

# MERCER

Management Consulting

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## **The Third Party Logistics Market in China: Opportunities and Challenges**

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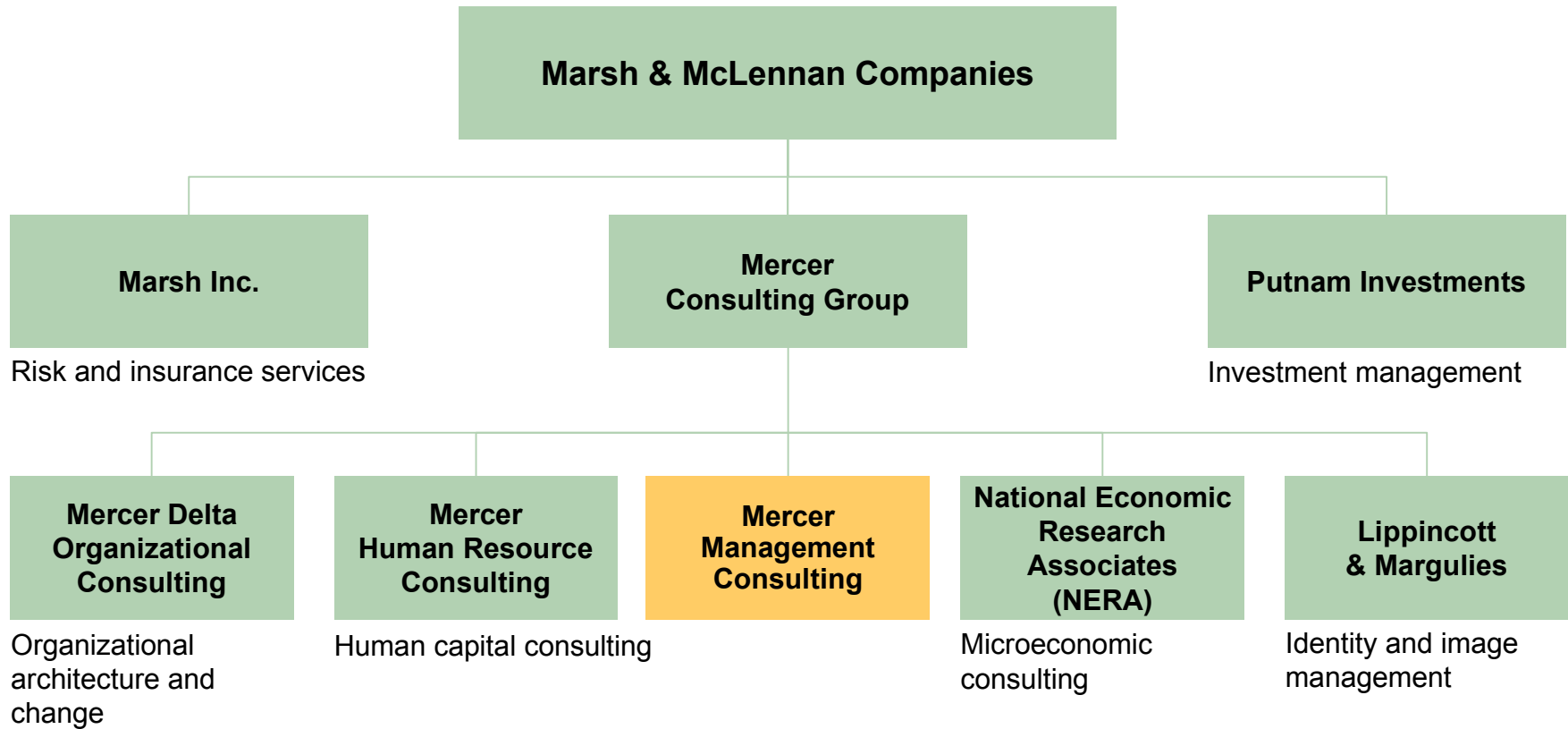
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- Key findings from Mercer's China 3PL Survey
  - Market overview
  - Customer requirements
  - 3PL provider tactics
  - Future trends

# Mercer Management Consulting

Mercer Management Consulting is part of Marsh & McLennan Companies (MMC), a \$10 billion professional services firm.



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Mercer Management Consulting is a leading international strategy and general management consulting firm with deep industry and functional expertise.



- **Professionals of more than 1,400**
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  - **Retailing, Consumer Goods, Healthcare**
  - **Process Flow Manufacturing**
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  - **Private Equity Institutions**
  - **MercerDigital**
- **Three capability groups**
  - **Supply Chain (logistics)**
  - **Value Growth and Implementation**
  - **Customer Strategy Team**
- **Leading edge thinking on Value Migration and Value-driven Business Design**

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## 3PL Survey in China

For our survey we interviewed about 20 major 3PL providers. Our shipper interviews focused on eight sectors with high potential for outsourcing. All the provider interviews were face-to-face, the shipper interviews were both face-to-face and by telephone.

### 3PL Provider Interview List

<b>Foreign logistics companies</b>	<b>Traditional transportation companies</b>	<b>Internal logistics departments</b>	<b>Emerging logistics companies</b>
▪ 8 companies	▪ 6 companies	▪ 3 companies	▪ 5 companies

### Shipper Interview List

<b>IT &amp; telecom</b>	<b>Consumer electronics</b>	<b>Food &amp; beverage</b>	<b>Apparel &amp; textile</b>
5 MNCs   3 Chinese	4 MNCs   4 Chinese	3 MNCs   3 Chinese	3 MNCs   3 Chinese
<b>Automotive</b>	<b>Chemicals</b>	<b>FMCG</b>	<b>Pharmaceutical</b>
5 MNCs   1 Chinese	2 MNCs   4 Chinese	3 MNCs   1 Chinese	4 MNCs   0 Chinese

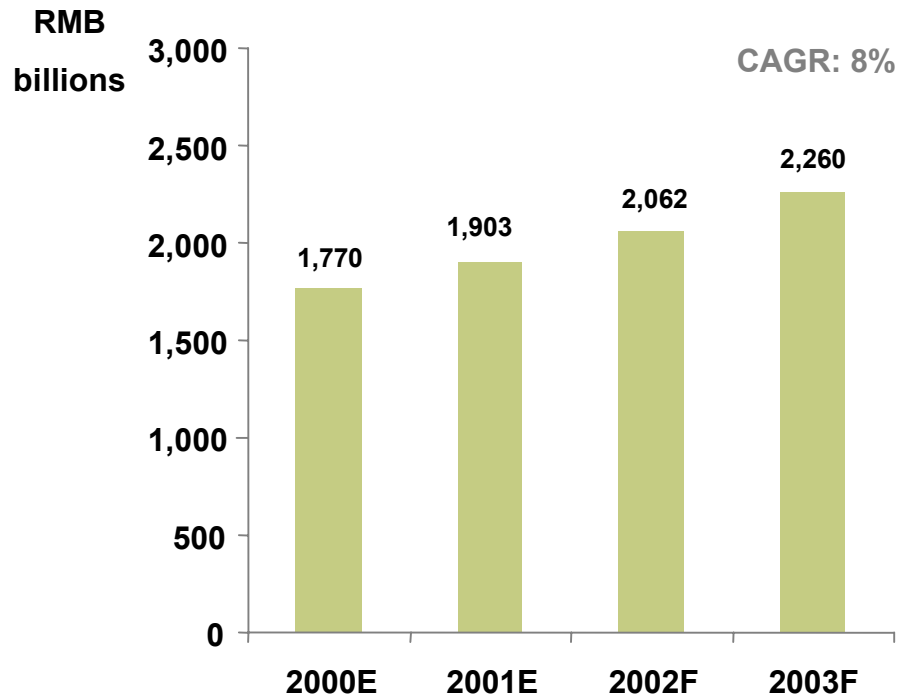
## Key findings (Overall market)

- The 3PL market in China is large, fast growing, in its early stage of development, and concentrated in geography
  - The China market for outsourced logistics was estimated to be just under RMB 40 billion (US\$4.8 billion) in 2001
  - A large majority of the logistics providers we surveyed reported annual growth rates in excess of 30% over the last three years
  - 85% of providers' revenue comes from basic services such as transportation management and warehousing; nearly 70% of providers believe clients are not ready for outsourcing, while almost half of the shippers surveyed cite obstacles for outsourcing, especially 3PL service quality
  - The market is very fragmented: No 3PL provider interviewed has a market share over 2%. About 80% of providers' revenues come from the Yangtse River and Pearl River Delta regions
- The demands of multinational versus Chinese shippers are very different, suggesting two distinct market development paths
- Many providers are seeking partners to compliment their capabilities and meet the growing challenges
- Government initiatives are also stimulating the 3PL market in China

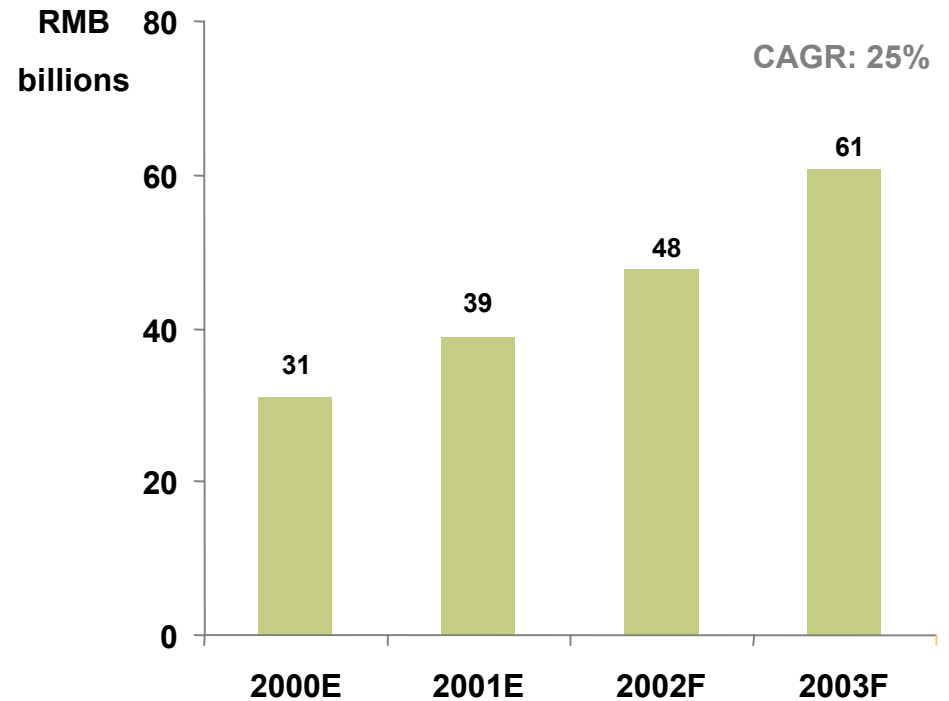
## Overall market opportunity

China has a large and rapidly growing market for transportation and logistics. The outsourced transportation and logistics market is also big at RMB 40 billion (US\$ 4.8 billion) in 2001, its growth is expected to be around 25% CAGR, faster than that of the US market.

Forecast China domestic transportation and logistics expenditures



Forecast China outsourced logistics market size

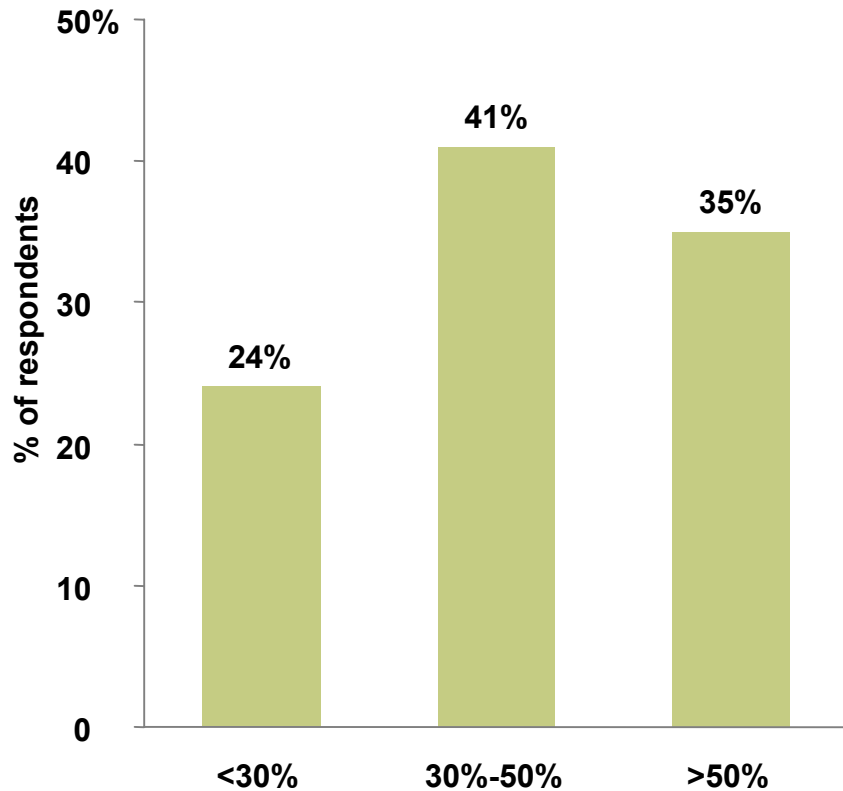




## China 3PL market features

The supply side of 3PL in China is growing fast, with over 70% of companies surveyed reporting over 30% growth. However, 85% of revenue still comes from basic services.

Annual growth rate of 3PL providers  
(1999-2001)



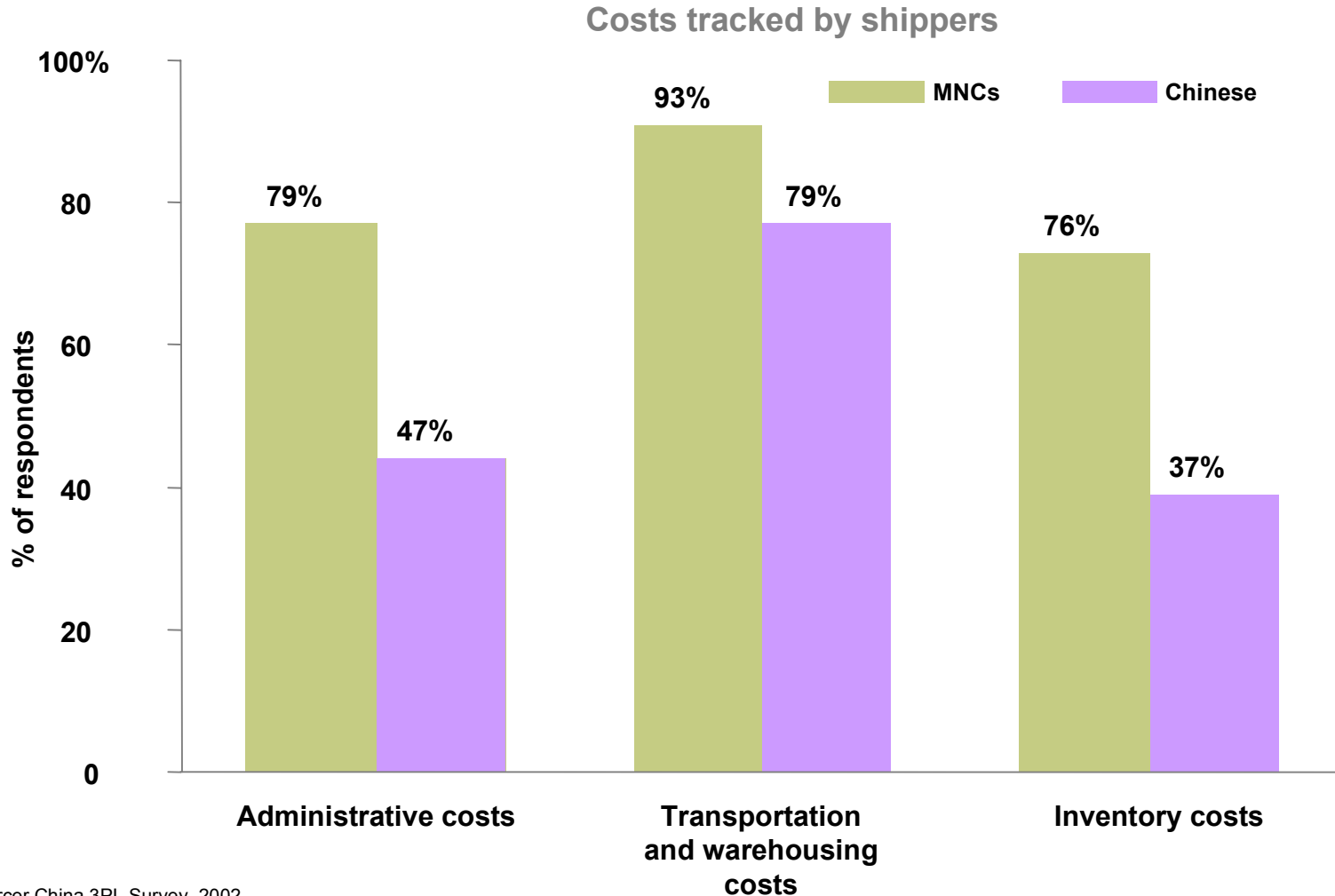
Breakdown of revenues<sup>1</sup>



Note: <sup>1</sup>Straight average of all responses (not weighted by size of each 3PL provider)  
Source: Mercer China 3PL Survey, 2002

## China 3PL market features

Logistics costs are not well tracked, especially by Chinese shippers. Only about 30% of shippers (all multinational corporations) calculate total logistics costs.



### **3PL providers' views of shippers**

Nearly 70% of providers think that clients, particularly Chinese clients, are not ready for outsourcing.

#### **Clients are not ready**

***“ What do they do with thousands of employees and tens of millions of logistics assets if logistics services are outsourced.”***

***“ I agree that the market potential is huge, but it will take time for domestic companies to outsource more.”***

***“ Many customers are willing to outsource, but only a small part. They are looking for 3PL providers to provide simple services.”***

***“Customers are ready for outsourcing direct transportation services. However, for more complicated services, they need more external pressure to push them to move forward.”***

#### **Clients are ready**

***“Clients are ready for outsourcing, especially MNCs. They are trying to outsource as much as possible.”***

***“ In China the customers still need some education on logistics, but Chinese companies will accept this idea much faster in comparison with other countries' customers, because they can learn from other experiences and they have more external pressure to improve current products and services to survive.”***

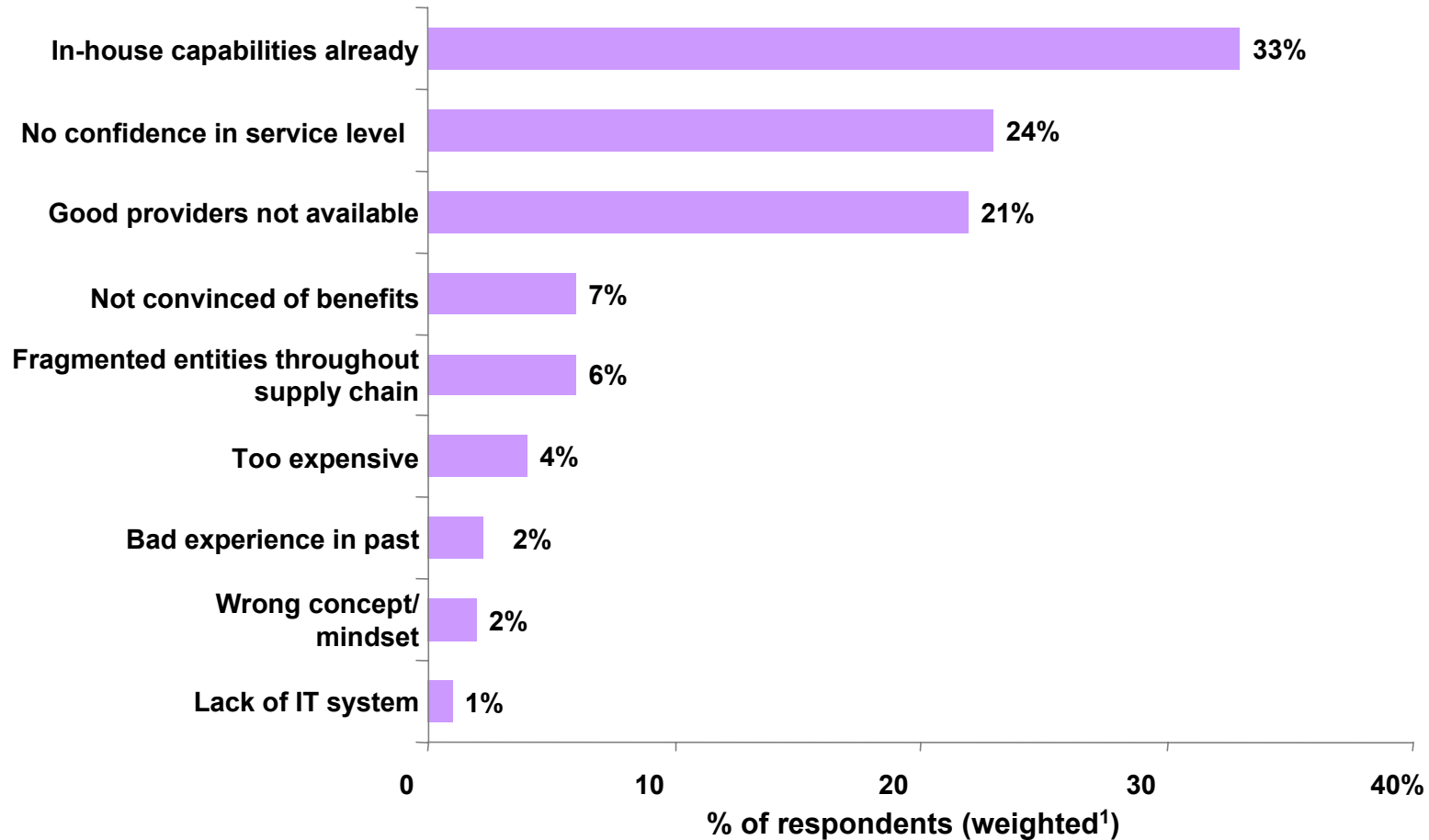
***“Domestic manufacturers will outsource more and need more sophisticated services.”***

***“Customers in East China are more educated and willing to outsource.”***

## Shippers' view of 3PL providers

Shippers lack confidence in service levels and have difficulty finding good providers. Many providers are good at marketing but fall short on delivery, especially in delivering high-quality and consistent services across geographies.

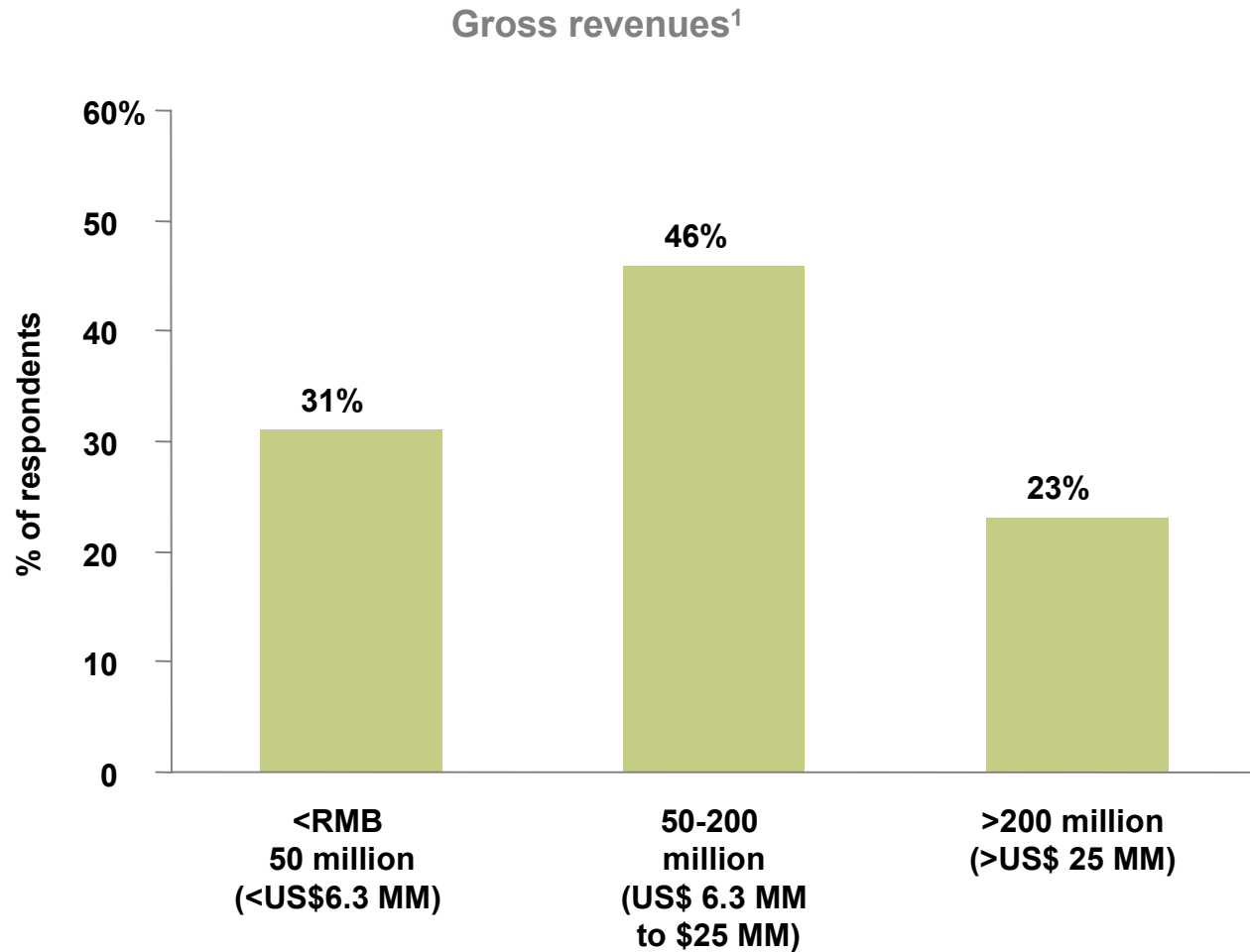
Reasons for not outsourcing logistics



Note: <sup>1</sup>Top three responses weighted by order of importance (#1 = X3; #2 = X2; #3 = X1) and calculated as % of total weighted responses.  
Source: Mercer China 3PL Survey, 2002

## China 3PL market features

The market is highly fragmented, with no one player achieving more than a 2% market share.



Note: <sup>1</sup>Gross revenues includes purchased transportation and warehousing.  
Source: Mercer China 3PL Survey, 2002

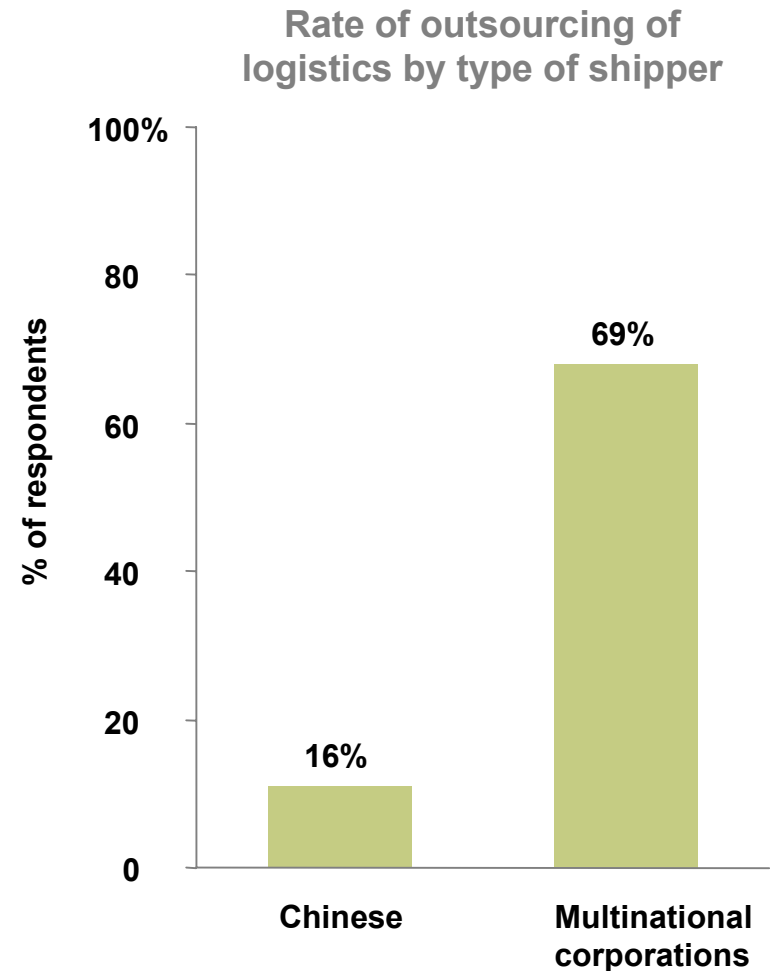
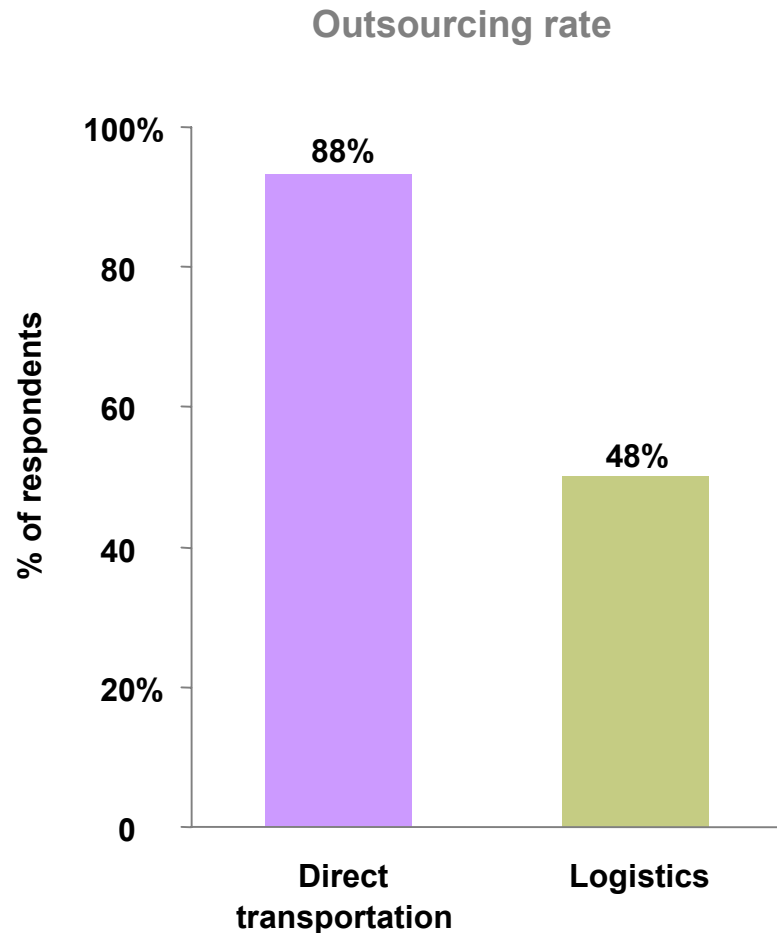
## **Key findings (Shippers)**

The demands of multinational versus Chinese shippers are very different, suggesting two distinct market development paths.

- Reducing costs and cycle times, and improving service levels are the main challenges for shippers
- About 70% of multinational shippers outsource logistics services; but only 15% of Chinese shippers do
- MNC shippers prefer MNC providers for their IT systems, industry/operational expertise, and standardized operations
- Chinese shippers prefer Chinese providers for their lower prices, local knowledge and national network coverage
- About 80% of shippers state that they will increase the use of 3PL providers, but the outsourcing process will be incremental and slow

## Current outsourcing of logistics

Although almost 90% of shippers surveyed outsource direct transportation services, only about 50% of shippers outsource logistics, and the rate drops to slightly above 15% for Chinese shippers.

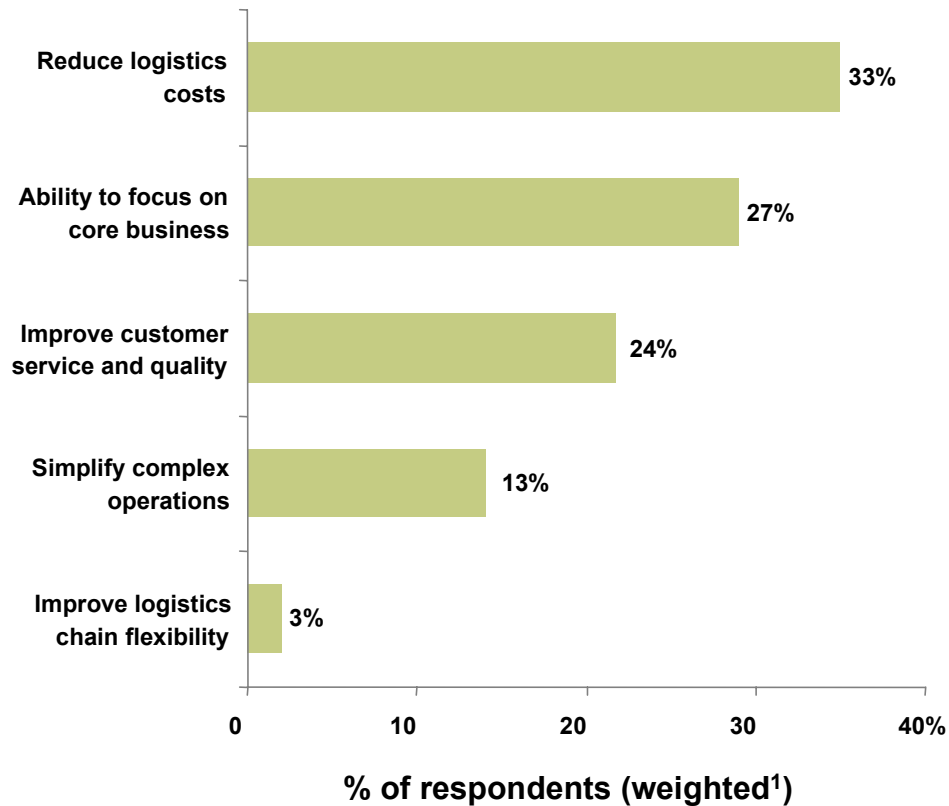


Source: Mercer China 3PL Survey, 2002

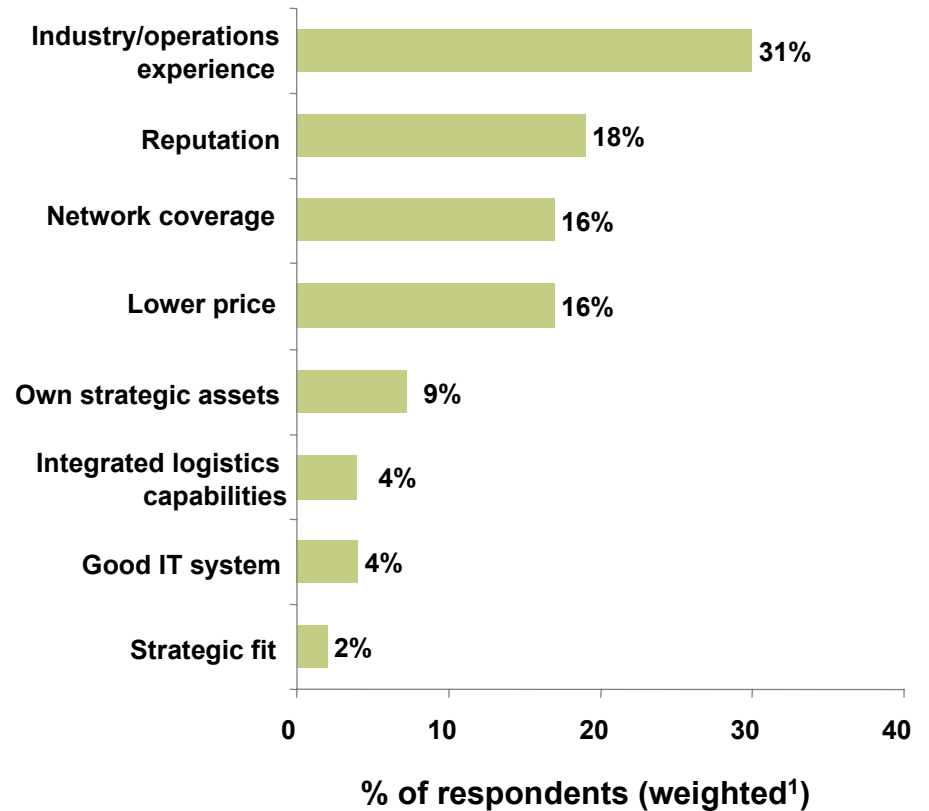
## Current outsourcing of logistics

Under pressure to reduce costs, many shippers look to their 3PL providers for industry and operations experience in order to reduce logistics costs.

### Reasons for outsourcing logistics



### Criteria for selection of 3PL providers

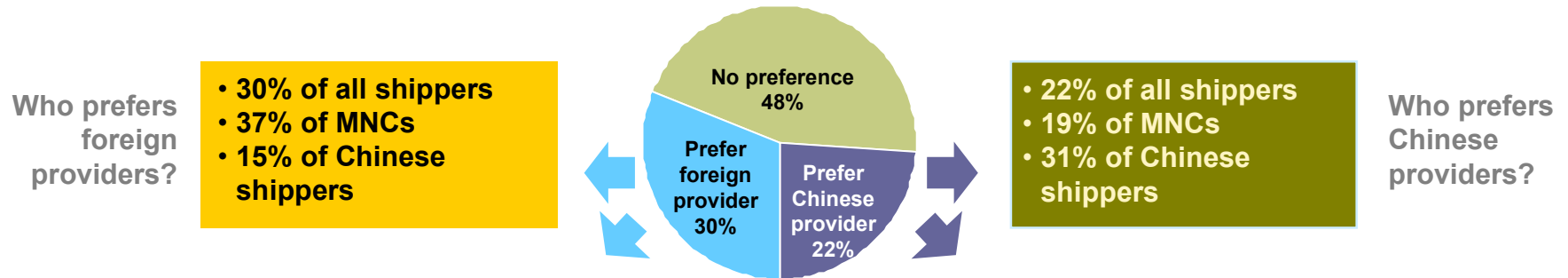


Note: <sup>1</sup> Top three responses weighted by order of importance (#1 = X3; #2 = X2; #3 = X1) and calculated as % of total weighted responses.  
Source: Mercer China 3PL Survey, 2002



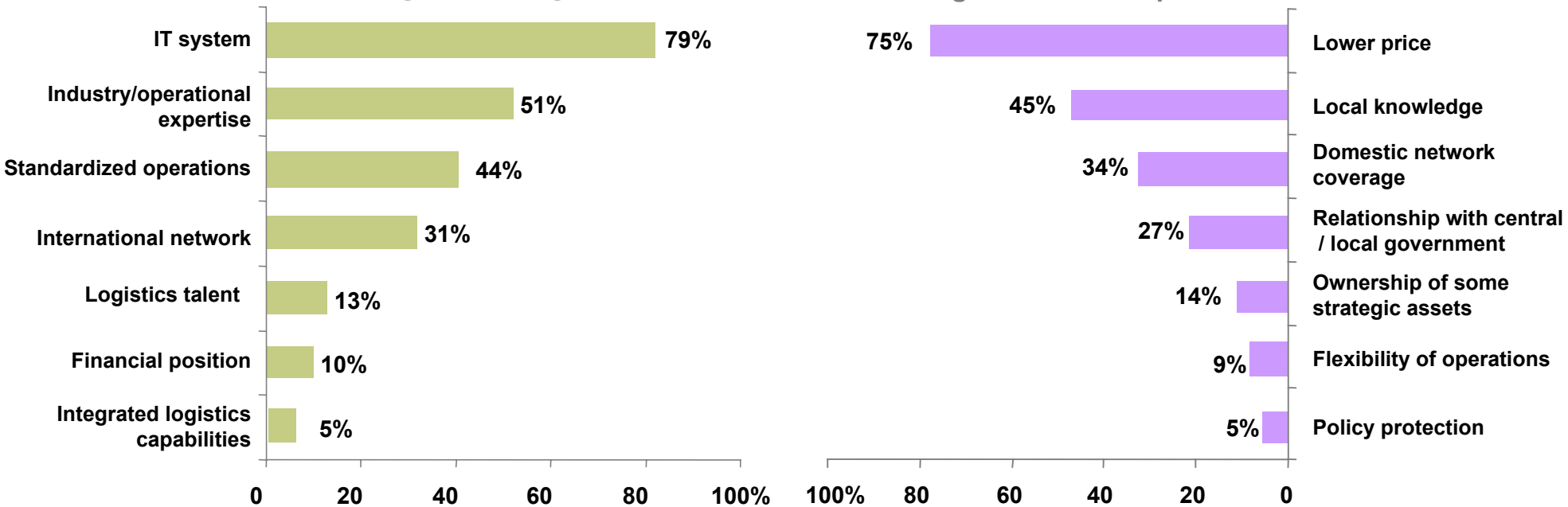
# Current outsourcing of logistics

About 30% of shippers, particularly MNCs, would prefer to outsource to foreign providers, while more than 20% of shippers, particularly Chinese, would prefer Chinese providers.



Advantages of foreign providers

Advantages of Chinese providers



Note: The charts show the advantages cited by all shippers who expressed a view, including those shippers who preferred to outsource to a different nationality of provider.  
 Source: Mercer China 3PL Survey, 2002

## **Key findings (Providers)**

Providers are seeking partners to compliment their capabilities and meet the growing challenges.

- Large SOEs such as Sinotrans and COSCO, are facing problems such as high levels of redundant employees, a limited customer service mindset, and ineffective performance measures
- Emerging logistics companies in China, e.g., EAS, PGL are facing challenges such as limited financial support, poor management talent, and lack of an effective organization structure to sustain growth
- Foreign companies have limited operations in China, having typically entered China with their MNC customers in an effort to provide global services
- Providers cite subcontractor management and client expectation management are the key challenges in execution
- About 80% of providers, domestic and foreign, are looking for partnerships and joint ventures to help achieve growth targets

## China 3PL Providers

Competition in logistics is intensifying with players from different origins entering the market.

Foreign logistics companies	Emerging logistics companies
<ul style="list-style-type: none"> <li>• APL</li> <li>• Maersk</li> <li>• HTB</li> <li>• Panalpina</li> <li>• Exel</li> <li>• Danzas</li> <li>• TNT</li> <li>• Schenker</li> </ul>	<ul style="list-style-type: none"> <li>• FedEx</li> <li>• UPS</li> <li>• DHL</li> <li>• EAS</li> <li>• St-Anda</li> <li>• PGL</li> <li>• Hurry Top</li> <li>• China overseas logistics</li> <li>• Jiuchuan logistics</li> </ul>
Internal logistics departments of Chinese companies	Traditional Chinese transportation companies
<ul style="list-style-type: none"> <li>• Annto logistics</li> <li>• Haier logistics</li> <li>• Attend logistics</li> <li>• Ding Xin logisitcs</li> <li>• TCL</li> <li>• Bright Dairy &amp; Food</li> <li>• Konka</li> </ul>	<ul style="list-style-type: none"> <li>• COSCO</li> <li>• Sinotrans</li> <li>• CMST</li> <li>• China Shipping</li> <li>• China Resources</li> <li>• China Post</li> <li>• CRMLC</li> <li>• CRE</li> </ul>

*Example*

# Features of each category's 3PL providers (1)

## Traditional transportation companies

## Emerging logistics companies

### Features

- Large standalone firms with national network and significant transportation and warehousing assets
- Good relationships with central and local government
- High proportion of excess employees and low efficiency
- Internally focused culture rather than customer- and performance-focused

- Private or joint ventures with more focused geographies, services, and customers
- Very high growth and relatively high productivity
- Limited ownership of fixed assets
- Lack strong financial support for market expansion
- Lacking internal management mechanisms and effective organization to support high growth

### Objectives

- Leverage extensive network and asset advantage to accelerate logistics growth and seize first-mover advantage
- Upgrade capabilities to enhance competitiveness (potentially via partnerships)
- Restructure to improve efficiency and economics

- Maintain high growth by introducing strategic partner or investor

## Features of each category's 3PL providers (2)

### Internal logistics departments

#### Features

- Provide services for some external customers, but internal customers still dominate
- Expertise in certain sectors
- Limited assets but good network coverage
- Weak in sales and marketing
- Strategy and future position strongly influenced by the parent company

### Foreign logistics companies

- International providers with strong overseas network
- Industry expertise and experienced operations
- Good relationships with global accounts
- Advanced IT systems
- Strong financial support from headquarters
- Limited presence in China and relatively high cost structure

#### Objectives

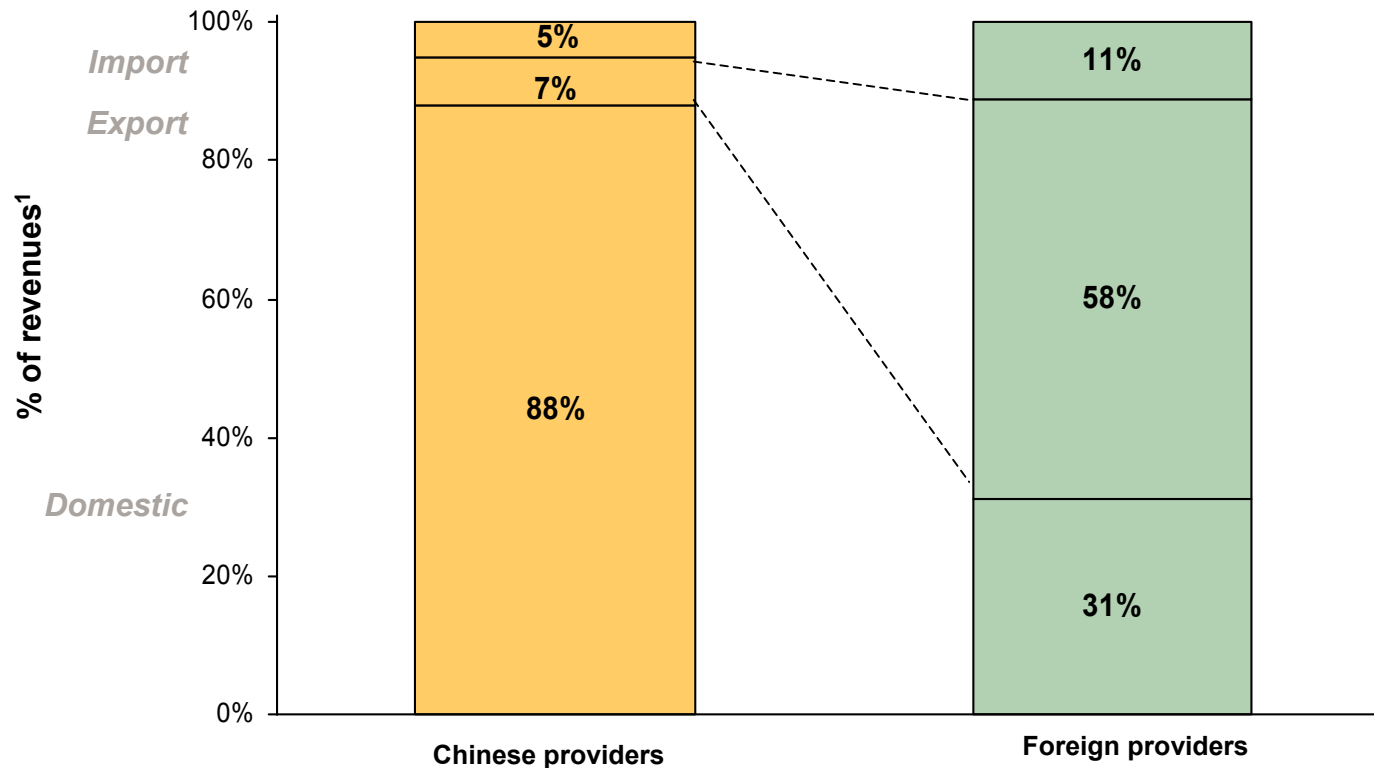
- Either strengthen or spin off logistics departments

- Strengthen market position through acquisition or partnership

### 3PL providers' operations

Chinese providers focus more on domestic logistics opportunities due to lack of overseas network; foreign providers draw most of their revenue from import and export logistics as they focus on serving their global accounts.

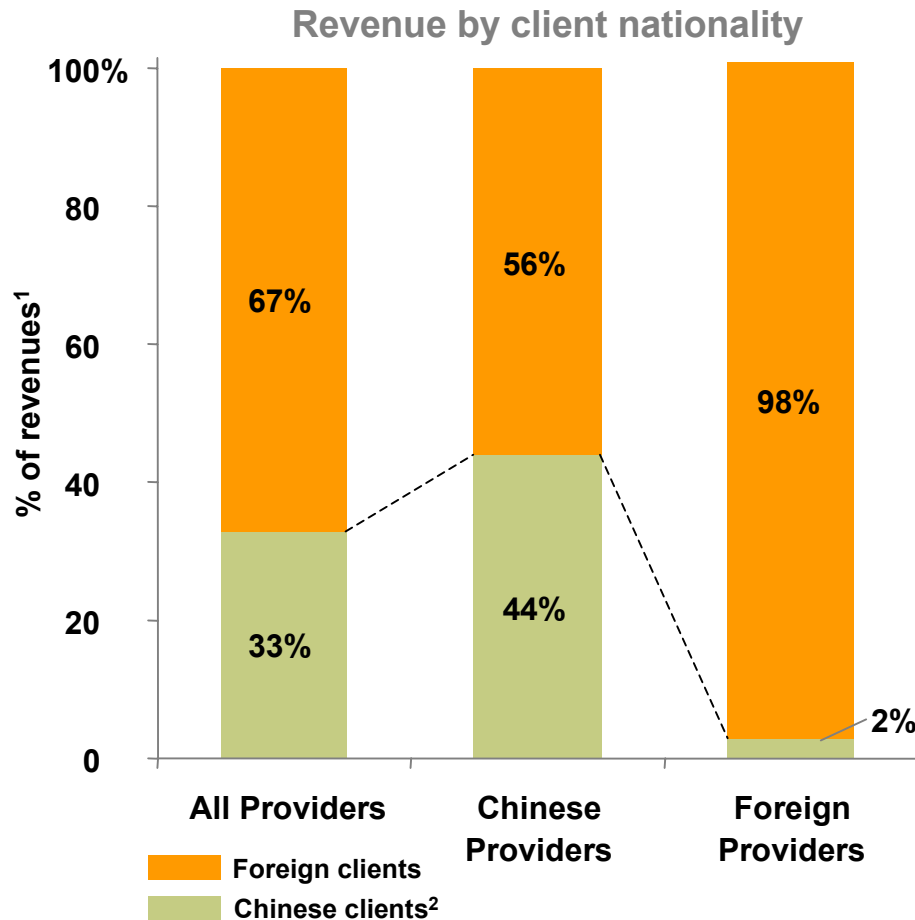
Revenue split between import, export and domestic



Note: <sup>1</sup>Straight average of all responses (not weighted by size of each 3PL provider)  
Source: Mercer China 3PL Survey, 2002

### 3PL providers' operations

Multinational companies with national logistics requirements are the main target clients for all 3PL providers, although Chinese providers have a higher proportion of Chinese clients.



#### Foreign clients

*“MNCs understand the logistics concept. It’s not necessary to spend lots of time to educate them.”*  
*“They are less price-sensitive.”*

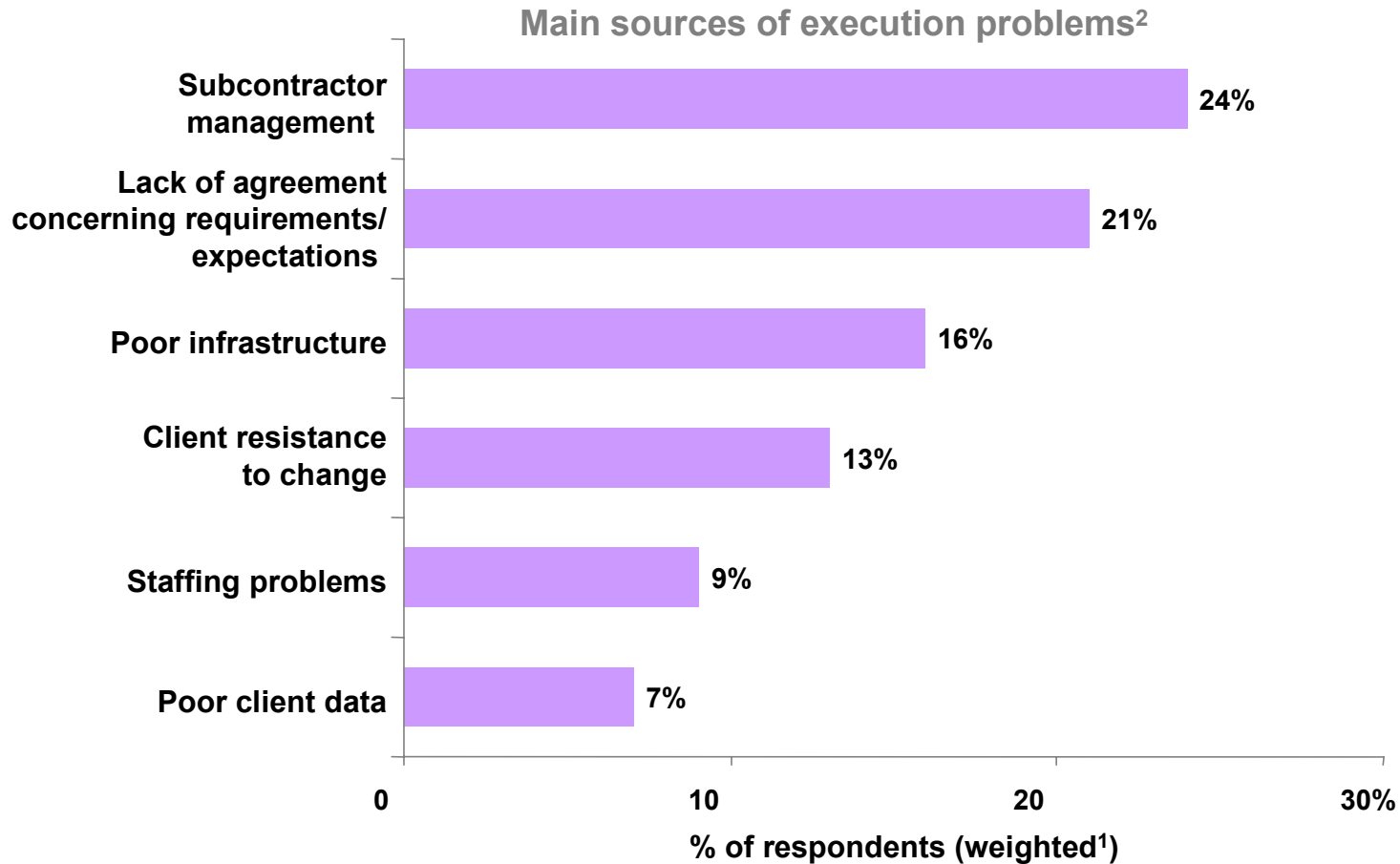
#### Chinese Clients

*“Some of them still regard logistics as only transportation and warehousing.”*  
*“Internal restructuring is required before they can outsource.”*

Note: <sup>1</sup>Straight average of all responses (not weighted by size of each 3PL provider) ; <sup>2</sup>Including internal customers  
Source: Mercer China 3PL Survey, 2002

### 3PL providers' views on execution

Providers feel the toughest execution challenge is finding reliable subcontractors and having control over their service quality. Managing clients' expectations is also an issue since they are not experienced in using external logistics services.



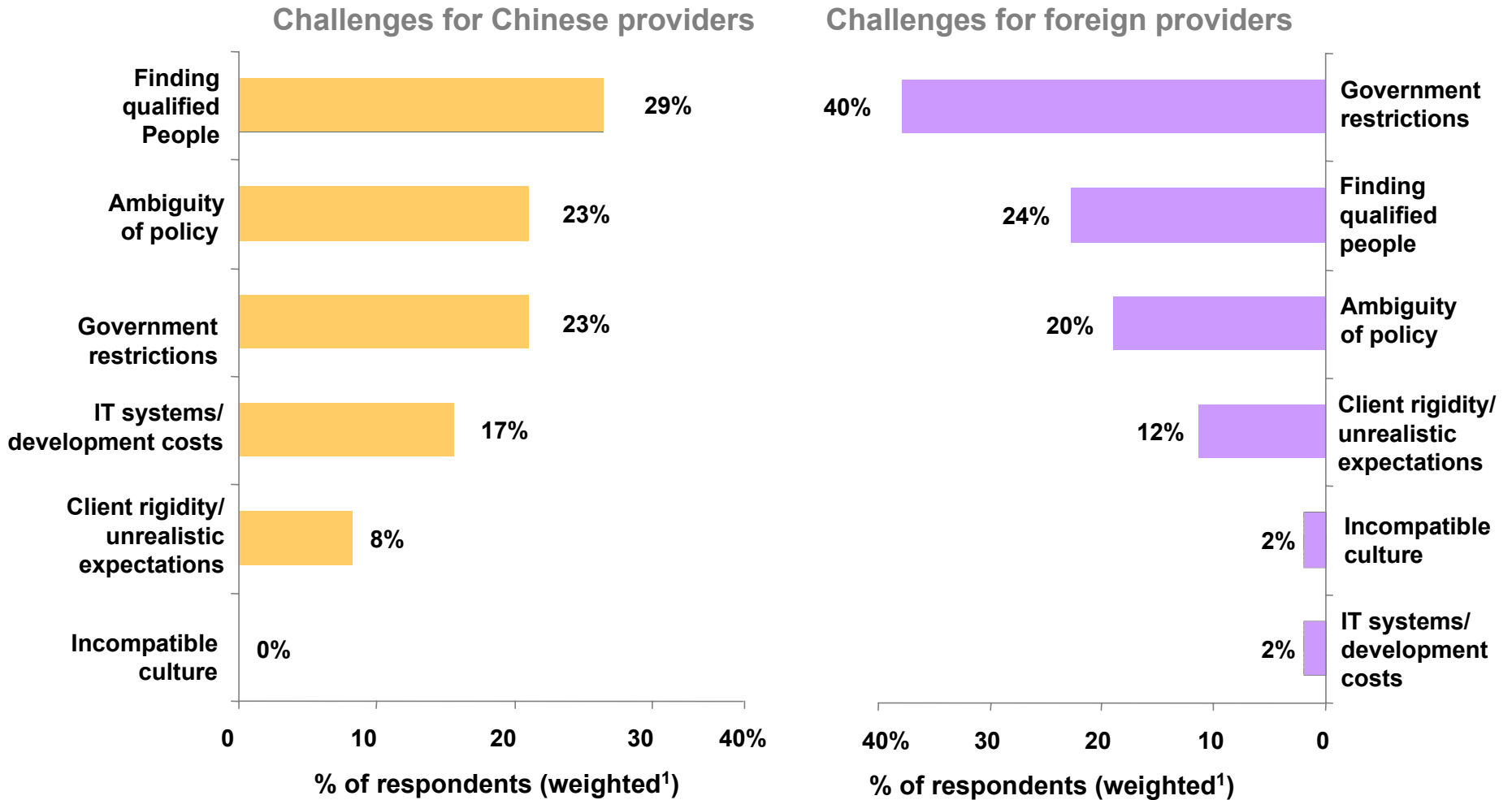
Note: <sup>1</sup>Top three responses weighted by order of importance (#1 = X3; #2 = X2; #3 = X1) and calculated as % of total weighted responses. <sup>2</sup>Other three less important sources are: management problems and client organization(4%); contract problem (3%) and pricing problem (3%)

Source: Mercer China 3PL Survey, 2002



### 3PL providers' views on challenges to growth

While government restrictions is clearly the top issue for foreign providers, all players are facing the challenge of finding qualified people at all levels.



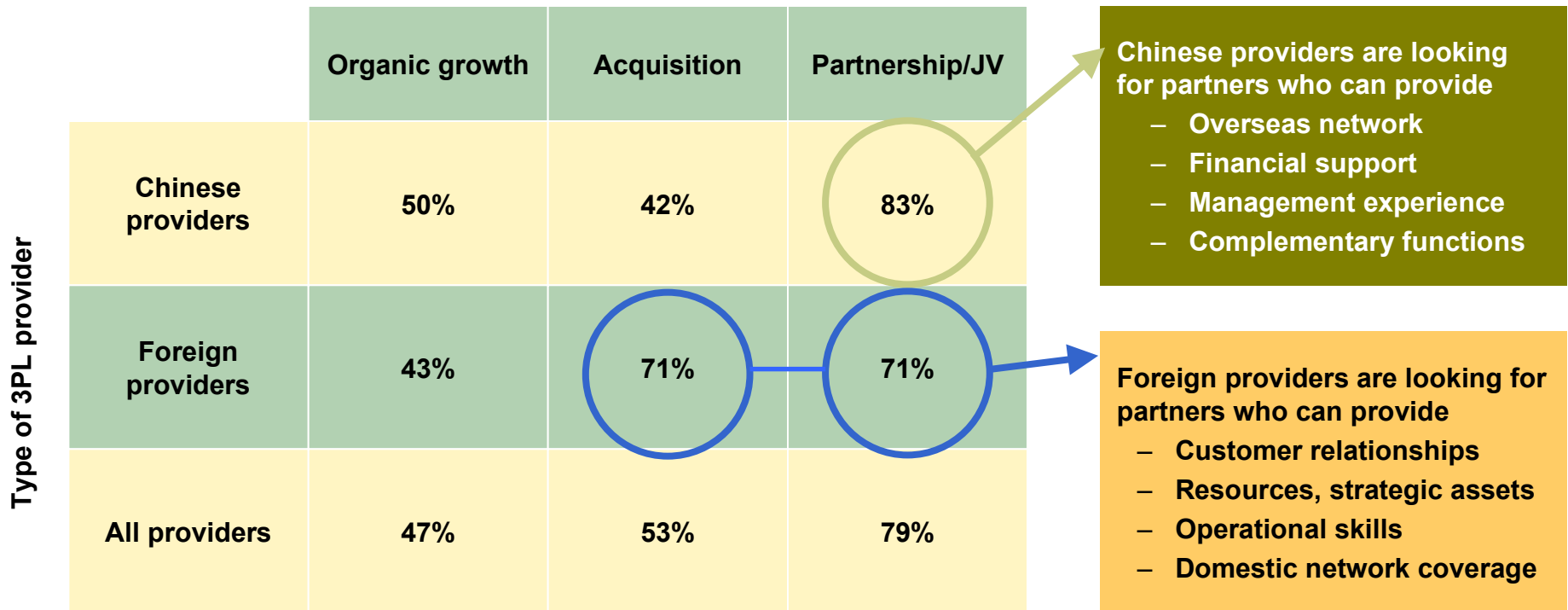
Note: <sup>1</sup>Top three responses weighted by order of importance (#1 = X3; #2 = X2; #3 = X1) and calculated as % of total weighted responses.

Source: Mercer China 3PL Survey, 2002

### 3PL providers' views on growth strategy

Most providers are looking for partnerships to help them achieve their growth targets.

Expansion strategy of 3PL players in China  
 (% of players of each type pursuing specific expansion strategy)



Source: Mercer China 3PL Survey, 2002

## **Driving forces for outsourced logistics**

Government initiatives are also beginning to encourage the outsourcing of logistics.

- A Logistics Development Plan is included in the “10th five-year plan.” MOFTEC/MOR/MOC/MII/CAAC issued “Suggestions to Speed up China Logistics Development” in March 2001.
- Once implemented, China’s WTO commitments regarding liberalization of foreign investment in logistics will dramatically change the landscape through multiple new entrants.
- As many foreign companies make China a manufacturing center for Asian and global markets, logistics demands and shipper characteristics will change rapidly.
- Retail consolidation and the emergence of national chains will also change the role of logistics providers.
- Emerging high-quality providers will start to set industry standards.

## Trends

The 3PL market in China will change, but not rapidly.

- Industry consolidation will result in a few larger players.
  - Large SOE providers will quickly develop restructuring strategies and some will become strong players.
  - In the flood of new entities, well-capitalized and specialized players will likely succeed, while many less focused, small players won't survive.
  - Multinationals will play a larger role, strengthening their domestic capabilities to leverage global client resources and gain market share.
- Providers will become more specialized in industries served and services provided.
- New practice industry standards will be set soon.
- Existing customers will reduce the number of providers used and begin to demand higher standards of reliability and quality.
- Customers will have higher requirements for providers' IT systems.

But

- Progress will be slow and profits likely meager in the near to medium term, given high competition and investment requirements.

- For additional information regarding the survey or Mercer capabilities, please contact:

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