



Storm over Logistics

Japan's transportation industry is fully exposed to the winds of change.

The logistics/transportation industry in Japan is on the cusp of a restructuring every bit as fundamental as the one still sweeping the financial-services industry here. Yamato Transport Co., Ltd., known for its ubiquitous Kuro Neko (Black Cat) trucks and often referred to by industry insiders as "the UPS of Japan," is the nation's leading provider of ground transportation service. Yamato Transport, perhaps co-branded with a global operator, is likely to survive. The same cannot be said, over the long term, about any of its domestic competitors.

As this restructuring gathers momentum, major players such as

Nippon Express Co., Ltd., Yamato Transport and Kintetsu World Express, Inc., can be expected to make fundamental changes to their business models. The latter two companies, should their self-managed restructuring efforts falter, would become acquisition targets. Other players will probably disappear altogether as a result of being bought out and folded into larger organizations. These include the likes of Toshiba Logistics Corp., NNR Global Logistics, Ltd. (a subsidiary of Nishi-Nippon Railroad Co. Ltd.), MOL Logistics (Japan) Co. Ltd. (a subsidiary of Mitsui O.S.K. Lines, Ltd.) and possibly Sony Supply Chain Solutions, Inc. The remain-

ing homegrown companies will lose their dominant positions in Japan's international freight-forwarding market, ceding share to global operators such as Exel plc, United Parcel Service of America, Inc. (UPS), and DHL International, Ltd. (DHL). These global players will also expand into the heretofore "local" markets of warehousing and distribution.

How the problem grew

An appreciation of the factors behind this impending upheaval can be gained by looking at Japan's logistics business as it developed from the end of WWII to the 1990s. During that period,

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the nation's major transportation companies all established international freight-forwarding and warehousing/distribution subsidiaries while the industrial conglomerates all established “in-house” logistics subsidiaries to handle parent company inventories. A panoply of laws, regulations and cozy business practices restricted foreign companies to servicing the market via joint ventures and, for the most part, to and from major gateways only. Strict pricing regulations forced air and ocean carriers to give large and small customers alike access to the same rates. The in-house providers all expanded into air and ocean forwarding, as well as establishing domestic trucking operations. Further, with lifetime employment being the norm, the subsidiaries provided parent companies a place to promote and transfer senior employees.

Within this structured and semi-protected market, over the years the industry's local players increased staff and expanded operations, with the in-house companies in particular establishing attractive, separately located headquarters. In building out their service infrastructures (terminals, warehouses, truck fleets, handling systems, IT systems, etc.), the subsidiaries utilized parent-company equipment and affiliated suppliers to the greatest extent possible. The largest spurt of growth coincided with the peak in the land-prices bubble.

As the industry developed, it achieved remarkable stability and



Prologis Inc., a leading provider of distribution facilities and services, established this new logistics center in Osaka for a relative bargain.

won renown for its high levels of service. However, without low-cost competitors, prices rose to levels appreciably higher than those in all other developed countries. Foreign and domestic customers alike had no choice but to pay the “Japan Price” for transportation and logistics services.

How the environment changed

Today, the factors behind the original industry structure have all been superseded. First, most of the impediments, regulatory and otherwise, to global players entering the market have effectively been eliminated. With fewer restraints on M&A activity, acquisitions have enabled global operators like UPS, Exel, Essén and Germany-based Schenker AG, to achieve order-of-magnitude increases in business scale. Further, foreign-based REIT (real estate investment trust) companies such as ProLogis Inc., taking

advantage of the more open environment, have built modern distribution facilities in or near major cities and have done so at 35-50% off the price paid by local players during the bubble era.

Second, with pricing regulations having been eliminated, volume-based space and rate contracts between logistics-service providers and air or ocean carriers are now the norm. Accordingly, smaller players, including the in-house subsidiaries, must now “co-load” their shipments (i.e., tender ready-to-carry cargo to larger forwarders rather than directly to air or ocean carriers) in order to gain access to competitive pricing. In this arrangement, however, the shipper effectively pays twice – to its subsidiary and then to the co-loading forwarder.

Third, IT infrastructure such as warehouse management systems can be sourced overseas and deployed domestically at a

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fraction of the cost of the domestic legacy systems.

Though the above list is only partial, it shows clearly how the storm clouds have coalesced. The most compelling force is the dramatic upsurge of competition in all sectors of the industry. This is destroying the ability of Japanese players to charge premium prices, as well as the ability of parent companies to pay them. Say goodbye to the Japan Price and say hello to a wholesale restructuring that will not be complete until all existing players have adjusted to the new dynamics, in particular, the imperative of low cost with high quality.

Delayed consequences

The conditions for the typhoon have been in place for at least three years, but two factors delayed it. First, on the “sell side,” was the Japanese phenomenon of “evenly-felt-pain.” That is, so long as all of Japan’s conglomerates were experiencing the same slow drain on resources, none felt compelled to restructure or divest. Second, the two groups on the “buy side” that one would expect to be sniffing around for deals – global logistics companies and private-equity companies – were otherwise occupied. The logistics players were (and are) tripping over themselves to build up service infrastructure in China. The private-equity investors were (and are) busy buying golf courses, resorts, banks and the like.

Nonetheless, industry insiders are convinced that these two restraining factors are a thing of



Door-to-door at speed within Japan, but not up to par on the global stage.

the past. In one illustrative deal, in the spring of 2003, Fujitsu Ltd. reached an agreement with UK-based giant Exel, whereby Exel would take over Fujitsu’s logistics subsidiary, Fujitsu Logistics Ltd., including its 450 employees. The price was purportedly in the ¥5-billion range, and therein lies the significance of the deal. Some years earlier, Fujitsu had quietly, and unsuccessfully, canvassed potential buyers, including UPS, at an asking price of ¥20 billion or so. That the price fell 75% in just a few years is seen as proof that prior evaluations, supported as they were by revenue streams based largely on Japan prices,

were indeed unrealistic. All of a sudden, other in-house subsidiaries look a lot more like liabilities than assets. At the same time, Exel’s competitors were faced with the fact that Exel had just expanded its business footprint in Japan by 300%. China will be big in the future, but the Japanese logistics market is big right now.

In the second deal, Mizuho Capital Partners Co., Ltd. agreed last spring to buy all the shares held by two UK-based private-equity companies – PPM Capital Ltd. and 3i Group plc – in Vantec Corp. In the original Vantec deal back in January 2001, Nissan

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PHOTOGRAPHY BY PHILIP C. JONES

An increasing presence on Japan's streets, UPS enjoys the leverage of being a genuine global player.

Motor Co., Ltd., a company in acute pain, offloaded its wholly owned logistics subsidiary, Vantec Logistics, to a consortium led by Vantec's senior managers and supported by 3i. PPM joined in later, and the combined stake of the two UK investors was reported to be in the neighborhood of ¥15 billion. Three years later they sold their stakes to Mizuho Capital Partners for ¥45 billion or so, three times what they had paid for them. Having paid such a high price, what value could Mizuho, as a company in the same line of business as PPM and 3i, hope to unlock from a company that had already been rationalized and was being run by competent managers? The answer lies in being able to use the Vantec rationalization experience as a template by which to restructure similar companies and fold them into the Vantec platform.

The point is that the storm is gathering force and, as it does, very little stands in the way of

owners selling assets to new owners who can make them more productive. As this plays out, the following developments can be expected.

First, the industrial conglomerates will follow the lead of Fujitsu and Nissan, selling off subsidiaries (or reducing them to little more than an inventory-management role) to exit the logistics business entirely. The one exception will be Hitachi Ltd., whose logistics subsidiary, Hitachi Transport System Ltd., long ago developed into an independent logistics player of viable scale. In fact, Hitachi Transport will be in the game along with the global operators (but without the foreign stigma), growing by buying some of the smaller players.

Second, as suggested earlier, private-equity companies will participate in the restructuring as intermediaries: buying and reconditioning smaller companies, then selling them to the investing public or to global operators (and in some cases to regional operators).

Third, large domestic players who are in the business on a stand-alone basis will make major changes to their business models. Nippon Express, with its global-scale freight forwarding and countrywide domestic trucking network, will insulate itself from commodity-type pricing by moving into high-value services such as inventory management, order processing, trade finance and supply-chain modeling and management. On the other hand, Kintetsu World Express, a high-cost operator and the country's second-largest international freight forwarder, will continue its present circle-the-wagons strategy of concentrating on core services within the geographies of Asia and, to a lesser extent, North America. Along these lines, two years ago Kintetsu World Express sold off its operations in Latin America, and more recently sold its Middle East offices. It is pouring resources into building what it hopes will be a dominant position in the Japan-China-Southeast Asia trade lanes. The company recently decided to supplement this basic strategy by entering into a "partnership" (i.e., cross-shareholding and joint services) with Mitsui O.S.K. Lines' logistics subsidiary MOL Logistics. As explained by CEO Hirokazu Tsujimoto, in an interview published in the June 25 *Nikkei Weekly*, this deal was partly to stave off the "radical restructuring of our operations, entailing massive job cuts" that Tsujimoto felt certain would be the price of any tie up with a foreign-equity partner. Further, both Nippon

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Express and Kintetsu World Express, as well as other high-cost operators, will reduce legacy costs by blending new and existing infrastructure. Nippon Express should succeed to a certain extent, but Kintetsu World Express's owners, at some point, will demand more fundamental restructuring.

Both Yamato Transport and Sagawa Express Co., Ltd. are local players of stand-alone scale, but they differ from the other large companies in that they are huge domestically and midgets on the international scene. Their problem is that neither can provide the door-to-door international service that the global players can. In the short-term, Yamato is likely to have earnest discussions with TNT N.V. concerning some kind of tie-up and the co-branding of an international door-to-door service package. Sagawa is currently attempting to bolster its international standing by offering intra-Asia service via a network tie-up

with Japan Airlines System Ltd. After this effort peters out, the company can be expected to engineer a tie-up with a foreign player (similar to that of Schenker-Seino Co. Ltd.).

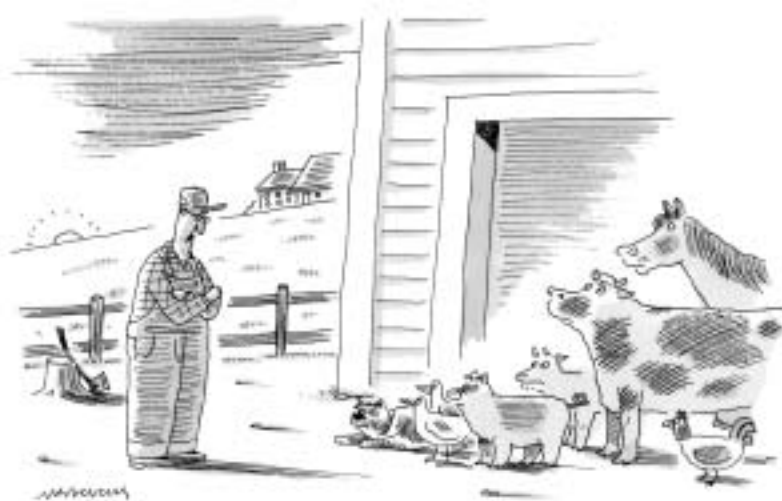
Enter the Dragons

Fourth, an unusual group – Taiwan-, Singapore- and Hong Kong-based operators of regional and global logistics networks – will join the restructuring on the buy side. At present, it seems farfetched that an “overseas Chinese” enterprise might buy and then rationalize a Japanese company. But these Asian companies would be very willing to let someone else do the heavy lifting for them and then buy the reconditioned assets – even at a substantial premium.

A quick look at the dynamics of the huge and growing China-Japan trade relationship will reveal why the stakes are so high. With China in the WTO and

largely free of trade restrictions, Japanese logistics providers are on a tear to add service infrastructure within China's primary and secondary industrial centers. They are doing this in order to build dominant positions via closed-loop service between shippers and consignees on both sides of the East China Sea, as well as between Chinese- and Japanese-affiliated companies in Southeast Asia. The overseas Chinese companies, which got to work well before the ink was dry on the WTO accords, already have substantial infrastructure in place throughout China. What they lack entirely is infrastructure on the Japan side. By buying a mid-sized freight forwarder like NNR Global Logistics, or a mid-sized trucking company ... Presto! ... these players can compete with the likes of Nippon Express, Kintetsu World Express and Yusen Air & Sea Service Co., Ltd. Can you say “*Ni hao*”?

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"Who tipped off the turkey?"

Errata

The feature story "More Rooms at the Top" in the September issue of the *ACCJ Journal* contained incorrect information about the Mandarin Oriental, Tokyo. The hotel is to open in December, occupying the top nine floors of the 38-story Nihonbashi Mitsui Tower building, offering 179 rooms. The *ACCJ Journal* regrets the error.