Commentary

FedEx should thank Teamsters for opening door to become market leader

In addition to lower labor costs, FedEx has pricing leverage to gain market share given it has the highest revenue per parcel for all levels of services compared to UPS, says Satish Jindel. Photo credit: Elliott Cowand Jr / Shutterstock.com.

Satish Jindel, president, ShipMatrix | Oct 9, 2023, 4:13 PM EDT

Raj Subramaniam, CEO of FedEx Corp., should send a thank you note to Sean O'Brien, general president of the International Brotherhood of Teamsters. By not striking and signing a new labor contract worth billions of additional dollars with UPS, Teamsters have provided FedEx a rare opportunity to leverage its One FedEx initiative to become the largest parcel carrier in the US.

The wage increases and other accommodations for Teamsters workers have further increased the spread between labor cost at UPS and FedEx. Total annual compensation for a UPS package car driver, even under the old contract, was $145,000, which on an hourly basis at $65 per hour is more than double the $30 per hour for a FedEx independent service provider (ISP) driver.

And, for a UPS feeder driver, the total compensation before the new contract was $172,000 per year (or 95 cents per mile). Again, this is more than double the amount received by linehaul drivers working for FedEx ISPs. So, the new contract with 3.3% compound annual growth rate for Teamsters members increases the spread even more.

If UPS had resisted O'Brien's demands, it would have led to a strike which would have diverted some volume to FedEx. However, it would have been temporary, because UPS could have replaced all Teamsters workers with mostly much lower-paid workers at FedEx and Amazon. A UPS strike and resulting shift of FedEx drivers would have practically shut down FedEx Ground and disrupted its planned merger of its Express and Ground units.

However, the opportunity to benefit from its lower labor cost structure to gain market share for FedEx has a limited time window before its three major competitors respond to not only protect, but gain share in a market with huge excess capacity.

UPS has a demonstrated track record of leveraging operational processes and technology to offset its higher unionized labor cost. In addition, it will not miss the newfound alternative to control its higher labor cost when the current contract expires in 2028.

Then, the US Postal Service (USPS), with capacity for 60 million parcels per day while handling just half that, will be looking for ways to fill that excess capacity.

While USPS' new Ground Advantage with two- to five-day delivery nationwide is not an advantage against FedEx Ground, which delivers 36% of parcels in one day, according to ShipMatrix data, it has no fuel surcharge or peak surcharges, among other favorable pricing attributes.

In addition, with more parcels delivered to residences, USPS' monopoly over the mailbox gives it a unique advantage for more secure and weather-protected delivery of small parcels. And, with such small parcels representing over 60% of all business-to-consumer parcels, per ShipMatrix, it can capture a huge share of the lightweight small parcel segment.

Then, as if the parcel market needed more capacity, Amazon's decision to offer door-to-door service will add more capacity and add pricing pressure. With its enormous backhaul capacity, a very low-cost structure and capital resources, it can disrupt parcel carriers just as it did to brick-and-mortar retailers.

FedEx pricing leverage

In addition to lower labor costs, FedEx has pricing leverage to gain market share given that it has the highest revenue per parcel for all services. In the company's 2024 fiscal year first quarter, which ended Aug. 31, FedEx's revenue for express parcel was $24.49 per parcel, compared with $22.40 for UPS in the second quarter of the 2023 calendar year. For deferred service, FedEx was $18.81 vs. $16.08 for UPS, and for ground, FedEx was $11.80 vs. $11.29 for UPS.

While the latest quarterly results were better than the market expected, one still must wonder why FedEx operated at just a 7.3% margin, even with a gain of 400,000 parcels per day that were diverted from UPS. In contrast, UPS achieved an operating margin of 12.6% in the second quarter of this year, even with the diversion of 932,000 parcels per day from the threat of a Teamsters strike and having higher labor costs.

Given such cost and pricing dynamics in its favor, FedEx has a limited opportunity to lower its total cost so that it can reduce shipping charges for shippers to increase its market share, offer higher payments to its ISPs and generate greater return for its shareholders.

While FedEx has had a labor cost advantage for many years, it still lags UPS in operating margin. Sean O'Brien has succeeded in pushing UPS costs up, while One FedEx will drive FedEx costs down.

Time will tell if FedEx has the DNA to leverage this cost differential and right-size its corporate overhead in the limited time window to close the margin gap — to the delight of all stakeholders that include ISPs, shippers and shareholders.

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