

PARCEL

Regionals: More Shippers Hit the Ground Running

Economic crisis drives companies toward lower-priced alternatives **By Ted Kauffman**

You might say that the ground parcel industry has undergone a dramatic transformation in the last century. In 1914, in one of the earliest and most unusual ground deliveries, the parents of May Peirstorff in Grangeville, Idaho, wanted to find the least expensive way to send their four-year-old to visit her grandmother 100 miles away. With no regulations to prevent such a delivery, they turned to a parcel post service, which shipped a 48-pound human package via rail cargo.

Since then, industry changes have included regulation, globalization, technological advances, e-commerce, economic volatility and ever-fluctuating consumer demands. Throughout this time, companies have weighed the options of multiple carriers that offer multiple services. Today, this multi-billion-dollar industry includes the United States Postal Service (USPS) and national and regional carriers that provide same-day, overnight and deferred services via air or ground transport. (Other services like LTL/truckload, rail and barge aren't considered "mainstream" business alternatives due to their much slower transit times.)

Over the years, what hasn't changed is the need to deliver goods in a timely and cost-effective manner. Regardless of economic conditions, a long-held perception has been that the best-known national carriers provide the most reliable service—at least that is what has been instilled in many consumers' minds through relentless advertising efforts. This branding has often led to knee-jerk decisions to ship parcels with the industry goliaths via overnight air.

Today, however, change is definitely "in the air." Due to the credit crisis and high cost of fuel, a new paradigm is evolving—and less expensive ground products are becoming more popular shipping solutions.

A recent report by Morgan Stanley indicates that ground revenue has grown at three times the rate of air revenue from 1999 to 2007. This coincides with another compelling statistic: fuel prices are up roughly four-fold since 2003. While Federal Express (FedEx) and United Parcel Service (UPS) are benefitting as business migrates to their ground offerings, the ultimate winners may be regional carriers, which provide ground services that are more cost-effective and more timely than those of the nationals.

Well-Grounded from the Start

Ground services actually date back to the Wells Fargo and Pony Express days in the mid-1800s. In 1907, a six-bicycle messenger service called American Messenger Company opened shop as the forerunner of UPS. In 1913, Parcel Post, a service of the US Postal Service, was introduced as a cost-effective product, but it had limitations including allowable weight. Further competition for the ground product was relatively quiet until the late 1900s, when regional carriers, including Eastern Connection, came on the scene.

From the onset, the regionals have relied on ground fleets for priority overnight as well as deferred service, featuring less costly, more personalized and more flexible alternatives than the nationals, with earlier deliveries, later pick-ups and 24-hour service. While regionals are

limited by geographic reach, they have filled a need and established a niche.

In 1997, many shippers were forced to look for ground alternatives during the UPS strike. Regionals stepped into the spotlight then, and they gained further attention during emergencies such as the 9-11 terrorist attacks (delivering blood supplies to Ground Zero) as well as major blizzards (operating when airports were shut down).

Recognizing that air transport wasn't always the answer—and seeing an opportunity to gain market share—Federal Express, founded in 1971, launched FedEx Ground (originally known as RPS) in 2000. Following suit, DHL entered the mix in 2003 when it acquired the ground operations of Airborne.

When Wall Street Is Grounded

Over time, UPS, FedEx and DHL grew their revenues significantly. But recently, the air services of these companies have experienced a significant downfall. According to Morgan Stanley, in the first quarter of 2008, FedEx's US air freight pounds fell 17.5%, the worst drop FedEx has ever reported; and tied to the frenzy on Wall Street, FedEx's stock has dropped precipitously. Meanwhile, in the second quarter of 2008, UPS domestic Next Day Air volume fell six percent, the largest since the company's IPO in 1998.

While UPS fares better in a recession than FedEx, the company has seen fuel costs take their toll. UPS air fuel charges alone are reported to exceed the total cost of a ground shipment with similar transit times. Based on that finding and others, Morgan Stanley forecasts that "more cost-effective ground service could cannibalize greater share of premium air shipping."

Add to the equation another dramatic development: Recent financial woes of DHL are causing the company to relinquish its US ground operation. As a result, with one less competitor, FedEx, UPS, the regionals and USPS are poised to grab parts of that business.

As the economy remains unstable, shippers, in an attempt to cut costs, are being more selective about the volume of their shipments and their method of distribution. Accordingly, more companies are considering ground services. And in the process, they are comparing the giants and the regionals. The differences of ground vs. air and nationals vs. regional are thus becoming more apparent and some age-old myths are being shattered.

A Regional Groundswell

With regard to flexibility, the nationals take up to three days or more to ship via ground. In contrast, Eastern Connection, through its latest deferred offering, guarantees next-day ground delivery by 5 PM in the same footprint. In terms of efficiency, regional ground transport, with fewer exchange points, has fewer margins for error, better damage control at sort centers and fewer claims. Despite public perception, ground transit is traditionally more reliable than air.

Efficiency is improving among regionals now that technology in most cases is on par with the giants. This includes automated web-based shipping and tracking, digital scanners with cameras and multi-carrier shipping systems enabled through proprietary partnership software with industry vendors.

Regarding ZIP Code coverage, the giants can't be matched in the United States and overseas. But that dynamic is shifting as well, with the regionals now providing service in 70% of ZIP Codes nationwide through business as well as residential deliveries.

And then there's that great equalizer: cost. Since May Peirstorff was "mailed" as a rail parcel, shippers have sought the most cost-effective solutions. But today, pricing is more paramount than ever as cost-conscious companies realize that they can save millions of dollars in annual transport expenses. So, when regional carriers demonstrate they can be 15% to 25% more economical than the giants, companies are apt to take a second look.

Looking ahead, air transport will certainly remain a critical part of supply chain management. But ground revenues should continue to increase, with the ground offerings of UPS and FedEx becoming greater profit centers. At the same time, in the battle of David vs. Goliath, the Davids may now be on even more solid ground.

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