarding business growing at 15% per annum in 2007 whilst underlying volume growth market growth has been around 10%.

There is, however, a dichotomy between profits and volume, but one not connected in a linear fashion to the air and sea freight cycle.

The key is the cost base of freight forwarders. That is driven by the rates of the shipping and airline companies. Of course in periods of growing demand, those rates will climb. In a period of falling demand, amplified by over-capacity, rates fall. The effect on the bottom line of freight forwarders is therefore perverse. In a period of falling demand, forwarders will often see increased profits. In a period of increasing demand, lower profits.



That is the theory. Can that be seen in present performance?

DHL Forwarding presents an equivocal picture. Its profitability, in EBITA terms, has fluctuated as revenue has consistently grown over the past few years. However, there are too many exceptional items, such as the demerger of contract logistics, to extrapolate any firm conclusion. Panalpina has had a very different dynamic, with profitability consistently climbing after a low of 2.5% EBITDA in 2005. Volume has also been consistently climbing. Different again is the record of K+N, which has had consistently climbing EBITA and revenue. It has a more stable record, with both volumes and profits increasing steadily over the decade.

What has dominated the picture of big forwarders' performance has been the consistent growth of volumes in air and sea traffic, particularly between China and the US and Europe. That has combined with an increased profitability of those forwarders. Thus, secular developments have obscured the cyclical characteristics.

So what does this augur as far as immediate prospects where freight forwarders are concerned? One possible outcome is that the past secular trend could reverse. Cargo volumes out of China could fall so much that lower freight rates would not compensate. Freight forwarders' profits would drop heavily. That 'race to the bottom' scenario might seem a little pessimistic and would assume large falls in consumer demand for Chinese products in the west.

A more moderate proposition would see flatter dynamics in the air and sea freight markets. With airlines aggressively cutting back belly freight and some rationalisation of capacity by container shipping companies, the global logistics industry would see freight forwarders in a weaker position to negotiate lower rates. In essence, the perception of the market by the providers of physical capacity – aircraft and ships – would turn 'bearish'. That is already being seen in the aviation market, with large airlines redeploying aircraft and smaller airlines going out of business. It has yet to happen in

container shipping and although slower vessel speeds must have some affect, that is a long way from the decommissioning required.

The present state of the global logistics market suggests, therefore, that over the next 12-24 months there may be a weakening of the position of freight forwarders in the air freight market on the back of lower volumes and lower available capacity. Here the number to watch is 'Available Tonne-per-Kilometres' (ATKs). In container shipping, the atmospherics still seem more optimistic with shipping lines more concerned by the effect of fuel costs than the shortage of trade. That suggests that if volumes do drop, the forwarders will be able to strengthen their position despite any falls in freight shipped as the shipping companies will not be able to get rid of capacity fast enough.

In summary, then, the prospects of the big forwarders have become more uncertain. Over the past 10 years they have experienced a period of stability and growth which has underpinned strong profits. That phase is likely to be over, yet will they enter a period of low growth, falling shipping rates and for them, strong profits? Will forwarders be able to 'buck' the business cycle and retain their market position?

Interested in the future of Freight Forwarding? To find out more about the issues discussed in this article, follow the link to purchase [Global Freight Forwarding 2008](#). Transport Intelligence's latest report contains analysis of:

- The state of the forwarding market
- Key trends and developments in 2007 and the first half of 2008
- The structure and drivers of the market and their implications for the future of the market

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