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Future proof plans

Transportation and logistics industry summary

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Recent events have clearly demonstrated the extent to which the world is interconnected. The crisis which began in the US banking system has spread through the global economy as a whole – and no region has emerged unscathed. This historic moment provides an unprecedented opportunity for companies, governments and individuals to think more deeply about the sophisticated eco-systems of which we are all a part.

The current crisis has highlighted the need for new institutions, new mechanisms, new strategies and – most critically, perhaps – a different mindset among those leading the world’s most important institutions and companies. Every CEO will have to make tough decisions about what actions are required to ensure his or her company’s short-term survival. Yet none can afford to ignore the need to build a business that is agile enough to respond to new situations as they emerge, durable enough to grow over the long term and responsive to the requirements of all its stakeholders.

Redefining success, the PricewaterhouseCoopers 12th Annual Global CEO Survey, explores how CEOs are reconsidering the fundamentals of business in response to extreme operating conditions and assuming responsibility for issues that were once considered outside the scope of industry. We interviewed 1,124 CEOs around the world between September 10 and December 2, 2008. Our findings show that they are collaborating more extensively to balance the interests of increasingly influential stakeholders. They are also seeking new kinds of information to help them anticipate changes in critical business drivers.

Here, we look specifically at what the 67 CEOs in the transportation and logistics (T&L) industry think, and how they are dealing with a combination of challenges such as mankind has never seen before.

The business environment

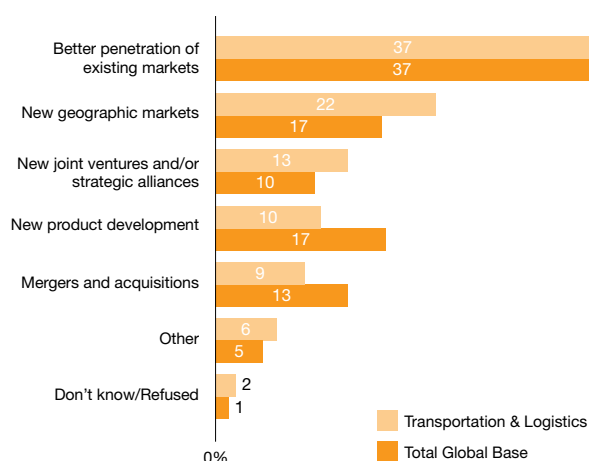
The global economic slowdown is hurting every area of the T&L industry. The airline sector is experiencing falling demand from consumers and business travellers. It has also been hard hit by the decline in exports from Asia; the International Air Transport Association reports that air freight volumes dropped by 13.5% in November 2008 alone; the largest drop since 2001. The railway sector, which makes much of its revenues from the transportation of steel and cars, is likewise gearing up for a massive drop in cargo volumes; Deutsche Bahn recently announced that it is taking 8,000 freight cars out of service. Container shipping has nosedived, with freight rates for dry-bulk shipping plummeting by as much as 90%, and the trucking sector is also feeling the pinch.

So it comes as no surprise that T&L CEOs are notably less optimistic than they were last year, when 92% of respondents were somewhat or very confident about increasing their companies’ revenues over the next 12 months. This year, the figure has dropped to 67%. However, T&L CEOs are more cheerful about the medium-term outlook; 76% are somewhat or very confident about the prospects for achieving revenue growth over the next three years, while 75% are somewhat or very confident that the industry as a whole will pick up.

Like their peers in other industries, they are banking primarily on better penetration of their existing markets to achieve that growth. Twenty-two percent also have their eyes on new geographic markets, and 13% on new joint ventures or strategic alliances, to stimulate sales (see figure 1).

Figure 1

Transportation and Logistics CEOs concentrate on existing markets to grow



Q: Which one of these potential opportunities for business growth do you see as the main opportunity to grow your business in the next 12 months?

Base: Total Global: 1,124; Transportation & Logistics: 67

Source: PricewaterhouseCoopers 12th Annual Global CEO Survey 2009

Note: Data for 2009 are based on interviews conducted in the last quarter of 2008

The biggest hurdles T&L CEOs anticipate in realising these ambitions are the downturn in the world’s major economies, the disruption of the capital markets and energy costs. In fact, fuel hedging is common practice in much of the industry. But, given the extreme volatility in oil prices in 2008, many companies may want to scrutinise their hedging strategies more closely. Some

airlines are now paying well over market prices for jet fuel, as a result of their hedging positions.

T&L CEOs are rather less concerned about inflation and low-cost competition, possibly because some sectors are already used to operating in a cut-throat pricing environment. Low-cost carriers have already transformed the airline sector, for example. Freight shipping is also extremely sensitive to shifts in supply and demand, as rates are continually negotiated in an open market between the owners, brokers and charterers. At the time of writing, daily hire rates for dry-bulk shipping – and probably container carriers – are lower than daily operating costs.

However, the economic downturn has emphasised the importance of several other risks. Some T&L companies may find it harder to extract payment for their services, for example, as a growing number of their customers experience financial difficulties. This would affect their cash flows, but it might also have long-term implications. High-quality customer service is a key element in the value propositions of most T&L companies – as evidenced by the fact that 97% of respondents believe it is an important or critical competitive advantage. So companies that are taking a longer view will need to ensure that they manage strained customer relationships carefully.

At the other end of the supply chain, local subcontractors may become more financially vulnerable – and the use of such partners is an inherent part of the industry's business model. T&L CEOs may therefore need to develop contingency plans to cope with insolvencies or other sudden changes in their supply chains. Eighty-five percent of T&L CEOs regard efficient sourcing and supply chain management as a critical or important competitive advantage. So here, too, they will need to balance short- and long-term issues carefully.

Nevertheless, despite all the challenges they face, T&L CEOs are still in deal-making mode. Nineteen percent of respondents have completed a merger or acquisition (M&A) in the past 12 months, while 25% expect to do so within the next 12 months. This is broadly in line with other research conducted by PricewaterhouseCoopers. In the 3Q 2008 edition of *Intersections*, our quarterly review of M&A activity in the industry, we noted that the number of deals had declined, but predicted that it would rise again when the credit markets stabilise and the US economy begins to recover. The economic crisis may spur some transport operators into initiating merger talks – either because they are struggling to survive or because they see it as a perfect time to cement their lead. Joint ventures and strategic alliances are also gaining in importance; indeed, 51% of T&L CEOs expect cross-border joint ventures to play a greater role in the growth of their companies over the next three years.

Balancing short-term survival strategies with the need for long-term durability

Addressing global risks

CEOs in most of the industries we surveyed are generally very concerned about the impact of global risks on the long-term success and durability of their businesses. T&L CEOs are no exception. Non-renewable energy tops the list of issues about which they worry; 60% anticipate that the world's dependence on carbon-based energy sources will have a negative effect. Sixty-four percent of T&L respondents are also somewhat or extremely concerned about energy prices – a finding which is hardly surprising, given that fuel costs are critical to the industry's profitability.

Most T&L companies are already taking steps to reduce their dependence on non-renewable energy sources. Eighty-four percent are looking for operational improvements to reduce energy consumption; 52% are turning to alternative energy sources; 36% are joining forces with other companies to reduce their dependence on energy; and 33% are investing in energy-efficient technologies.

Robert A. Milton, Chairman, President and Chief Executive Officer of ACE Aviation Holdings Inc., explains how the airline sector has responded to rising energy costs by managing capacity more effectively. 'Traditionally what's happened is that airline capacity worldwide just keeps going up until one or more airlines collapse, and then it picks right back up,' he says. But the US industry broke with tradition and reduced capacity in response to high fuel prices. 'This was a controlled decision by airline managements to reduce capacity. It's the first time I ever remember capacity falling at the same time as demand was falling.'

The connected world has also magnified the risk of pandemics – and many airlines are now better prepared for such events, following the SARS outbreak. Milton notes, 'You've got to have a contingency plan in place, which we do, to deal with shuttering the operation if necessary...Most of the people running most of the [airline] companies around the world don't have minds like the people at [the US government's] Center for Disease Control in Atlanta...But even without knowing how a rapidly-moving infectious disease affects us, we do have the ability to figure out how to clamp the operation down.'

Collaboration with government to achieve regulatory stability

Many T&L companies have already become more energy-efficient but, if the industry is to make further progress on this front, many CEOs believe that more extensive collaboration with governments and other industries will be necessary. Aircraft- and engine-makers have played a large part in helping the airline sector to secure efficiency gains, for example, and many commentators argue that more consistent air traffic control regulation across national borders could also reduce unnecessary fuel use substantially. The trucking sector faces similar issues; traffic congestion is a significant cause of fuel wastage, so more investment in infrastructure could help companies to use fuel more efficiently.

Addressing climate change and other such global risks poses a much greater challenge. Even so, many T&L CEOs are optimistic about the future; 57% think that government and business will jointly be able to devise ways of reducing mankind's impact on the environment, and minimising risks like terrorism or financial crises, compared with only 46% of the total survey sample.

Cultivating key skills

Despite the gloomy economic outlook, 39% of T&L CEOs plan to increase the number of people they employ over the next 12 months. More predictably, perhaps, 33% anticipate having to downsize. But any company that needs to cut its headcount should take great care to ensure that it retains its most talented employees and continues to provide them with appropriate career opportunities.

Demographic changes (e.g., aging populations in many industrialised countries) will make it even more difficult for many companies to find suitably qualified staff in the future. This is probably one reason why 42% of T&L CEOs anticipate that the 'demographic time bomb' will have a negative impact on the long-term durability of their businesses.

Looking forward

T&L CEOs face a difficult balancing act. They must do all they can to ensure that their companies survive in difficult economic circumstances. Yet they cannot afford to focus on the short term to the exclusion of long-term, global risks such as climate change or the impact of demographic shifts on the talent pool.

Nor can they afford to stand still. Seventy percent of respondents believe the centre of gravity is moving to the developing world, and that a new set of countries will emerge to challenge the economic, political, and cultural power of the G8. That, in turn, means they will need to adopt new business models. Fortunately, many T&L CEOs view this as a positive development; 40% believe that structural changes to the industry's business model will have a positive impact on their companies.

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Full findings of the PricewaterhouseCoopers 12th Annual Global CEO Survey are available at www.pwc.com/ceosurvey

For additional information regarding PricewaterhouseCoopers' transportation and logistics sector practice, please visit www.pwc.com/transport