Beset by loose capacity and weak demand, where do parcel express carriers go from here?

Shippers are regaining pricing leverage as an uninspiring peak season has carriers pining for pandemic-era volumes.

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It seems like just yesterday that parcel carriers were gearing up for huge demand growth as Covid kept consumers stuck at home, where they ratcheted up online ordering of everything from food to home office supplies and exercise equipment to electronics and other hard goods. Industry prognosticators at the time were projecting multiple years of 20% growth as e-commerce exploded.

As the market enters the final stretch of 2023, it's a far different picture. To say that parcel demand has taken a hard swing in the other direction would qualify as an understatement of epic proportions.

"The capacity-demand imbalance [in the parcel markets] is of a magnitude that I have never seen in my 38 years in the business," observes Satish Jindel, principal at ShipMatrix, a consulting and analytics company that specializes in parcel shipping. "Given the stagnant demand and [absence of] new initiatives on the horizon to encourage consumers to spend more money on goods, supply will exceed demand for the next three or more years," he predicts.

IT'S ALL ABOUT RELATIONSHIPS

Jessica Dankert, vice president of supply chain for the Retail Industry Leaders Association (RILA), hears similar sentiments from her members. "It's more of a shipper's market than we have seen in the last couple of years," she notes. That's giving leverage to large retailers who are looking to rein in the rapid increases in shipping costs they absorbed during the pandemic. "There is a lot more capacity [available], and we expect shippers to take advantage of that," particularly those who have flexibility to shift their volumes among carriers, she says.

Even with the pricing pendulum swinging back to shippers, Dankert stresses that savvy retailers are not abandoning strategies that emphasize solid relationships, communication, and collaboration with carriers. “Maintaining that relationship on both sides is very important,” she notes. Retailers will still want to “collaborate to maintain service,” rather than simply go after the lowest price.

And while the shipper may have a newfound ability to negotiate, she believes these discussions won’t be strictly transactional in nature but rather, will focus on the longer-term relationship” and how the shipper can obtain both reliable, cost-effective service and ample capacity.

Ryan Kelly, vice president of vertical and alliance marketing for FedEx, reinforces Dankert’s point. “Any shipper knows that there is more to it than just a box and a price. It starts with a relationship. We want to understand our customer’s business [and] the experience they aspire their customers to have,” he says.

He emphasizes as well the importance of planning, particularly ahead of the holiday peak season, pointing out that some retailers ship five times their normal volume during peak. Servicing that surge in volumes “comes at an increased cost that is well known,” he says. “[We strive] to operate as efficiently as possible,” so communicating with shippers and understanding their needs is paramount. “Are we ready? Absolutely. We plan year-round for it,” Kelly says.

THE “SWIFTIE EFFECT”

As for what’s shaping the parcel markets and causing the current imbalance between capacity and demand, there are several factors at play. Consumers, who already have homes full of hard goods, have shifted discretionary spending away from products to services, such as entertainment, restaurants, and travel, which ShipMatrix’s Jindel calls the “Swiftie effect.” At the same time, extra capacity added during the pandemic is now underutilized, forcing carriers to adjust and adapt.

FedEx is a good example, with its “Drive” initiative to cut costs, merge its ground and express pickup and delivery operations, and close underperforming locations as it rationalizes its global network. In a recent report, TD Cowen analyst Helane Becker wrote that “there is growing confidence that the turnaround plan has legs,” adding, “The company still has [its] work cut out for it, and investors ultimately remain in a ‘show me’ mode with management.”

UPS, on the other hand, now has a new Teamster labor contract in place, which, by the end of the agreement, will have drivers earning some $170,000 annually in wages and benefits. In the meantime, UPS is “aggressively” working to recapture, by ShipMatrix’s calculations, about 935,000 packages per day that were diverted to other carriers during the contract negotiations, with some 400,000 going to FedEx and the remainder to regional carriers and the U.S. Postal Service.

TOO MUCH CAPACITY, TOO FEW PARCELS

The market currently has capacity for some 110 million parcels per day, estimates ShipMatrix’s Jindel. “But it’s seeing demand for only 68 million. Demand is not growing, and capacity is. Amazon just added [capacity for] 2 million [parcels] a day by offering its network to independent shippers. That’s in direct competition to UPS and FedEx,” he notes. Regional parcel carriers, who mostly focus on business-to-consumer deliveries, also are implementing expansion plans intended to push them closer to nationwide coverage.

Then there is the U.S. Postal Service, which Jindel cites as the biggest contributor to the capacity glut. “They claim capacity for about 60 million parcels, but they are handling only about 25 million. They will do things to fill that [excess] capacity, and that will result in pricing actions,” he predicts.

Jindel adds that the Postal Service also has a built-in advantage. According to ShipMatrix data, 60% of parcels delivered to residences are under five pounds and can be placed in a mailbox. “The cost of delivery for an eight-ounce package to a mailbox is no greater than that of a large envelope of the same weight,” he explains. “The Postal Service could lower its rates for such parcels, which would force its competitors to respond or lose that volume.”

A GLUT … AND A DRIVER SHORTAGE?

John Janson, vice president of global logistics for branded-apparel distributor SanMar, thinks that the impact of the UPS contract and its high wages—along with regional carriers’ expansion plans and Amazon’s decision to open its network to all parcel shippers—may have one unintended consequence: creating a driver shortage.

“One of the challenges is that the new UPS contract will put pressure on the driver marketplace. How do other [regional and last-mile carriers] hire and retain talent when UPS is offering the wages it is? That puts pressure on FedEx, the regional players, and even Amazon for drivers,” he says.

Over the first six months of the year, as UPS’s negotiations with the Teamsters were ongoing, SanMar “stayed the course. We had contingency plans but did not divert any traffic,” Janson notes. Now as peak season has arrived, finding capacity isn’t an issue, Janson says, even for a company that ships over 100,000 parcels a night out of 10 U.S. distribution centers. “I don’t think there are any signs that the market is going to dramatically change over the next six to 12 months,” Janson adds. “It will be what it is today.”

He emphasizes that even in a loose-capacity market, carriers still are looking for every opportunity to add or recapture revenue, whether through rate increases, accessorial fees, or other charges—so logistics managers and planners must stay on top of their game. “Shippers have to be extra diligent; this is the battleground,” he says. “You need to be very aware of where your packages are going, what zone they are in, and if the package’s size or its delivery location will trigger extra costs.”

He cites as one example a recent update he received from UPS outlining changes to service times and fees for some rural ZIP codes. The communiqué said, “On the deferred days, UPS will not deliver or pick up in these postal codes—shipments to these postal codes will have an extra day in transit added to the delivery commitment time.”

Janson cites this as an example of a carrier moving the goal line on service—without any benefit to the shipper. “[Shipments to] 2,700 ZIP codes will now be a day slower and will potentially get hit with an accessorial fee,” he says. “Same lane, same pickup and delivery destination as last week, no added service benefit, yet they are generating more revenue simply by shifting ZIP codes into another category.”

WHAT PEAK SEASON?

While demand and volumes are down, some industry players still expect the industry to have a peak season, however muted it may be.

“I think we will continue to see a peak,” says Micheal McDonagh, president of parcel for AFS Logistics, a logistics services provider whose offerings include parcel management.

“We have always seen a peak. Certain holiday times, people just buy more, so I don’t see anything stopping that. It won’t be the peak we saw in 2021, but it will be in line with last year.”

RILA’s Dankert is also optimistic. “We expect a strong holiday season in terms of what retailers are planning for, depending on the vertical,” she says. “The numbers on consumer confidence are pretty good; consumers are still spending.”

And while it won’t be a “break the bank” peak season, Dankert says that in the past two years, retailers worked to clear out old inventory, so consumers faced fewer choices. Consequently, “there definitely is a hunger on the part of consumers [for] fresh merchandise,” she notes. “Retailers have heard that message and are responding to it,” which may provide somewhat of a silver lining for parcel carriers.

She says going into the end of the year, retailers are focusing on cementing their relationships with parcel carriers to ensure cost-effective service as well as on getting all of their internal ducks in a row. By that she means “having good communication and internal alignment among functional groups,” where the supply chain team is in lockstep with the marketing and sales, finance, purchasing, e-commerce, and product planning teams.

“That’s the foundation for accurate planning and forecasting, and it’s fundamental to efficient supply chain function, flow, and velocity,” she says. “Collaboration brings together the right people and right information to give your carriers the accurate forecasting information they need to plan their operations—and deliver the service retailers expect for their customers.”

BALANCING THE SCALES

With capacity and demand remaining out of balance, and as shippers revisit the rate increases they had to swallow over the past two years, “[shippers] have a one-time opportunity … to right the scales,” says ShipMatrix’s Jindel. “They need to look at their shipment characteristics and how and when they tender their parcels, and then determine who brings the greatest value at the lowest cost. That argues for putting your business out to bid—but doing it in a very analytical and strategic way, not just [focusing] on price.”

It’s more than just comparing freight charges, he says; it’s also about knowing and understanding what can be a confusing and complex list of accessorials and fees—all driven by the size, type, tender location and day, and travel distance of the parcel. On top of that, that assessment needs to include an internal examination of how the shipper’s parcel operations and management practices affect a carrier’s ability to service that traffic efficiently and make money on it, Jindel says.

The shipper is in the driver’s seat today, but that eventually will change, as it always does.

“This is a noteworthy peak season, especially since shippers have more flexibility and control,” says RILA’s Dankert. “It will be interesting to see how it all plays out, especially as shippers establish their benchmarks and strategies, and carriers respond to demand levels, adjust their networks, and look to counter shipper strategies through pricing, accessorials, fees, and how they deploy their assets.

“Shippers have a vested interest in maintaining carrier relationships that keep service consistent, capacity available, and parcel costs in check as they compete for the consumer’s dollar,” she concludes.