

FedEx's Smart(Post) strategy

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 compound annual growth rate 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, FedEx announced that FedEx Ground will start delivering more SmartPost packages itself instead of tendering to the US Postal Service

compete collectively for all domestic US parcel services.

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

Although FedEx's 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 representing only about 20 percent of volume. The introduction of two-day free shipping by Amazon in 2005, however, 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's 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 minus-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.

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

In 2000, FedEx Ground's pickup and delivery operations were handled by independent contractors. Now, the local pickup and delivery is handled by Independent Service Providers who 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.

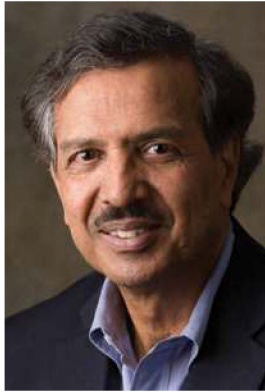
During this same period, FedEx Ground has generated a higher average operating margin of 14 percent compared with less than 7 percent for FedEx Express. The combination of the two networks will eliminate many Express service centers, slash the number of aircraft, and remove costs resulting from more 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. But with express parcel yield being more than two times that of Ground and three times that of SmartPost, the benefits far outweigh the difficulty of merging the two networks.

Even in Europe, after acquiring TNT Express, FedEx now operates a 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." **JOC**

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The introduction of two-day free shipping by Amazon in 2005 fueled explosive growth of deliveries to residences.

for last-mile delivery and that it would help increase density to support Sunday deliveries starting 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 a day — to be handled in the Ground network. In essence, the two divisions then would operate and