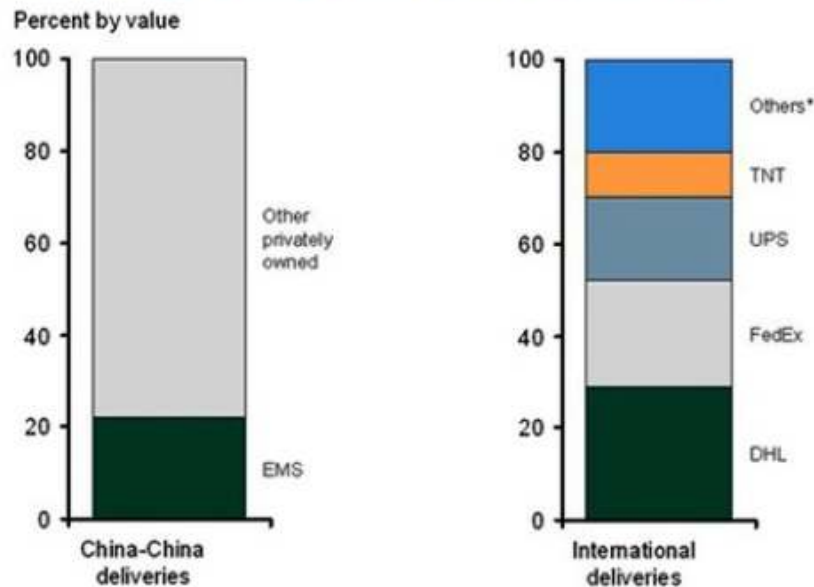


# China express logistics growing rapidly, creating opportunities

China's express logistics industry is characterized by two broad segments with very different growth characteristics. - by Michel Brekelmans and Stephen Sunderland

**Figure 1: China express delivery competitive landscape**



Note: \*Mainly EMS

Source: China State Post Bureau; L.E.K. analysis

China's express logistics industry has seen 23% annual growth between 2008 and 2011, reaching annual revenues of

RMB76 billion in 2011. This fantastic pace of growth has been underpinned by rapidly rising business and consumer demand,

and government policies supporting better and more efficient logistics services. However, the express logistics industry

in China is characterized by two broad segments (domestic and international) which have very different growth characteristics and competitive dynamics.

The international delivery segment, c.25% of the market by value, is dominated by four global express logistics service giants, whereas China-China deliveries have seen 3x faster growth and are served almost entirely by local players. A key driver of this dynamic has been the form of PRC Government regulation, which, for example permits foreign enterprises to deliver only from companies within China but not from individuals, and requires

foreign enterprises to either obtain a license to operate in China, or form joint ventures with Chinese entities, in order to gain more access to operate in the market.

Although regulatory restrictions and local protection have been easing in recent years (e.g., allowing foreign enterprises to service companies within China), foreign players' higher cost services have been unable to compete effectively in the domestic delivery segment.

Local firms have rushed in to service rapidly developing needs and a few domestic players have come to prominence

on the national stage. Domestic companies such as EMS and SF-Express are building scale and starting to extend feelers on an international basis.

Whilst there are a number of well-known players in the industry, just four providers (EMS, SF-Express, Shentong Express and Yuantong Express) now make up almost two thirds of the domestic express delivery market, and, whilst consolidating, China's express logistics industry can still be characterized as fragmented. There remain hundreds of small-scale (sometimes unlicensed) delivery businesses operating across the country. Smaller firms focus on regional offerings, often focusing on servicing one province or one district and have seen expansion constrained by the limited availability of affordable capital.

## THE DOMESTIC INDUSTRY IS FACING DISRUPTIVE CHANGE

There are six major trends affecting the market dynamics of China's express delivery logistics industry:

### 1. Increasing customer dissatisfaction creating scope for investment that can deliver differentiation

The domestic express logistics industry has seen problems with theft, delays, lack of quality talent and adoption of advanced technology, all of which culminates in poor perceptions of service levels. The industry as a whole has struggled to deliver on service expectations and complaint rates that have increased massively (for example by 200% during 2011 alone). In response, Chinese officials have issued the 2009 Plan to Adjust and Rejuvenate the Logistics Industry pushing for higher standards of service,

innovation and efficiency.

However, a fundamental driver for the lack of quality service is lack of capital; smaller firms particularly, do not have access to adequate capital for the development of technology and personnel needed to consistently deliver a higher standard of service.

### 2. Consolidation pressure increasing

The logistics industry will continue to see more M&A activity driven by a combination of regulation calling for the integration of the resources of large and small firms, and a competitive environment where larger firms are squeezing out smaller players and bringing valuable innovation to the industry.

### 3. Ongoing organic investment providing capacity for growth

The industry is seeing substantial organic

investment, ranging from aircraft and vehicles to the geographic expansion of warehouse footprint.

### 4. Improving market access for international competitors

The express logistics market is seeing signs of liberalization, allowing more experienced competitors into the market. The Vice President and Secretary General of China Express Association indicated at the 2011 China Express Forum that there were plans to further liberalize the market by allowing foreign enterprises to enter the domestic delivery segment of services. In September 2012 UPS and Federal Express were granted licenses for domestic delivery.

### 5. Emergence of online retailing increasing demand for better logistics services

An ever increasing number of Chinese

consumers are shopping online or by mail order. It is estimated that c.40% of China's express delivery volume comes from e-commerce delivery, with further strong growth expected.

The emergence of online e-commerce firms such as Alibaba, Tabao and 360Buy.com at scale has also transformed the need for reliable fulfilment as a core part of the consumer proposition. E-commerce firms are now also entering the express logistics market directly by developing in-house logistics platforms with the intention of ensuring better consistency and reliability.

### 6. Ownership structures are changing

Franchising is currently the dominant operating model in China, and is widely used by top domestic players. 60-80% of companies operate a franchise model which is

seen to reduce the risks borne by the company and the capital required for expansion, and therefore supports rapid network expansion.

However, poor control over franchisees results in duplication of resources, as each franchisee grows its own business independently, and delivers inconsistent levels of service.

Companies now are realising the challenge of managing national franchisee networks and considering taking back direct control. Notably, SF-Express, Shentong, Yuantong, TTK and Yunda started out using franchise models but have been buying back franchisees.

China's express logistics industry has enjoyed exciting growth of 20% – 30% p.a. in recent years. However the market is facing disruptive change due to liberalisation and consolidation and

attractive investment opportunities are coming up, particularly for those who can help China's emerging titans develop better technological platforms, enhance service quality and/ or expand their geographic reach.

Please click here for full article.

**About the authors: Michel Brekelmans and Stephen Sunderland are Directors of L.E.K. Consulting and are based in Shanghai. They have been deeply involved in L.E.K.'s extensive work in the global transportation and logistics sectors. For more information, please contact LEKCHINA@lek.com.**