FEDERAL EXPRESS'S BATTLE OVERSEAS The world's biggest air freight carrier rushed to go global but so far is losing big money on the effort. Even so, nobody's ready to write off the folks from Memphis yet.

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(FORTUNE Magazine) – WHEN Federal Express bought the legendary Flying Tigers international air freight operation last year for $883 million, it seemed as though the company had cemented the capstone on a strategy to turn itself into a global carrier. Tigers, FedEx management opined, provided the key international connection to link North America and a web of freight and package companies that FedEx has picked up around the globe since 1984. The Tigers acquisition also brought with it unrestricted cargo landing rights at three Japanese airports, including Tokyo's, and a heavy-freight business that overnight turned FedEx into the world's biggest air cargo outfit. The company's long-term plan: to reach beyond the U.S. market, where its growth was slowing after 17 years, and build new markets overseas. What happened next is a lesson for all managers with dreams of going global. A product that sells well in the U.S. carries no guarantees in alien markets. And while you're busy trying to make your domestic magic work overseas, your competitors may well come charging in to steal customers from under your nose, as FedEx is finding out. The Flying Tigers has become an albatross around the Memphis company's neck. Even though FedEx's international revenues have more than doubled since 1989, losses are piling up, reaching $194 million for the fiscal year ended May 31, 1990. Security analysts say international losses could exceed $200 million in 1991. They say about 50% of that will come from Tigers, the other 50% from continuing losses from earlier acquisitions. FedEx's net earnings are taking a severe drubbing as a result. They fell 37% to $115.7 million in 1990. Some analysts expect an upturn in 1991, helped by bigger U.S. profits. Tell it to United Parcel Service, DHL International, and other overnight delivery companies, whose overseas strategies are on a collision course with FedEx's. Even in heavy cargo, Flying Tigers' new parent faces competition. Many major airlines, including U.S. carriers, want a bigger piece of the international freight business -- and they have a distinct competitive edge: Passengers pay most of the costs of the flights while cargo gets a relatively cheap ride under their feet in the plane's belly. Says William R. Boesch, president of American Airlines' cargo division: "Passengers won't ride in the basement. So I have excess capacity, and that's how I price the cargo." Another major challenge for FedEx: its fragile relationship with freight forwarders, the agents around the world that handle customs, local delivery, and most of the paperwork on goods in transit -- and select which airline freight will be shipped on. Some forwarders claim FedEx is trying to put them out of business. Small wonder that when security analysts gathered in October for their first big meeting with Federal Express in three years, some hoped that CEO Fred Smith, 46, would pull a rabbit out of his hat. Smith didn't. He admitted problems and was upbeat about the company's future. But he did not say when FedEx would make money overseas. Smith also criticized his critics, complaining of "negative media coverage" and "skeptical analysts." Said he: "They were all there in the Seventies, and they're back today. We stayed - the course then and made it to the promised land. We're going to stay the course again now." The ranks of those who left the meeting as worried about international losses as when they arrived include Paul Schlesinger, a transportation analyst at Donaldson Lufkin & Jenrette: "They've got an enormous amount of work and risk ahead of them. I just question whether they're going to run out of money." Smith has proved skeptics wrong before, convincing a U.S. market of the need for -- as the ads have it -- an absolutely positively overnight delivery. Today, FedEx has a 55% share of the domestic overnight letter market and 33% for overnight packages, making it a clear leader over No. 2 UPS in the business. Hoping to duplicate that kind of market dominance overseas, FedEx began to go international in 1984. It bought Gelco Express, a Minneapolis package courier firm that served 84 countries. Other acquisitions followed as FedEx assembled its global parts in such diverse nations as Britain, Holland, and the United Arab Emirates. Saul Steinberg, a financier who had a 16.5% stake in Tiger International, Tigers' parent, approached FedEx in December 1988 and said the whole company was for sale. FedEx executives saw Tigers as the way to truly globalize its delivery systems and moved fast. Three weeks later they bought it. Did FedEx move too quickly -- or pay too much? One reason for haste was to beat UPS, which FedEx feared would buy Tigers and the international entree it promised. UPS now says it had looked at Tigers earlier but passed. Some analysts believe that FedEx paid too much, particularly since some of the planes needed fast repair work to meet Federal Aviation Administration maintenance deadlines -- as FedEx soon discovered. The acquisition gave FedEx 6,500 Tiger employees to add to its own 65,000, and 39 cargo jets, pushing its fleet to 151 aircraft. Merging all that into a single operation soaked up about $100 million in fiscal 1990. Of that, some went to repair fuselage corrosion, make structural repairs, and otherwise bring the Tigers' fleet up to U.S. requirements. The company negotiated a single seniority list for FedEx's 1,000 pilots and Tigers' 970, but an excess of pilots, some just sitting around, added to the merger cost. So did a drop in the international freight market. One positive: A degree of peace has been achieved between FedEx's mainly non-unionized but bureaucratic corporate culture and Tigers', which was unionized but freewheeling.

The brightest jewel in the Tigers acquisition may be its international landing rights. Analysts such as William Clarke, a senior associate of Airline Economics, a consulting firm, say these alone were worth the price FedEx paid for the carrier. Before, FedEx had five foreign slots: Montreal, Toronto, Brussels, London, and Tokyo. But the Tokyo slot was limited: FedEx couldn't use Tokyo as a jumping-off spot for anywhere else in Asia. Now it can, since Tigers had such rights. Says James Barksdale, FedEx's chief operating officer: "We realized that if we wanted to be dependable overseas, we had to fly our own routes. Flying on other people's planes just doesn't work as well. We were looking for a solution, and Flying Tigers was it." Like CEO Smith, Barksdale declines to say when he thinks international operations might make a profit. But he's also just as ready to talk about the past: "All those who used to say the good ol' days around here were great -- now we're able to tell them that this is what the good ol' days were like." In one respect in particular, the struggle will evoke the 1970s, when FedEx had to awaken the American public to the value of overnight delivery. It took several years. Says Thomas Oliver, 49, FedEx's hands-on VP for international operations: "We didn't make money in the U.S. until we were over 25,000 pieces in 1976. None of our regions outside the U.S. have come close to that number yet, and in a nutshell that is why they lose money. Europeans think that three-day delivery is very reasonable." Now he'll try to wake them up. Oliver promises a lot of advertising and door-knocking in that market. The hope is that as Europeans go more global they'll see the competitive need for overnight delivery of parts and equipment. BUT THESE SAME Europeans won't necessarily pick FedEx as their carrier. Instead they might choose DHL International, which is headquartered in Brussels. It is the market leader for air express delivery of small packages around the world, serving 188 countries with 190 airplanes. After FedEx announced its Tigers acquisition, DHL decided to broaden its international base too. It made a deal with Lufthansa and Japan Airlines, whereby the two companies would purchase 5% of DHL with an option to buy up to 25% each. The extra cash -- and the availability of space on the two national airlines when needed -- will put DHL in good shape to maintain its lead. UPS is also trying to land more foreign business. Last year it increased ! from 41 to more than 150 the number of countries it serves. Big Brown bought Seabourne European Express Parcels in Brussels and plans for a pan-European express trucking business to provide ground transportation. Recently UPS obtained rights to fly six times a week into Tokyo. Says Donald W. Layden, UPS senior VP for international operations: "We have about all the geographic expansion we want and will begin developing the express delivery market." In Asia the Japanese are overnight delivery enthusiasts; customers in other countries have yet to be convinced. FEDEX HAS ALSO developed a nettlesome competitor in international freight forwarders. Here's the problem: Tigers used to be like most freight outfits. It flew airport to airport and let independent freight forwarders handle local logistics -- just the sort of things that FedEx does on its own in its small-package operation. Forwarders worry that FedEx will take away their business. Rather than further offending these agents, whose influence on overseas customers is big, FedEx has guaranteed it would only go after packages weighing less than 150 pounds and use its own couriers and customs- clearing devices to handle them. The forwarders would get the business for anything heavier. FedEx says the compromise settles the issue. But many forwarders suspect the boys from Memphis will gradually raise the weight limit and steal their business. The forwarders argue that tossing them cargo over 150 pounds is a lean bone, given that the average package they handle weighs about 50 pounds. Says Thomas Heinz of Switzerland's Jacky Maeder, a leading European freight forwarder: "We feel the limit should be about 30 pounds. We are definitely in competition with them in that range." FedEx's Barksdale says he won't back down. "If we run a more reliable airline, it's still to the forwarders' advantage to use us," he says. "They'll sit back and complain that they don't know what Federal Express may do, but day in and day out our relationship is good." Maybe that was so when capacity was tight, particularly on Pacific routes. But now traffic is down, and some planes have been flying partly empty. "On some Pacific routes there wasn't an alternative to FedEx a year ago," says Airline Economics' Clarke. "With the softening traffic, competitors now have an alternative." Indeed, several forwarders say they are now using several airlines to ship goods, when just a few years ago they primarily used Tigers. "It's not that + we won't use FedEx," says one forwarder. "We just don't want all our eggs in one basket any longer." COMPETITORS are happy to tweak FedEx over the problems it has with the forwarders. In the October issue of the Air Cargo Guide, an industry reference, Northwest ran a full-page advertisement aimed at freight forwarders that showed a picture of a white picket fence. "How long do you think FedEx can sit here?" the text read. "Sooner or later they'll have to decide: you or your customer. Are you willing to bet your business they choose you? That's why you should always switch to a carrier who has always been on your side. Northwest Cargo." Says David Behrends, VP for Northwest's cargo operation: "We have to take advantage of what there is to take advantage of, and we did that. About 90% of our business in the Pacific is done through agents. We want them to know that we don't have any problem determining who our partner is. It's the agent." For all Fred Smith's problems, nobody is ready to write off his company. For one thing, he could still sell enough of the Flying Tigers to slow his ongoing losses. Even competitors concede that Smith's entrepreneurial drive, which created the very overnight delivery system they now want to supplant, is as fresh as ever. So is his vision: In his October remarks to the analysts, Smith observed, "It is an inescapable fact that the U.S. economy is becoming much more like the European and Asian economies, entirely tied to global trade." A lesson he might have learned, however, is that European and Asian companies sometimes move more deliberately in the race to dominate an industry worldwide.

CHART: NOT AVAILABLE CREDIT: SOURCE: FEDERAL EXPRESS CAPTION: ABROAD, FED EX LOSES MORE AS IT GROWS Despite the losses, some say Flying Tigers' international rights cover the price of the acquisition.

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