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Transport Perspectives

This edition of Transport Perspectives focuses on two highly topical issues in the transport sector.

In the first article, Ed Thomas and Stan Stavros update readers on developments in public transport opportunities in Australia.

In the second article, Justin Zatouroff and Shazar Dhalla explore the growth in Asia's logistics sector.

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Australia poised to become a major opportunity for global transport players

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The UK rail market is currently undergoing a period of franchising bidding which is the most intense since the initial wave of competitions in 1996-97. The Essex Thameside and Thameslink bids submitted to the Department for Transport on 24 December 2013 are under evaluation, Transport for London's Crossrail competition is ongoing and the tender documents for Scotrail and East Coast mainline will soon be released. At the same time, UK rail franchising is becoming increasingly competitive with Eurostar, via its joint venture with Keolis, becoming the latest operator to enter the market.

Amongst a number of major transport groups, maintaining an anchor in the UK is seen as a priority. The scale of the UK's franchises is unmatched in any other transport market and the prestige of the contracts adds to any operating group's global credibility. However, intense competition means that operators have begun to look to other markets overseas in order to secure profitable growth. In previous editions of this publication, we have explored the state of the passenger rail market in a number of European countries and reviewed rail developments in the Middle East. Another country posing significant opportunity for global transport groups is Australia. The combination of an established pedigree of franchising along with moves towards further liberalization means that the Australian market has been identified by many as an attractive opportunity.

Australia's history of rail franchising dates back to 1999 when the train and tram systems in the State of Victoria were privatized. The original bid competitions created two Melbourne train operators (Bayside Trains and Hillside Trains), two Melbourne tram operators (Swanston Trams and Yarra Trams) and one regional train operator (V/Line).

Subsequently, there has been a consolidation of the franchises into two metropolitan contracts and further rounds of bidding in 2004 and 2009, while the regional train operations were brought back into State ownership. The 2009 competitions were notably successful in attracting new overseas entrants to the Melbourne market. Ultimately, the train franchise was awarded to a consortium led by the Hong Kong operator MTR and the tram franchise was awarded to a consortium led by the French operator Keolis. As well as being of high value, these opportunities were attractive to overseas players as the contracts were broadly based around the UK model, albeit with some structural differences (for example the Melbourne franchises are vertically integrated) and adjustments to risk transfer arrangements, so were therefore easily understood.

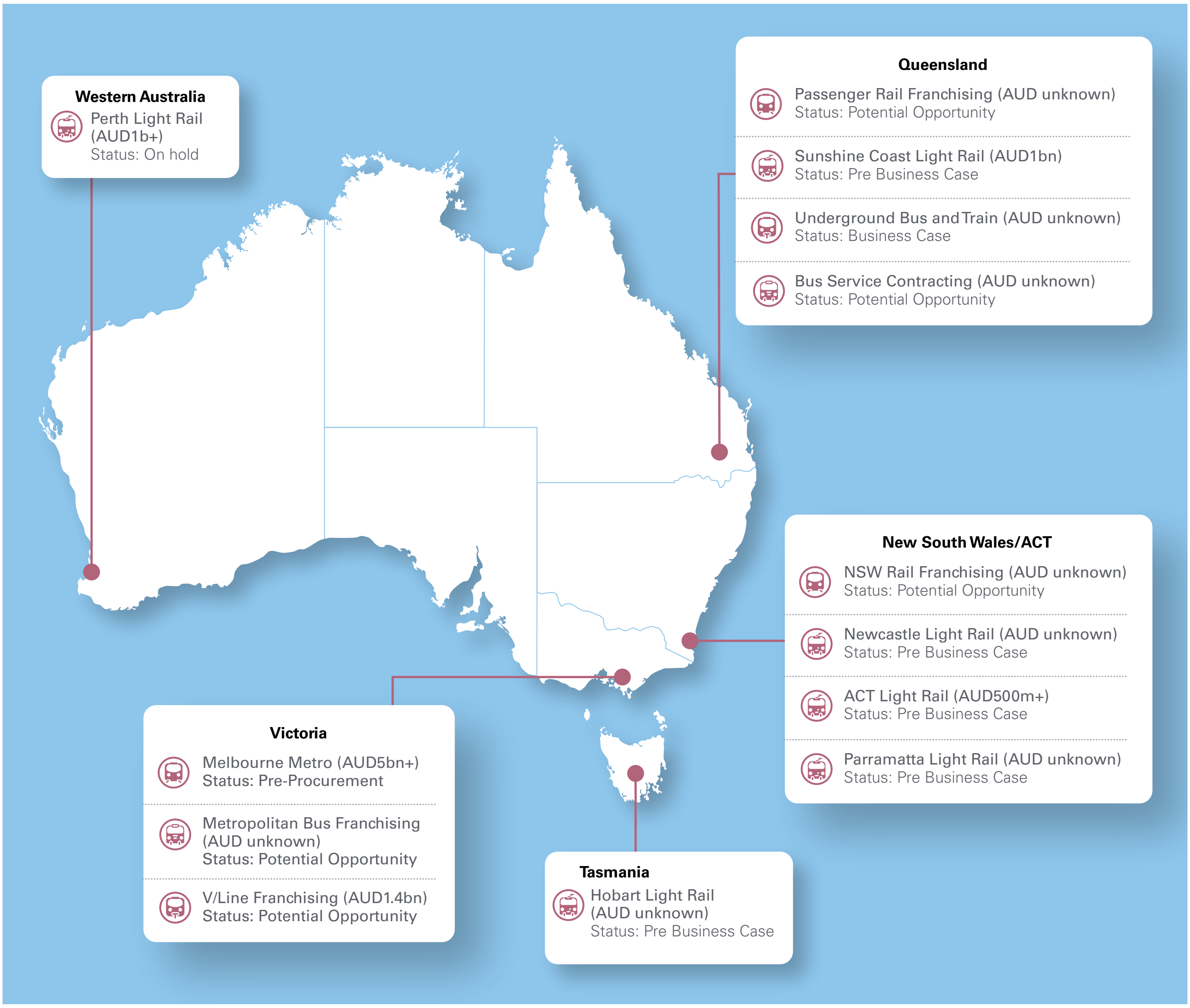
Building on this history in Victoria, a number of Australian States are now actively considering options to increase the liberalisation of their passenger transport markets.

For example, new opportunities for passenger rail franchising are on the horizon in Queensland. The Queensland Commission of Audit's final report and Government's response was publicly released in April 2013 and included recommendations to reform both the passenger rail and bus sectors. In particular the government accepted the recommendations to:

- Open up the city passenger rail services and network infrastructure to contestability;
- Introduce competitive tendering for long distance and tourist passenger rail services; and
- Introduce competitive tendering to bus service contracts throughout Queensland.

Queensland Rail, the Government owned operator of passenger rail services, has now been transferred to a statutory authority, allowing for a greater focus on cost control and performance. With the next State Government election to occur no later than June 2015, there is some chance that the Queensland Government will look at tendering franchises to the private sector at some point in 2015/2016. Any Queensland process is likely to adopt a model highly influenced by the experience in both Victoria and the UK.

Figure 1: Overview of future Australian public transport opportunities



In New South Wales, the rail operator Railcorp was restructured in July 2013 to create two new entities: Sydney Trains, which operates services in the Sydney Metropolitan area, and NSW Trains which operates all other passenger services. Both Sydney Trains and NSW Trains are currently owned and operated by the New South Wales Government. The next step for New South Wales is likely to be some form of private sector involvement, potentially through franchising.

Timelines are not yet agreed but, as in Queensland, contracts may come out to tender at some point in 2015/2016.

Finally, in Victoria itself, in 2013 Public Transport Victoria carried out a competitive tender process for approximately 30 percent of Melbourne's public bus services – the first time that a significant portion of the network had been put out to competitive tender.

This reflected a desire to attract innovation and greater focus on customer service by tapping into a broader market of operators, including international experience and skills. Whilst precise timings are yet to be determined, competitive tendering may also be extended across the whole of Victoria's bus services with a rolling programme of franchising established.

Furthermore, there is the potential that the Victorian Government may consider the long term operating model for its V/Line business with the delivery of key capital projects impacting on regional services now almost complete. Finally, Victoria's Metro Trains Melbourne and Yarra Trams franchise may come back to the market in 2017 if the State decides not to take up the option to extend the contracts let in 2009.

Therefore, with its established history of franchising and moves towards liberalisation across a number of States, Australia looks to offer a pipeline of attractive bidding opportunities. In addition to this, a number of major capital investments are either currently in progress or are being planned across the rail sector. These include major schemes such as Sydney's North-West Rail, the Underground Bus and Train project in Brisbane and Melbourne Metro in Victoria, in addition to light rail projects in Perth, Sydney, Canberra, Newcastle, Parramatta, Hobart and the Sunshine Coast. With this volume of activity, the signs are that Australia could become a keenly contested market for the major global transport players in the coming years.

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The growth of Asia's logistics sector: observations from Europe

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The globalisation of supply chains was driven by world trade growing even faster than GDP. As this trend has reversed reflecting the slowdown in Western economies, growth for Asian logistics has been driven by the rise of local consumer demand. While the Asian geography is physically much more of a challenge than either Europe or North America, which are large land masses with relatively consistent levels of infrastructure development, the logistics sector in Asia is made increasingly complex by the political and regulatory diversity in the region – making the challenges to a pan-Asian supply chain very real. However given Asia's young, educated and urbanising populations the opportunities for logistics companies are very real.

Despite the significant differences between the Asian and European/North American markets (growth rates, geography, regulation, and infrastructure) are there any observations that can be drawn?

Given the highly developed, complex but most importantly efficient supply chains of Europe and North America – the US spends approximately eight percent of GDP on logistics compared to over 16 percent in Asia[1] – this article aims to explore some of the trends experienced in these regions and the parallels that can be drawn to the Asian market.

The growth of the Asian market

Five years on from the financial crisis many of the world's advanced economies are yet to fully recover – indeed it is really only the US and Germany of the major advanced economies that have exceeded their pre-recession output levels. Meanwhile emerging economies, such as those in the Asia-Pacific region have performed strongly – generating the majority of world growth over the past few years. Underpinned by strong domestic demand and rising per-capita incomes, we expect continued growth in this region. The world's middle class is expected to reach 5 billion people by 2030; 3.5 billion of them living in the Asia-Pacific region, which will boost private consumption in the region[2]. Simultaneously, e-commerce is growing at an incredible pace – Alibaba (China's biggest e-commerce site) is larger than eBay and Amazon combined, generating US$170 billion of [gross] revenue in 2012[3].

The air freight sector also poses a significant opportunity to investors. The value per kilogram of goods shipped by air is significantly more than by ship. Airbus forecasts that China will become one of the largest domestic express markets in the world, similar to the development the US market experienced through the '70s, '80s and '90s which saw growth rates averaging 26 percent during this period[4].

Historically Asia has been a manufacturing centre with goods being shipped overseas but we are increasingly seeing both the production and consumption of goods taking place within the region. Intra-Asia trade has been steadily increasing for the past ten years at approximately 14 percent per year, a faster rate than that of Asia's exports to the world which has grown at 11 percent per year for the same period[5].

Investment opportunity

This changing global landscape presents significant opportunity for logistics providers. Despite the inherent challenges of operating in the region which can include slower border clearance times, concerns around security, and a developing transport infrastructure network, a number of global operators have already made significant investments in the region. In the first half of 2013, companies such as Kerry Logistics,

1. http://www.scdigest.com/assets/newsviews/13-06-20-2.php?cid=7168
2. Airbus Global Market Forecast: Future Payloads, Freight Forecast 2013-2032. http://www.airbus.com/company/market/forecast/?eID=dam_frontend_push&docID=33976.
3. Ibid.
4. Ibid.
5. Asia Pacific Transport & Logistics 2013. Transport Intelligence Ltd. February 2013.

Yusen Logistics, and the Goodman Group opened warehousing and distribution centres in the region while logistics providers Norbert Dentressangle, CEVA, and FedEx Trade Networks are just a few of those who have existing operations[6]. However, the sector remains highly fragmented, especially in China where the number of small and medium sized owner-managed logistics businesses in operation is significant.

Is consolidation inevitable?

Will the multi-national logistics provider win? Is there a future for the local operator versus a national or regional player? In Europe we have seen the local, mid-market operator thrive despite pressure from much larger organisations. Theoretically, one might have expected that the economic down-turn would force consolidation of the industry but in practice this has not happened for a number of reasons.

Firstly, the value of local knowledge and expertise cannot be underestimated. The delivery of goods to customers is at its core a local activity. Ignoring the local culture and treating the market as a homogenous unit is likely to be disastrous and there are few examples of companies expanding across Europe without experiencing issues.

In addition, local operators have been able to compete by cooperating with each other. In Europe, the small regional hauliers often work together to offer services across a large geographic region which allows them to lower their effective cost base and significantly improving asset utilisation to the point that the large 3PLs often use these networks to deliver their single pallet deliveries.

Strong supply chains and logistics services are tailored to local needs, focused on locally developed capabilities and talent and agile and flexible enough to manage on-going change. We therefore expect that the logistics companies which will thrive in the Asian market will be local in their execution and provision of services.

E-commerce as a driver of growth

In Europe, the retail sector has been a primary driver of change and innovation in logistics services, while in Asia change has historically been driven by developments in manufacturing.

As the Asian middle class grows and domestic consumption balances export led growth, we expect this to change. We have already seen the rise of e-commerce giants such as Alibaba and well developed payment technologies such as Alipay which are gaining increasing acceptance in the region, but what further developments have we seen in Europe that may impact the Asian logistics landscape?

The growth of reverse logistics as products are returned to E-Tailers from buyers, has significantly increased in Europe in recent years. Women's wear retailers anticipate more than a 50 percent returns rate. While return provisions currently may not be as flexible in China as they are in the United Kingdom (where most of the major retailers offer some form of 'free returns'), with the significant increase in private consumption expected in the region, we would expect an increasingly discerning consumer to demand a greater degree of flexibility with respect to returns. Retailers and logistics companies must consider how to handle the collection or drop off of returned goods and their potential re-sale.

6. Transport Intelligence. 2013 TI Briefing. July 31, 2013.

The challenge of the so called 'last mile' of the supply chain has also led to increasing delivery options for the consumer. While we see primarily traditional delivery to home with payment made mainly by cash on delivery (COD) in Asia, we are seeing the increase use of multiple delivery channels including 'deliver to work', parcel shops, click and collect and drop box deliveries in Europe. To ensure the quality of service and to facilitate payment many retailers in Asia are increasingly taking logistics in-house. In Europe this trend has been limited to the new entrants (e.g. Amazon) cherry picking urban areas and some premium E-Tailers. When the delivery driver is the retailer's only physical point of contact with a customer the quality of the service becomes paramount. As the Asian urban markets for e-commerce develop and the need for multiple routes to market increases, one operating model does not fit all, suggesting the retailers will need to rely on third party logistics providers.

We have seen in the UK that multi-channel can be successful if a secure payment system is in place, giving the retailer confidence that they will get paid and a flexible returns policy provides consumers confidence that they will get the product they are looking for. It remains to be seen who will win the last mile but what is apparent is that there is a need for retailers and logistics operators to remain flexible to meet the changing expectations of the consumer.

How will post offices react?

Itella, the Finnish state-owned post and logistics provider, has recently announced its new vision and strategy which is in large part a response to its anticipated reduction in traditional letter volumes to half of the current levels by 2020[7]. E-commerce is often seen as a solution for postal networks facing a structural decline in letters and packets; however, parcels do not necessarily easily fit down the letters network and those that do, including CDs and books, are being increasingly digitized. This can create significant issues for postal operators. A number of postal operators have shifted increasing focus on developing successful e-commerce delivery and e-fulfilment operations. Royal Mail in the UK, continues to grow this part of its business both through its core letters network which delivered one billion parcels last year and its specialist parcel operations, Parcelforce and its international counterpart, GLS. Over the last two years, SingPost has been developing its capabilities to capitalize on the booming e-commerce market, especially in Asia[8]. Postal operators often have well developed regional networks that can provide a competitive advantage in the industry but need to consider if the letters and parcels networks can be interchangeable or if separate networks need to be developed. European logistics operators have found multi-user e-fulfilment has been difficult to do profitability. Traditional postal operators may be able to provide this solution.

In conclusion

In a region with a young, educated and increasingly urbanised population where intra-Asian trade flows have consistently grown, we expect continued economic growth. Supply chain and logistics operators can act as a motor for this growth by anticipating the requirements of industry from experiences in other parts of the world rather than acting as a brake by always being in catch up mode.

7. http://www.itella.com/group/english/current/2013/20131030_vision.html.
8. CEP Research. October 2013.

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