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Since 1997, FedEx Ground has seen annual revenue increase by a compounded annual growth (CAGR) rate of 13 percent, while annual revenue for FedEx Express has grown by a CAGR of 2.9 percent. Photo credit: Shutterstock.com.

The following is part of JOC.com's The Industry Speaks series, highlighting new perspectives within the cargo shipping industry.

In October 1997, when announcing the company's purchase of trucking operator Caliber System, Fred Smith, chairman and CEO of FedEx (then Federal Express), stated, "The acquisition creates a powerful combination that will propel both companies to new heights." Instead of merging its ground and air express networks, Smith said the two would "operate independently, but compete collectively."

Over these last 22 years, the strategy has helped FedEx Ground (formerly RPS) annual revenue increase from $1.3 billion to $20 billion, a compounded annual growth rate (CAGR) of 13 percent, while annual revenue for FedEx Express, the company's air express division, has grown from $11.5 billion to $21.6 billion (excluding the company's acquisition of TNT Express) for a meager CAGR of 2.9 percent.

On May 30, 2019, FedEx announced that FedEx Ground will start delivering more SmartPost packages itself instead of tendering to the US Postal Service for last-mile delivery and that it would help increase density to support Sunday deliveries starting in 2020.

With 2 million daily SmartPost packages added to last-mile delivery by FedEx Ground independent service providers, it affirmed that operating collectively is good for building density and a better model than operating independently.

Given that SmartPost packages are used by price-sensitive shippers, the Ground network will be absorbing lower-priced packages. If it makes sense to dump the low-priced SmartPost packages into the Ground network, it will be even more advantageous for FedEx Express domestic US packages — about 2.8 million per day — to be handled in the Ground network. In essence, the two divisions would then operate and compete collectively for all domestic US parcel services.

A compelling, but challenging combination

Given e-commerce-driven changes in the last several years, the domestic US parcel market of today is dramatically different and requires the merger of the two operating networks.

While FedEx stock price dropped with the May 30 announcement about SmartPost volume being merged with Ground, the merger of the Express and Ground networks will send the stock to new highs because it will expand the operating income of the Ground and Express units from $4.67 billion to more than $8 billion.

There are many compelling reasons to combine the two networks. In 1998, the Express and deferred air services were extensively used for the certainty of delivery that came with their guarantee for delivery by a specific time.

That changed when UPS guaranteed the Ground service in May 1998, and RPS followed in July 1998. This development has diverted express and deferred parcels to ground service, thereby contributing to the decline in revenue for premium services of more than $40 billion and the corresponding drop in volume in the last 20 years.

In 2000, business-to-business (B2B) sales were dominating the parcel market, with residential deliveries only representing about 20 percent of volume. However, the introduction of two-day free shipping by Amazon in 2005 fueled explosive growth of deliveries to residences such that business-to-consumer (B2C) volume now represents about 52 percent of the total.

As a result of these changes, FedEx Ground average daily volume has increased from 1.4 million parcels in 2000 to 8.3 million in 2018, a CAGR of 10.3 percent. By contrast, FedEx Express average daily volume was 2.9 million in its 2000 fiscal year. By 2018, it had declined to 2.73 million for a CAGR of negative 0.3 percent. With three times the daily volume, FedEx Ground can easily absorb the express/deferred volume.

In addition, the characteristics of B2C parcels in terms of weight, cube, and zone of travel are very different, requiring even more need for building density in the delivery routes. The importance of this is affirmed by FedEx's announcement about delivery of 2 million daily SmartPost parcels with its own delivery personnel.

On-time performance evolves

Even the on-time performance of the two operating units has changed. According to ShipMatrix, FedEx Ground on-time performance in October 2002 was 95.4 percent and improved to 98.4 percent by October 2018. In contrast, FedEx Express on-time performance in October 2002 was 96.2 percent and was 97.3 percent in October 2018; it's now below that of FedEx Ground.

In 2000, FedEx Ground pickup and delivery operations were handled by independent contractors. Now, the local pickup and delivery is handled by independent service providers, which are incorporated businesses and use employee drivers. This model is more suitable to absorb the employees of FedEx Express whether they want to own their own business or continue working as an employee driver.

During this same period, FedEx Ground has generated a higher average operating margin of 14 percent compared with below 7 percent for FedEx Express. The combination of the two networks will eliminate many Express service centers, dramatically reduce the number of aircraft, and remove cost resulting from more express and deferred parcels moving in the ground network.

No doubt, merging FedEx Express and Ground will be more challenging than Ground absorbing SmartPost volume. However, with express parcel yield being more than two times that of Ground and three times that of SmartPost, the benefits far outweigh the difficulty with merging the two networks.

Even in Europe, after acquiring TNT Express, FedEx now operates one single network. That alone makes for a compelling argument for doing so in the US domestic market.

To simplify the work for employees and shippers and to add billions in value for shareholders, the company should implement the new strategy "operate and compete collectively."

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