Analysis of Financial Strategies of 3PL Companies in the GCC

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ABSTRACT

This article aims to analyze the financial strategy of publicly listed third party logistics (3PL) companies in the GCC over a period of four years (2010–2013). It evaluates the financial strategies employed by 3PL companies under consideration and subsequent value generation and wealth maximization for their shareholders. A comparison of financial strategies adopted by 3PL companies in the GCC countries reveals that all three companies included in the authors’ sample use different financial strategies; however, these strategies are effective in yielding greater returns on common equity. The article highlights the importance of investing and financing decision for equity providers, an area which has received less importance in the logistics literature.

KEYWORDS

Dividends, Financial Strategies, Financing, Investing, Reformulated Financial Statements, Return on Common Equity, Third Party Logistics, Wealth Maximization

INTRODUCTION

The purpose of this article is to appraise the financial strategies and outcomes of their execution in selected publicly listed 3PL firms in the GCC. The study employs an alternative analysis technique, reformulation of financial statements, which provides detailed insight into the mechanisms for sales and earnings growth, and the impact of operating and financing activities on shareholders.

Globalization has led to amplify trade volumes across regions; subsequently, efficient value chains and networks have become inevitable to enhance the profitability of organizations, which in turn has amplified the importance of transportation and logistics industries (Hesse and Rodrigue, 2006). Anderson et al. (1997) suggest that superior logistics performance leads to lower costs, better utilization of assets and high profitability. Effective and superior logistics functions allow companies to respond to changing consumer needs promptly, subsequently leading to greater profitability (Ellinger et al., 2000; Mitra and Singhal, 2008; Rajesh et al., 2012) and sustainable competitive advantage (Sandberg, 2013; Mellat-Parast and Spillan, 2014). Veljovic (2010) argues that there is a strong move towards outsourcing of logistics, as companies focus their efforts on their core competencies, cost cutting in relation to employees and efficient use of resources.

Berglund et al. (1999) comprehensively defined Third Party Logistics (3PL) as “activities carried out by a logistics service provider on behalf of a shipper and consisting of at least management and execution of transportation and warehousing. In addition, other activities can be included, for example, inventory management, information related activities, such as tracking and tracing, value

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added activities, such as secondary assembly and installation of products, or even supply chain management.” (p. 59).

The literature identifies that the competitive advantage of 3PL companies lies in the resources they own due to their capital intensive nature. Wong and Karia (2010) used the Resource Based View (RBV) to evaluate the competitive advantage of 3PL companies in the US and suggested that despite having ample physical, human, information, knowledge and relational resources, the financial performance of these 3PL companies has not been superior.

The logistics industry is capital intensive, and the competitive advantage of logistics companies lies in the fixed and long-term assets they own. These fixed and inflexible assets comprise a large proportion of assets of logistics companies (Hoffman and Lampe, 2013). These assets can either be financed through debt or equity, and poor investment decisions lead to poor financial performance. Potential investors, primarily equity providers, may opt to provide capital if the return on their capital is sufficient.

The financial strategy entails capital budgeting, financing, and dividend decisions. Formulation and execution of an appropriate financial strategy determine the success of any business venture. It has a direct link with its superior performance, which in turn increases the value of the firm and maximizes shareholder wealth. Hence, there is a need to evaluate the financial strategies that the public listed 3PL firms employ to achieve the purpose of their existence, that is, shareholders’ wealth maximization.

While the analysis of financial performance of companies belonging to various sectors is abundantly available in the literature, financial performance analysis of 3PL companies is surprisingly missing from both accounting and finance, and supply chain literature. To our knowledge, there is no literature available on the financial performance and financial strategy analysis of 3PL companies except Hoffman and Lampe (2013). The authors evaluated only one aspect of financial strategy, that is capital structure, of 150 listed logistics providers around the world, which were found to be largely homogenous. Also, the GCC logistics industry remains largely neglected in the literature. This study will attempt to provide some insight on a neglected financial aspect and region concerning 3PL providers.

**Background of Logistic Industry in the GCC**

The GCC countries are well positioned to act as a trading hub between east and west (Economic Intelligence Report, 2011). Moreover, the governments are focusing on diversifying their economies and preparing for the post oil era. These countries can benefit greatly in trade and logistics due to their strategic location. Accordingly, the governments have opted to invest heavily into improving infrastructure to support the logistics industry (Al Masah Capital, 2015).

This has resulted in improved rankings and scores on the Logistics Performance Index (LPI). It is evident from Table 1 that the LPI ranks of some of the GCC countries have improved gradually since 2007. Currently, the UAE ranks the highest amongst the GCC counterparts. Qatar exhibited a great improvement in ranking from 2010 to 2012, while Saudi Arabia’s ranking improved marginally. The ranking of the other three GCC countries Kuwait, Oman, and Bahrain have declined considerably. However, the decline in rankings may not be a sign of deterioration; however, they may suggest that the other countries in the sample have improved significantly and the above-mentioned countries have not invested enough in improvements.
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