

# Your Guide to Investing in the Freight Transportation and Logistics Industry in the United States



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## I. Introduction

This Guide is meant to help foreign transportation and logistics companies (Investors) seeking to invest in the US industry. Generally, these Investors are trying to provide customers with efficient door-to-door shipping: from supplier to end user, from a foreign country to the US, or from the US to a foreign country. In this Guide, an investment can be a strategic agreement with a US company, formation of a new US company, a joint venture with another US investor or an acquisition of a US company.<sup>1</sup>

<sup>1</sup> This Guide does not address investment in publicly-traded US companies because many of the attractive US transportation and logistics companies are privately owned. If you are interested in acquiring a substantial interest in a publicly-traded company, please contact us, and we can provide you with that guidance.

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## II. Executive Summary

The transportation and logistics industry in the US is diverse and immense. The industry spans many different sectors (from trucking to rail intermodal, air freight, ocean and inland barge, warehouse and terminal services). US transportation companies can be asset-based or non-asset based and may have a national or regional strategy. The owners of these companies have different levels of sophistication and ideas of corporate success. It is critical that Investors understand the different characteristics of US transportation and logistics companies early in the process of considering investment.

The Investor must first assess its customers' needs to evaluate how they can be served by the potential investment. The Investor will need to determine what type of involvement, if any, by US management it prefers. This can be a major stumbling block for Investors, and it is a critical step in planning an investment. The Investor will also need to determine the type of return it is seeking from the investment. Hiring competent advisors will ensure that the Investor is able to navigate the insurance, legal and tax regimes in the US.

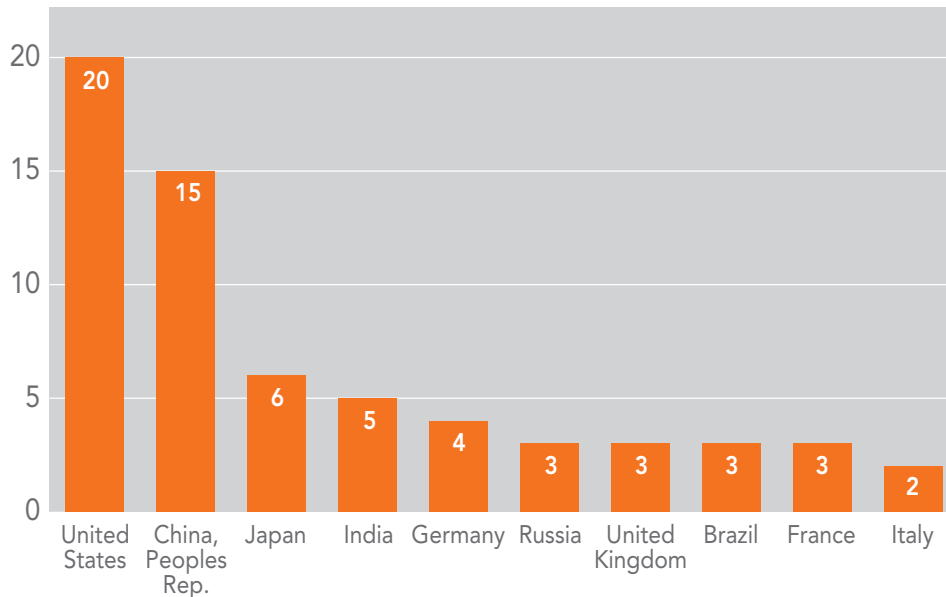
Finally, the Investor must settle on a particular investment vehicle. This Guide covers the four primary vehicles: agreements, a new wholly-owned business, joint ownership and acquisition. This Guide will explain that each of these investment types has its own advantages and disadvantages.

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### III. Background Information on the US Transportation and Logistics Industry

The US has the largest percentage of the world's gross domestic product (GDP), and there are thousands of transportation and logistics companies in the US.

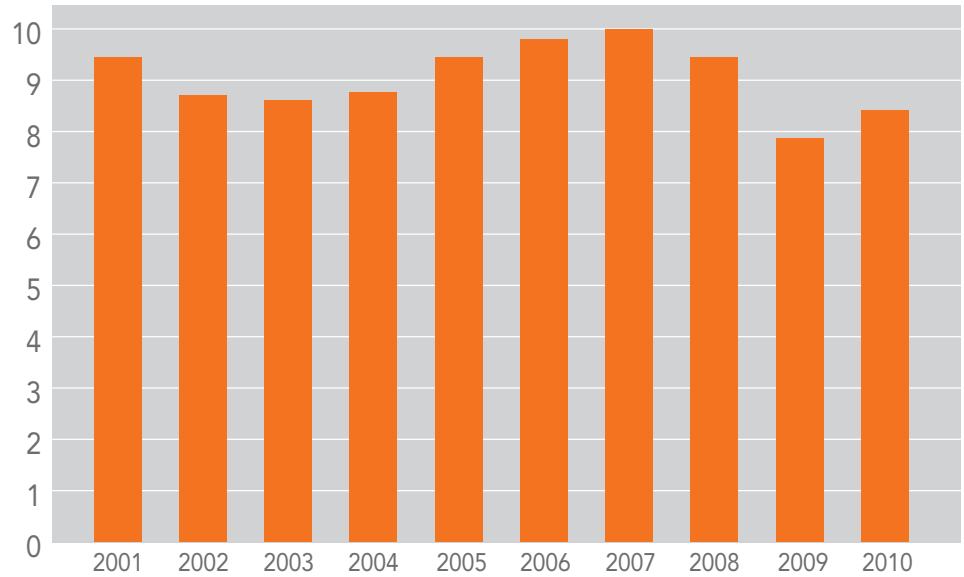
#### Top Countries by Percentage of World GDP



*Charts in this Guide are provided courtesy of Transportation Intermediaries Association.*

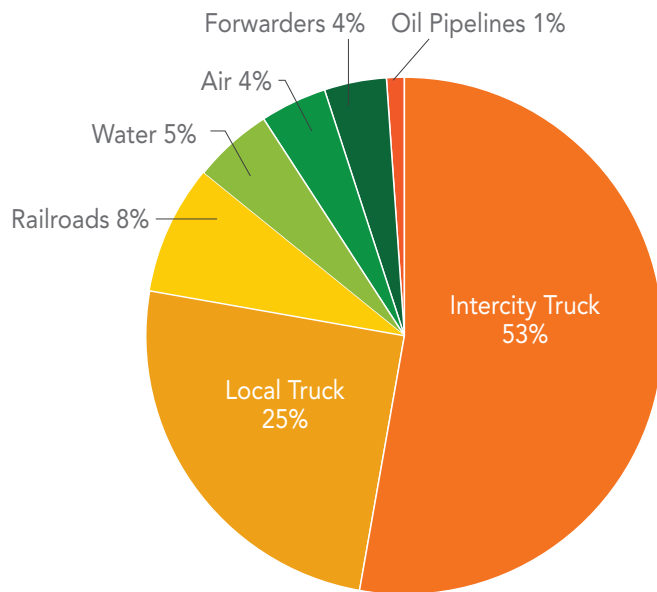
The US logistics industry accounted for 8.3% of the US GDP in 2010.

### US Logistics Cost: 8.3% of GDP



The breadth of the US industry is immense, and it is important that Investors familiarize themselves with the various characteristics of the US industry so that they can distinguish among potential investments.

### Transportation by Mode of Carrier (\$1,211 Billion)



## A. Industry Sectors

There are a variety of industry sectors that may interest Investors. These sectors include:

- Air freight
- Cold chain (refrigerated)
- Customs broker
- General commodities
- Heavy lift
- Inland barge
- Intermodal
- Port management
- Project cargo
- Sea freight
- Supply chain management
- Third party logistics
- Trucking
- Warehousing

A US transportation and logistics company could encompass several of these sectors or just one, depending on the company's size and complexity.

## B. Asset-Based or Non-Asset Based

The next way to characterize a US transportation and logistics company is by whether it is “asset-based” or “non-asset based.”

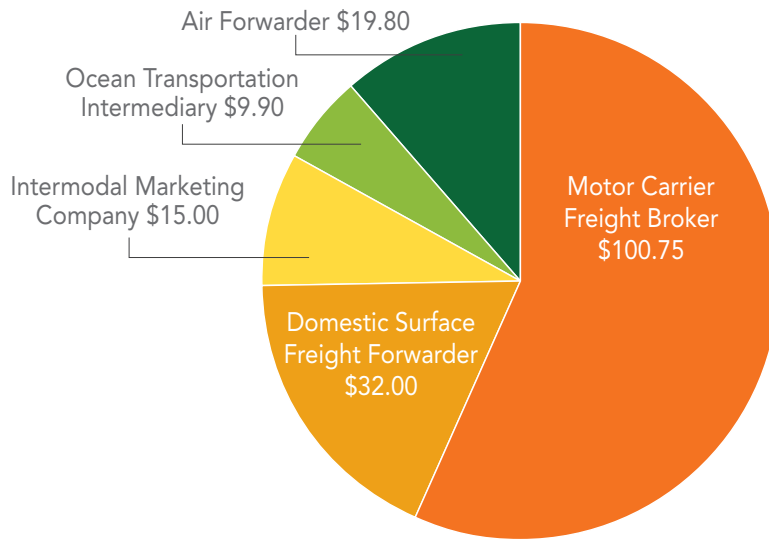
- *Asset-based*: has equipment, trucks, vessels, aircraft, rail cars, terminals and warehouses, perhaps other real estate.
- *Non-asset based*: includes for example, third party logistics companies, air or surface freight forwarders, intermodal marketing companies, domestic truck brokers, or non-vessel-operating common carriers (NVOCCs), which have few or no hard assets.

An *asset-based company* is often considered more substantial. If an Investor enters into a venture with an asset-based company, the Investor must conduct due diligence on the condition of the assets. If the Investor will obtain an ownership interest in the US company, it must determine whether the assets are owned or leased, and whether they are used as security for loans to the operating company. If the Investor will be an owner of an asset-based joint venture, the Investor will be required to maintain and upgrade the assets. Additionally, potential liability is greater in an asset-based company. A company operating transportation equipment can face serious third party liability if the human operators or the equipment causes harm to other parties.

A *non-asset based company*'s main value is often based on its relationships, clients, contracts, and goodwill, as well as information technology tailored to its customer base. An Investor needs to conduct due diligence on the financial health of those intangible assets. The non-asset based companies are often referred to as “third-party logistics companies” or “3PLs.”



## US Third-Party Logistics Providers (3PLs) = \$177.45 Billion



Either type of company may have developed or use state-of-the art software and intellectual property (IP) in its business, and therefore its legal right to use or own the IP should be checked by the Investor.

### **C. Types of Owners or Potential Business Partners**

There are many different types of owners or potential business partners that may be best for the Investor. Examples are:

- Single owner nearing retirement age, looking to sell an established business for cash and payment stream.
- Family-owned business looking to sell an established business for immediate cash. Some family members may seek to remain involved in the business after the acquisition.
- Young entrepreneur seeking to grow quickly by going into business with an Investor with financial resources and a long-term goal.
- Large company seeking to divest (spin off) a division or subsidiary that either does not fit with the large company's other businesses or is not performing well financially as part of the large company.
- Distressed company looking for fresh financing. The assets may be inexpensive, but Investors will need to be careful to minimize exposure to liability.

## D. Special Licenses or Relationships Required to Operate

Many US companies require access to particular licenses or relationships for success of the business. Transportation modes are often regulated by different government agencies that require their own licenses, bonds, and insurance. These licenses may not necessarily be transferable. This should be explored early to make sure time is not wasted on the wrong target company.

### US Regulation by Mode



#### **TRUCK [Department of Transportation (DOT)]**

- Trucking Companies
- Property Brokers
- Domestic Freight Forwarders



#### **RAIL [Surface Transportation Board (STB)]**

- Railroads
- Intermodal Marketing Companies



#### **OCEAN [Federal Maritime Commission (FMC)]**

- Ocean Carriers
- International Freight Forwards
- NVOCCs



#### **AIR [Transportation Security Administration (TSA) and DOT]**

- Air Carriers
- Air Forwarders

## **E. US Cities and Regions**

US companies generally employ a nationwide strategy or focus on one or more regions of the US. Possible locations include the following:

- Nationwide
- Baltimore/Norfolk/Mid-Atlantic US
- Chicago/Minneapolis/Upper Midwestern US/Great Lakes
- Denver/Rocky Mountain/Western US
- Florida/Southeastern US
- Los Angeles/Southern California/Southwestern US
- New York/Boston/Northeastern US
- San Francisco/Northern California/Northwestern US
- Seattle/Portland/Pacific Northwestern US
- St. Louis/Lower Midwestern US
- Texas/New Orleans/Gulf of Mexico Area

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## IV. Planning Your Investment

After familiarizing yourself with the nature of US transportation and logistics companies, an Investor should begin the process of considering investment in the US by focusing on four general categories of issues, as follows:

### A. Customers' Needs

The first step for the Investor is to analyze the needs of its customers for services at the US end of international movements of cargo. Customers' needs commonly include some or all of the following:

- Customs clearance
- Warehouse services
- Cargo tracking/supply chain management data
- Distribution internally within the US, including deconsolidation and local deliveries
- On-time and efficient delivery
- Cargo security
- Processing of payment against delivery of goods
- Multi-modal transportation (air, rail, truck, ocean or a combination of these modes)
- Specialized or project-specific services
- Ability to obtain compensation from carriers if loss or damage to cargo occurs (availability of adequate insurance)

## B. Degree of Involvement from US Management

Next, an Investor should consider how much involvement the Investor wants in a US business. *Does the Investor want to own and operate a US business or is the Investor comfortable relying upon the assistance of US management?*

An Investor should consider the following questions:

- Is the Investor most comfortable with, at least initially, establishing a contractual relationship with a US company, *e.g.*, a distribution agreement, sales representative or other agency agreement, or a cooperation agreement?
- Is the Investor willing to make an investment in a US company that will be managed by US management?
- Is the Investor seeking to form its own US company based on the Investor's unique business model?
- Is the Investor seeking to acquire a US company that will be operated by foreign management?

Related closely to each of these questions is the Investor's tolerance for risk, primarily the potential exposure to liability in the US. The US business culture is known to be very litigious, and it is common for US businesses to make and defend against claims that may end in court or arbitration. An Investor should consider risk management and insurance issues and costs in connection with its analysis of involvement in a US joint venture.

## C. Desired Qualities of Potential Investment Targets in the US

Collaboration and the meeting of each other's expectations is often the single biggest source of frustration between parties. If an Investor seeks to rely on US management of the US operations, the Investor should determine whether the potential investment target in the US has the skills, experience, and willingness to adapt its business operations to meet the needs of the Investor, the Investor's business culture, and the Investor's customers.

The required collaboration is mutual: Investors need to work to understand the customs and traits of US businesses; and US businesses need to understand the customs and traits of foreign Investors. Each side must work to meet and manage the expectations of the other side. This requires the right personnel and clear communication. Face-to-face discussions and confirming memoranda can ensure that parties do not leave the same meeting with different understandings of what was agreed.

Once the Investor is satisfied that the potential investment target will be a good partner, the Investor should consider the following questions:

*What type of financial return or benefit is sought?*

The answers to this question will depend on the form of investment. For example, if the investment takes the form of a simple contractual agreement with a US company, then the Investor's direct interest will be the Investor's own revenue and not the revenue of the US company. If the Investor acquires an ownership interest in the US company, then the Investor will have an interest in increasing the profit of the US company.

The varying goals can be:

- For the US operations and/or US company to have US services and operations that can complement the Investor's services offered to foreign customers in foreign countries.
- For the Investor to generate cash from US operations.
- For the US company to generate cash from its operations, perhaps even for use in future US investments.
- For there to be an increase in the enterprise value of the US company, rather than cash flow from operations.

*What is the size of the target company or companies?*

- Approximate revenue (this can range from \$5 million to \$500 million or more.)
- Approximate number of employees (this can range from 5-10 to more than one thousand.)

*Examples of companies that may be good targets in different sizes and stages of development:*

- A small company that has little revenue but has state-of-the-art technology and strong, active management.
- A mid-size company that has grown as large as possible given current financial resources but is ready to expand with new financing and management.
- An established company (of any size) that has a good network of reliable customers and contacts but aging technology and is in need of new financing, new management, new spirit, and new sources of potential business.

## **D. Competent Advisors**

An Investor should identify and hire competent business, financial, legal, and accounting advisors to assist in choosing and executing joint ventures. Industry experts can help the Investor identify potential targets, review their suitability for investment, and assist in opening discussions with the targets. Legal experts can help an Investor avoid obstacles and pitfalls the Investor will face in a legal environment very different from the foreign legal environment. Financial and accounting experts can help identify unseen value or hidden financial liabilities.



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## V. Four Models of Private Company Ventures

Generally, there are four primary models for ventures in the US:

- Agreement with existing US business
- Establishment of a new wholly-owned business
- Joint ownership
- Acquisition of existing US business

There are advantages (“pros”) and disadvantages (“cons”) to each model. The importance of each pro and con will vary from transaction to transaction.

### A. Agreement

Under this model, the Investor enters into agreements with US companies for a fixed period to work together. The agreements can take numerous forms and names. The most common forms are: mutual cooperation agreements (where the parties will agree to cooperate to arrange transportation and handle cargo within their respective countries or regions); agency agreements; subcontracting agreements; distribution agreements; and connecting carrier agreements.

#### Pros

- Each party confines its operations and contributions to the areas where it has the strongest presence and greatest expertise.
- Each party carries its own risk.

#### Cons

- The business relationship does not involve any financial integration and can be easily terminated if either party decides that it has better opportunities elsewhere or with others.
- The Investor does not create direct relationships with the customers of the other contract party.

## B. Establishment of a New Wholly Owned Business

Under this model, Investor starts a new US company as a wholly-owned subsidiary. Investor begins operations from nothing and grows using its own efforts.

### Pros

- Good model if the foreign company has a popular brand name and a unique business model or operation (*e.g.*, McDonald's) that it wants to pursue without interference from other parties.
- Also good if it has the right people with the right experience to lead that operation and wants to avoid acquiring problems of an existing company.

### Cons

- Requires self-sufficient financial resources, a commitment to learn new market on its own, the ability to hire good local managers, and patience for business to grow.
- The Investor must learn, on its own, how to operate using a foreign language in a foreign culture.

## C. Joint Ownership

There are two main types:

- Investor acquires equity in an *existing* US company.
- Investor and existing US company form a *new* jointly-owned company.

### Pros

- Investor can begin in the US with a strategic US partner who knows the US business practices for the industry.
- US partner may be able to share expenses and risks with Investor and offer capabilities that complement those of Investor.

### Cons

- Investor must share management and revenue with the US company and is at risk if US company pursues interests separate from Investor's interests.
- If Investor wants to grow and become independent, Investor will need to buy out the US company.

## D. Acquisition

There are several types of acquisitions. To keep this Guide simple, three types are described here: strategic single acquisition; strategic multiple acquisitions; and the “roll up.”

### **Strategic Single Acquisition**

Investor acquires all or a controlling portion of a single US company and expands that US company to grow revenue and market share. Sometimes key assets of a company will be acquired instead of the whole business, in what is called an “asset acquisition.” The assets are typically transferred into an entity specially formed to hold such assets as a separate business enterprise.

#### **Pros**

- Focusing on one company is less complex and may not be expensive.
- Investor may use this as the chance to get an introduction to the US market.
- Investor gains an operating business from day one.

#### **Cons**

- The single US company may be limited in its business scope and growth potential.
- Investor may be taking on the problems of existing business.
- Changing the corporate culture of the target to conform with Investor’s other operations may be difficult.
- Revenue potential may be limited.

### **Strategic Multiple Acquisitions**

Investor acquires all or a controlling portion of a small number of US companies to create an affiliated group of companies, then expands all or some of them to grow revenue and market share. Investor can use one of the companies as the main company (called the “platform company”) or can form a holding company to oversee the multiple operating companies.

#### **Pros**

- Buying multiple established companies gives Investor a foothold in multiple sectors.
- If the companies can be meshed together, then the resulting operations may greatly expand Investor’s operational capacity and growth potential.

#### **Cons**

- This model requires a strong US management team to oversee the acquisitions.
- With each acquisition, the potential for local operational problems and risks increases.
- It may not be easy to tie the companies together.
- Each acquisition increases the cost of the venture.

## “Roll Up”

This is similar to the strategic multiple acquisitions type above, but is pursued on a bigger scale and in accordance with a particular strategy to grow quickly by a series of acquisitions. In this type, Investor picks a trusted manager or management team with expertise in the transportation and logistics industry to identify specific targets. Investor provides financing to allow the manager to make acquisitions and integrate the acquired companies into one or two larger companies. The roll up can begin with the acquisition of one established company that will be the “platform company” for the roll up, or Investor can use a holding company to manage the multiple operating companies that it acquires and combines.

### Pros

- Buying many established companies in a series of acquisitions in accordance with a specific plan would allow Investor to grow and gain a market share quickly.
- Investor can gain value by reducing costs, yet expanding business, if Investor’s management team is expert at combining the multiple operations, finding more efficient ways to operate, and cut costs.

### Cons

- A roll up can be very expensive and can be hurt by bad acquisitions with an unskilled management team.
- Investor will not be in control of the acquisitions and operations, if Investor uses a local management team.
- Combining the companies can be difficult.
- If the targeted industry sectors are not growing, then the rolled up company may not have enough business to justify the acquisition costs.
- With each acquisition, the potential for local operational problems and risks increases.
- Each acquisition increases the cost of the joint venture.

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## **VI. Conclusion/Next Steps**

As this Guide shows, a foreign company seeking to enter the US market to expand its transportation capacities should conduct an analysis to determine: (a) the nature of the US transportation and logistics industry; (b) the needs of the foreign company's customers; (c) the method of market entry; and (d) the best advisors to help the foreign company achieve its goals. We hope the questions and information in this Guide will provide an initial framework for planning.



Garvey Schubert Barer (GSB) has assisted international ventures in the transportation and logistics industry for more than forty years. The firm is especially proud that one of its founders helped to negotiate the opening of maritime trade between the US and the People's Republic of China. Today, through its representation of both individual companies and trade associations, GSB has a broad network of relationships in the transportation and logistics industry in the US, Canada and around the globe.

For additional information, please contact any of the following:

**Richard D. Gluck**

Washington, D.C.

202-298-1786

[rgluck@gsblaw.com](mailto:rgluck@gsblaw.com)

**Sara P. Sandford**

Seattle

206-816-1464

[ssandford@gsblaw.com](mailto:ssandford@gsblaw.com)

**Leo C. Peng**

Beijing

86-10-8529-9880

[lpeng@gsblaw.com](mailto:lpeng@gsblaw.com)



[gsblaw.com](http://gsblaw.com)