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Home > ARO 2020: It takes more than being digital to disrupt freight industry

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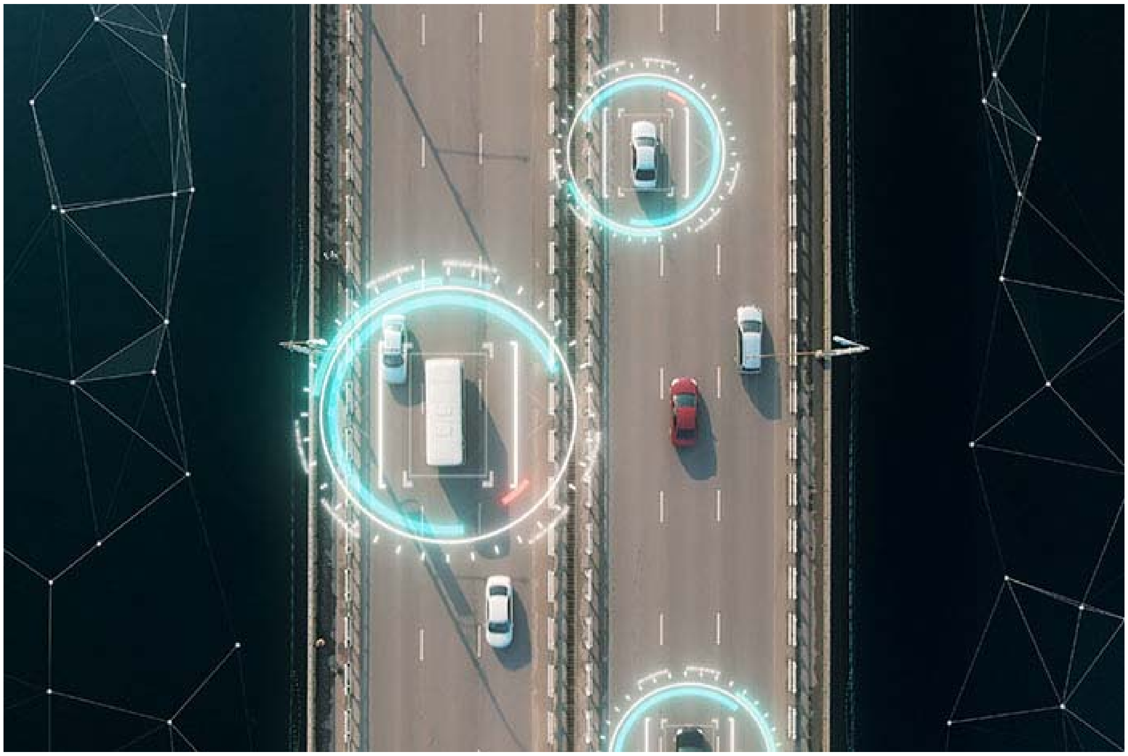

Digital freight broker Convoy recently received $400 million in funding at a valuation of $2.75 billion, while established freight broker Echo Global Logistics is valued at $564 million despite much higher gross revenue. Photo credit: Shutterstock.com.

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The past year has been an uncomfortable roller-coaster ride for investors in so-called disruptors Uber, Lyft, Grubhub, Blue Apron, and WeWork. Few will dispute that these companies have woken up the established companies in their respective industries, forcing them to improve via digital technology.

However, the reversal in the financial fortunes of these companies shows that it takes much more than just use of smartphones to disrupt and, perhaps more importantly, generate sufficient value to create a profitable enterprise.

Even so, venture capitalist investors continue to plow millions of dollars into digital freight brokers such as Flexport and Convoy. WeWork, for example, saw its valuation plummet from $47 billion to $7 billion in a few weeks, and it is far from certain that the company will survive given that even this dramatically reduced valuation now seems too high.

Within the freight segment, Convoy recently received $400 million in Series D round at a valuation of $2.75 billion. By contrast, established freight broker Echo Global Logistics is valued at $564 million despite generating gross revenue that is many times more than that of Convoy.

Based on Convoy's gross and net revenue, publicly traded broker C.H. Robinson would have a valuation of $86 billion, more than twice that of FedEx. That's insanity.

Softbank's recent record of losing billions of dollars invested at outrageous valuations in companies such as Uber and WeWork should be seen as an indication of its inability to assign proper valuation at other companies. Could it be that its investment in Flexport, which raised a record-setting $1 billion in its last funding round, will turn out to be similar to that of Uber and WeWork?

In the ride-sharing business, Uber and Lyft introduced digital technology that had more attributes than just matching a driver with a rider. Their tech involved digitization of payment systems, providing directions to unknown destinations, and monitoring performance of the drivers and the behavior of passengers to weed out the bad ones. They also converted riders from taxi companies that were ill-equipped to compete after years of protection from public utility commissions.

Most importantly, they converted thousands of men and women into commercial drivers willing to give rides to strangers in their personal vehicles, thereby offering cab service to areas that previously lacked adequate coverage.

Freight brokers, on the other hand, have a long history of operating in a competitive market, and they generate billions of dollars in annual revenue. They also have longstanding relationships with shippers, who often require lots of attention, want payment terms of 30 to 60 days, and don’t pay for each transaction via credit card. Furthermore, the freight brokers still have to comply with many state and federal regulations, most truck drivers do not own and operate their own tractor trailers, and existing brokers already provide coverage to all parts of the country.

For established brokers, labor productivity is often measured by gross revenue per employee, which ranges from $850,000 to $1 million. One might expect that the new, digital freight brokers would have much higher gross revenue per employee, but this isn’t the case. Convoy, for example, sports a gross revenue per employee of approximately $1 million.

If these startups are only achieving revenue growth by offering lower prices subsidized by venture capital investments, this game of musical chairs will end one day with all left standing except the founder — just as happened at WeWork, where the founder received over $2 billion for eight years of work, while the employees’ options are under water and the investors may have to write off millions of dollars invested in the company.

The allure of startups’ use of digital technology continues to cloud the issue for venture capitalists, which should instead be paying attention to whether these companies will be able to compete with incumbents that are spending more on technology upgrades than the net revenues of those same startups. J.B. Hunt Transport is spending $400 million on its 360 freight-matching service, for example, while XPO invests upwards of $450 million annually in information technology that includes a digital load-matching platform.

The brokerage industry has experienced similar technological transformations in the past. It went from using faxes for communicating with shippers, carriers, and drivers to using email and then to instant messaging. Now, it is quickly adapting to leveraging the ubiquitous presence and usage of smartphones to speed up communications and sharing of all aspects of loads with applicable parties.

Adoption of fax, email, and instant messaging didn’t “disrupt” any company in the brokerage industry. And yet use of smartphone technology by new startups is now improperly viewed as disrupting the established brokerage industry.

Amazon’s disruption of the retail sector is evidenced by the closing of thousands of brick-and-mortar retail stores, as well as the bankruptcy of several high-profile retailers, from Sears to Payless Shoes (twice). Comparatively, not one brokerage company has closed offices or filed for bankruptcy since the so-called digital brokers entered the market.

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