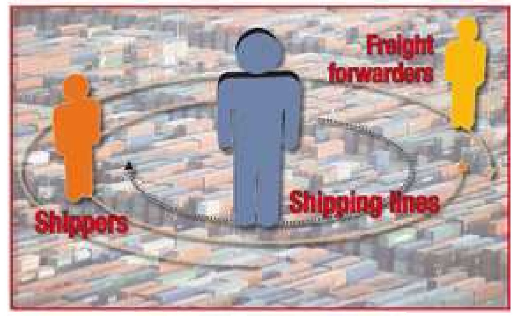
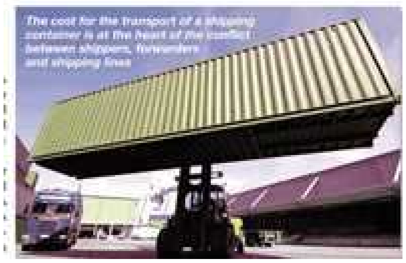
e-Cargonews Asia

November 01, 2010

Tight capacity and high rates ensure shipper-line friction





Commercial relationships between shippers, carriers and freight forwarders need to be reorganised and realigned during the coming years to ensure smooth transit of containerised shipping, says Mark Millar, managing director of M Power Associates, a provider of industry-specific marketing, consulting and education services, in an analysis of the current situation in the shipping industry A recent survey by Eyefortransport revealed that 55 percent of shippers expect to be able to continue paying the reduced freight rates they negotiated during the recession. However, the same survey revealed that only 14 percent of carriers expected to be able to maintain such low prices. This huge discrepancy in expectations is another confirmation of the tension in the shipping industry. At industry events this year, shippers have been complaining about carriers raising rates and imposing surcharges while restricting capacity and the carriers have been complaining that shippers have unrealistic expectations of post-recession rates. Post-boom blues Until mid-2008, container shipping lines had enjoyed continuing growth for a number of years. Container volumes continued increasing, freight rates were healthy and the carriers confidently ordered more new ships with even greater capacity. As the financial crisis hit, consumer confidence in Europe and the US crumbled and Asia exports plunged. Manufacturers had less volume to ship and suddenly ships were sailing well-under capacity. With volume demand falling, there was pressure on unit rates while additional new capacity was coming into the market - a potent combination. As carriers adjusted to the situation, hundreds of container ships were idled and rates were slashed to compete for the diminishing amount of business. Schedules were altered and slow steaming introduced in order to reduce costs. Uncertainty arising from the economic crisis resulted in brutally competitive pricing in the midst of unfulfilled commitments on volume and space, thereby putting enormous strain on even the best of relationships in the fight for survival. The shippers enjoyed unprecedented low rates throughout 2009 and naturally wanted rates to stay that low. Now that the green shoots of recovery are building confidence, more cargo is being shipped. However, with so many container ships still laid up, volume increases in January and February resulted in capacity shortages with the container rates rising once more while cost-saving slow-steaming practices extended transport transit times. Shippers' view From the shippers' corner, the latest complaints are aimed at carriers for keeping capacity idled even though demand increased and reducing service levels through less frequent port calls and slow steaming and at the same time increasing rates and imposing surcharges. Carriers say lines are using creative terminology - over and above regular seasonal adjustments such as general rate increase and peak season surcharges - such as "emergency revenue charge", an "extraordinary surcharge" and an "emergency bunker charge" to impose further rate increases. The numerous charges created a complex and confusing situation, making it challenging for shippers to compare rates and being unable to predict freight costs. Shippers are calling for more of the laid-up vessels to be brought back into service and for surcharges and rate rises to cease. They feel they are being forced to pay higher rates for poorer service. Carriers' complaints The carriers grumble that shippers are being unrealistic and do not appreciate the difficulties faced by the container shipping industry. New capacity is due to come on-stream and hence there is reluctance to reinstate idled capacity - even though volumes have increased. Slow steaming initiatives not only reduce fuel costs, but also slow down the transit time, reconfiguring trade lane networks. Fewer vessels in service has resulted in reduced port calls on many routes. Carriers noted that during the recession in the frantic battle to keep some cargo on ships, the rates were reduced to unsustainable levels so much so that the top 20 container lines lost over US$12 billion in 2009, with the industry leader alone reporting losses of over $1 billion. The situation was clearly untenable and it is surprising that there have been no bankruptcies among the major carriers. They had to continually adjust price and capacity in relation to demand. However, the carriers should recognise that it was they who had reduced the rates to such unsustainable levels - and as it turns out, the ensuing price war has helped nobody and hurt everybody. Stuck in the middle Freight forwarders have been caught in the middle of this rumbling disagreement. One senior executive of a global forwarder said they are unhappy with continually being in the crossfire. With rates fluctuating wildly, schedules altering frequently, transit times changing due to slow steaming and increasing volume demand putting strains on restricted supply, the freight forwarders have been continually re-negotiating space, price and service agreements with their carriers and their shippers - putting a strain on relationships. The senior executive also said that freight forwarders are unhappy with both the carriers and the shippers for business activities that undermine the forwarder's role. The term "partnership" has been overused, with the struggle for survival taking precedent over agreements, he said. Carriers are encroaching on some of the freight forwarders' business and shippers are negotiating contracts directly with the carriers, he added. Direct contracts About 10 years ago, only companies moving more than 10,000 containers per year would have a direct contract with the shipping lines - space and price negotiations being directly agreed and contracted between carrier and shipper. These days, shippers with volumes as low as 500 containers, are entering into direct contracts with carriers, thus to an extent bypassing the wholesaler role of the freight forwarder. This has put a strain on traditional relationships between shippers and freight forwarders because their customers are choosing to deal directly with their suppliers in a bid to save costs and cut out the middleman. Many of the shipping lines have also established their own freight forwarding and logistics units to negotiate with shippers, thus bypassing the forwarders. The traditional tri-partite structure of the industry - shipper, forwarder and carrier - is coming under increasing threat. The way forward The industry is now in a tense situation - adversarial relationships, combative negotiations and plenty of friction. Containerised shipping moves over 90 per cent of global trade, so all the parties involved need to find ways to work together. We could see a re-organisation and re-alignment of commercial relationships between shippers, carriers and freight forwarders during the coming 24 months depending on how the economy recovers through 2011. All three constituent groups need to diligently review and reconsider their arrangements with their business partners and make conscious choices - on a case-by-case basis - between "strategic" and "transactional" relationships. There will likely be more transactional business, with the various buyers and sellers shopping around on a more ad hoc basis, expanding the size of the spot market, but with all parties having a clearer understanding of the purely transactional nature of these deals. There will also be some re-alignment within the strategic relationships, resulting from the enormous strains induced by the economic crisis. We see various major shippers reconfiguring their allegiances with forwarders and likewise some major forwarders realigning their commitments with carriers. In the major account sector, companies will likely get more selective about who they work with - suppliers and customers - and be very clear with their business partners about the nature of their relationship and related future expectations and responsibilities, both in good and bad times. The global economic crisis has exacerbated tensions to create this adversarial environment in the industry. The volatile supply and demand situation will not greatly change until later this year, when we should see some steady economic recovery on a global basis and therefore some stability in the markets. This will enable more predictable demand, leading to better balanced supply, improving equilibrium in the market, enabling those that have survived the crisis to settle down into their new relationships - whether they be transactional or strategic.