WINNING BIT BY BIT

Gaining a foothold in China's domestic time-sensitive logistics market will require patience and local know-how, says the Global Intelligence Alliance.

With annual growth estimated to be about 30%, on average, China is by far the strongest developing market in the global supply chain management (SCM) and logistics sector. Tremendous growth in foreign trade and direct investments, strong domestic economic development and state support for massive infrastructure investments means that China will continue to offer tremendous opportunities for SCM and logistics services. And, as the country becomes ever more integrated into worldwide manufacturing processes, time-sensitive logistics for global supply chains will grow in importance.

Hard to Capture

Global integrators such as UPS, TNT, DHL and FedEx have been in China for two decades and have, during this time, captured a large share of China's international time-sensitive SCM and logistics market. However, a developing regulatory framework, heavy fragmentation, a weak transport network and congestion still present huge challenges to doing business domestically. Any further market development will depend on how these global winners operate within China and how they manage to build and fortify their domestic delivery networks. Today, DHL remains the only international operator in a joint venture relationship with a local partner, Sinotrans. Joint ventures such as this will hopefully help to open up the right routes to greater market penetration through local connections.

Other global integrators have chosen to stay independent to maintain efficiencies in decision making, to gain more control over their operations and to avoid internal cultural conflicts. It would seem that there are enough challenges in the external environment to deal with. The geographical and regulatory landscape of local Chinese logistics operations is highly fragmented. Amongst the players are thousands of small to medium-sized companies, the vast majority of which are local truckers who operate at low prices and varying service levels. The strong protectionism of local authorities, especially regarding road transport, has put up significant barriers to large expansion strategies. Local operators are very active in the domestic market and have been snapping up opportunities in an effort to stay ahead of the intense competition. Although some have expanded profitably, no one has managed to capture more than 10% of the market. Most providers offer comprehensive service levels, competitive prices and some competencies in serving markets in Europe and North America. Yet, no one seems to have a major competitive advantage, which is critical in taking on more than just a regional role.

To Buy or Not to Buy?

In late 2005, China announced that it would open up the ground transportation market to wholly owned foreign enterprises (WOFEs). This seems to offer global players new strategic opportunities, even if WOFES will still face challenges such as limited network coverage and cutthroat prices from local operators. Certainly, foreign international integrators with their global reach and scale could turn the race in their favour through local acquisitions to quickly gain market share. Unfortunately, there is very little history of mergers and acquisitions (M&A) in China and the typical evaluation criteria — listed below — may not apply.

- Potential to fully acquire the target or at least obtain a majority stake
- Brand reputation and awareness in China
- Geographic attractiveness (domestic versus international)
- Financial attractiveness/soundness of operations and customer base
- Product/service mix, vertical industry coverage
- Target relationship with local government officials.

First, Chinese culture values 'guan xi' relationships in business. Those with successful M&A ventures already had a strong local presence and relationships, as well as domestic management in China for long periods. What's more, high market fragmentation results in few known targets and limited data available, making it challenging to conduct detailed due diligence. Rolling up and integrating regional time-sensitive SCM and logistics players into an existing network and organization will be very difficult.

Despite all these hurdles, the most straightforward choice for global operators may be to directly buy a smaller partner instead of co-operating to deliver time-sensitive SCM and logistics capabilities. Although some of the acquisitions may not add significant operational assets and capabilities, they can help to build the customer base and add volume into the acquisitions network. Local infrastructure providers can hopefully offer the "last mile" component. Looking ahead into 2010, we are likely to see more small acquisitions by service or by geography in China's time-sensitive domestic SCM and logistics market. This will result in incremental (and slower) growth for industry players, instead of a "great leap forward." Indeed, gaining a foothold in China's domestic time-sensitive logistics market will require much patience and local know-how. •

For more information

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