DC VELOCITY

PARCEL EXPRESS

Shippers back in the driver’s seat as parcel market growth softens

A number of factors are conspiring to tap the brakes on two years of accelerated, pandemic-driven growth in parcel volumes. That means that unlike last year, shippers in 2022 are finding ample capacity and competition for their parcels.

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For those who remember the original Monday Night Football broadcast crew of Frank Gifford, Howard Cosell, and Don Meredith, when one team got so far ahead there was no doubt they’d win the game, Meredith would break into that old Willie Nelson favorite “Turn out the lights … the party’s over.”

Well, for the parcel express market, as pandemic-driven demand wanes, the 2022 peak season staggers to a close, and an uncertain 2023 looms on the horizon, that classic lyric seems to have found a new home.

Led by FedEx reporting an unexpectedly large miss in its September earnings call, the nation’s parcel express carriers are adjusting to a new post-pandemic reality. They’re dealing with an uncertain economy, persistent inflation, higher energy costs, shifting consumer spending priorities, and weaker-than-expected e-commerce traffic—all of which are driving slower growth and creating excess capacity.

THE TABLES HAVE TURNED

As the upshot of all that, “this year’s peak season put the shipper back in the driver’s seat,” says Satish Jindel, president of consulting and parcel data analytics firm ShipMatrix. Using ShipMatrix’s demand-supply model, Jindel predicted in September that this year’s peak season demand would hit 92 million parcels per day. Yet as peak season moves along, he’s scaling back those projections, noting that it now appears the market would be hard pressed to reach 90 million.

Some carriers continued to add capacity going into the peak, including the U.S. Postal Service (USPS), which upped its capacity to 60 million parcels per day from 53 million. Collectively, Jindel’s analysis estimated that the industry had excess capacity for this peak season of some 18 million parcels per day, leading to financial challenges for carriers—and a potential windfall for savvy shippers.

“The tables have turned,” Jindel notes, adding that the new status quo will require some adjustment on the part of shippers. “Because shippers have not been in the driver’s seat for two-plus years, they will face new challenges driving a new car, because the car is different now in numerous ways.”

By different, he means market practices and other changes that shippers need to consider. Among those: the impact of carriers assessing multiple additional surcharges; the shifting of some fuel surcharge amounts into base pricing; the rise of alternative parcel carrier options to the “Big Two”; and an aggressive Postal Service working to rationalize its operations and capture more parcel market share.

Jindel cites one other factor that has influenced peak volumes, especially late in the season: Amazon Prime Day.

“Amazon already had a Prime Day in October,” he notes. “That pulled forward retail sales into October from the normal peak. Consumers will already have spent that money,” partly because they are ordering earlier to avoid late-season missed deliveries like last year’s, he says.

“Those orders, along with other retailers who have advanced holiday sales offerings even earlier in response, will blunt retail sales later in the year,” Jindel believes. “And with most of those packages moving in Amazon’s network, that will further impact peak volumes for FedEx, UPS, and USPS’s door-to-door services. So they will feel the pain from those e-commerce sales being sucked into October instead of happening later in the year.”

ONE TREADMILL IS ENOUGH

Helane Becker, a long-time industry analyst for Cowen & Co. who covers the airlines and parcel carriers, recalls how in 2020 and 2021, cargo company executives were talking about how they were dealing with volume levels once projected for 2025.

Not anymore. “So, by definition, if you pulled forward four to five years’ worth of growth [into one or two years], at some point, it is going to slow. It’s inconceivable that you are going to see 40% growth every year,” she says. Becker notes as well that consumers seem to have “kept their wallets in their pockets,” as more of their weekly paycheck goes to increasingly expensive food, fuel, and utilities, and as other spending once devoted to discretionary goods shifts to services.

“Once you have your treadmill or stationary bike or whatever you bought for your home during the pandemic, you really don’t need to buy another one,” she notes.

As for parcel carrier strategies for dealing with a shifting market, she observes that coming into peak season, “FedEx invested in and prepared for a level of volume” that did not arrive. In response, FedEx is “hitting the pause button, focusing on consolidating operations and cutting costs, then allowing [slower] growth to catch up to the facilities [it] has.”

UPS, on the other hand, has been focusing on “revenue quality” and, in Becker’s view, has been sounding the alarm on a slowing parcel market since earlier this summer.

In her experience covering both companies for many years as an industry analyst, Becker has observed that “FedEx has always thought of investing to stay ahead of growth. UPS always invested to catch up with growth.”

REGIONAL PARCEL OPTIONS EXPAND

Market makeup and capacity dynamics also are shifting due to the impact of Amazon’s now operating its own parcel delivery network, along with the rise of regional parcel carriers. They provide an often-attractive option to shippers, who are increasingly carving out some of their parcel volumes to give to regional players instead of putting all their package freight into one or two big national buckets.

One example can be found in two of the largest regional parcel network operators: East Coast-based LaserShip and West Coast-based OnTrac. Last year, LaserShip agreed to acquire OnTrac in a $1.3 billion deal. Now the two companies are in the process of expanding operations as well as launching connecting transcontinental services among points in their two primary regions, says Josh Dinneen, LaserShip’s chief commercial officer.

While it’s not at the level of the past two years, Dinneen says, 2022 definitely is experiencing a peak season. “No one is canceling Christmas.” But is demand softer? “All signs point to yes,” he says.

Nevertheless, he believes that there is excess capacity for "millions of packages," which is providing shippers with better options for securing capacity at competitive rates.

Dinneen emphasizes that there is still profitable growth to be had in the parcel business, particularly within the regional markets, citing their lower cost structure and the ability to provide consistently good service. And despite weakening demand, LaserShip and OnTrac haven't put the brakes on plans to invest in their network.

Dinneen says they are spending more than $100 million this year on expansion. The company in July launched transcontinental service between major hubs in Southern California; New York City; Columbus, Ohio; and Reno, Nevada. It just finished construction on a new automated sort center in Columbus. It will soon open a new, fully automated sort center in New Jersey, doubling its capacity to serve Eastern Seaboard customers.

Lastly, by year's end, LaserShip will have moved into new, larger facilities in Charlotte, North Carolina, and Nashville, Tennessee. A Texas expansion with new sort hubs opening in Dallas, Austin, San Antonio, and Houston is on the drawing board for 2023.

The market, however, remains in a somewhat fragile state, facing pressures and challenges from all sides.

"Everyone's cost of labor has increased materially," Dinneen notes. "Amazon has announced another warehouse labor wage increase. The challenges will be labor inside the four walls, the costs of moving packages, securing sufficient rate increases, and keeping a consistent balance between capacity and demand."

SHIPPER TACTICS GETTING MORE SOPHISTICATED

At the same time, shippers, out of necessity, are becoming more sophisticated about their parcel tactics and strategies, leveraging access to inexpensive, powerful new technology tools; better, more timely data; and far more accurate visibility into costs and alternatives.

"Talking to our clients, they want more reliability and more speed," says Gaston Curk, chief executive officer of e-commerce shipping specialist OSM Worldwide. "Amazon has changed the experience for the end consumer. Customers want more predictability, [enhanced] visibility, better tracking." He notes that shippers are concerned about market disruption going on today, from a slowing economy to a potential recession and other issues on the horizon, including "UPS entering negotiations with the Teamsters next year on a new labor contract. They're afraid to put all their eggs in one basket," he says.

He also cites the evolution of the U.S. Postal Service, "which is transforming as we speak," Curk notes. "Traditionally, they were a letter carrier. Now they are evolving to become more competitive [in parcels and packages] with UPS and FedEx, as a more reliable and cost-effective option."

GIRDING FOR THE LONG TERM

Adds ShipMatrix's Jindel: "Keep in mind that the Postal Service has a monopoly on first-class mail and that gives them a monopoly on your mailbox"—and it's a federal crime for anyone else to use that consumer's mailbox. "They can deliver a letter and package at the same time," and most of the time, they don't have to take a package all the way up to the front door or porch, like other parcel carriers. "A letter carrier can make up to 300 stops a day. On average, UPS and FedEx can get to 200 stops a day. That's a huge cost advantage for the Postal Service."

The softer market and demand/supply imbalance is not a short-term phenomenon, Jindel believes. "It's not temporary; it will continue well into 2023." Shippers, he says, "should leverage this opportunity for more reasonable prices and for reliable capacity and consistent service. The [pricing] pendulum has swung back to the shipper. Enjoy it while you can."