

MANAGEMENT OF OVER CAPACITY – NEW CHALLENGE FOR LINER TRADE

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Abstract

Maritime transport is the backbone of international trade and a key engine driving globalization. Around 80% of global trade by volume and 70% by value is carried by sea. International seaborne trade grows and falls in tandem with the developments in world economy and global merchandise trade.

But even this giant of an Enterprise is having severe problems that are easy to detect but difficult to arrest- that is the problem of over-capacity coupled with shrinking demand and falling tariff rates.

The Companies adopt various strategies to stem this tide. This paper covers the general measures taken by the liners for matching the oversupply to the volatile demand.

Key words: Liner Trade, Demand, Supply, TEU, Carrier, Economies of Scale, Triple – E, Order book, Slow steaming, Tonnage , Alliance, Knots

Introduction

As per the UNCTAD report of 2011, the world fleet tonnage grew at about 10% against the 4% growth rate of global seaborne trade, as the ship owners continued to take delivery of the vessels ordered prior to the economic crisis. In line with above trend, container trade also decelerated to 7.1% in 2011, down from 12.8% in 2010, whereas the tonnage grew at 7.7% to make up 12.9% of the world tonnage (Source: UNCTAD's Maritime Review Report 2012). As the supply, i.e., the vessel capacity, outstripped the demand, ie, the shipped volume & the freight rate fell to unprofitable levels for most Liners in 2011-2012.

As a consequence of the continued oversupply of tonnage in 2012, the fleet capacity and freight rates fluctuated so violently that even the high profit making lines plummeted into heavy losses. The investment in large capacity ships accelerated competition among liners to the extent that they were even willing to accept freight rates below or close to operating cost. According to Drewry Maritime research,

container shipping sector made an estimated collective loss of USD 6 billion in 2011! The financial status of the container liners were not so positive in 2012 too, as many lines reported financial losses in the first quarters of 2012.

Carriers have invested in ever larger ships to benefit from economies of scale which in turn add to the general oversupply of capacity and put further downward pressure on freight rates. Lines are taking different approaches to confront the oversupply and the worsened financial performances.

1. Regulate New Orders to check on Capacity Growth

The world fleet continued to expand to reach 1,534 million dwt. in January 2012. However the drastic downturn in new orders due to the world economic crisis has led to a reduction in the world order book by one third during the 2008-2012 period. The order book in early 2012 is down to approximately 21% of the existing fleet tonnage compared to 44% four years earlier.

According to Clarksons, container ship on order is 3.5 million TEU which is equivalent to 22% of the current fleet. This is still relatively large but the figure has come down significantly from the year 2008 (1209 new orders) to 2011 (602 new orders). Nevertheless, the order book for container ships actually increased between the period of end 2010 (566 orders) to end

2011(602 orders) as some of the leading container liners placed new orders for ships above 10,000 TEU in the quest for economies of scale and cost reduction. The following figure shows the trend in order book position.

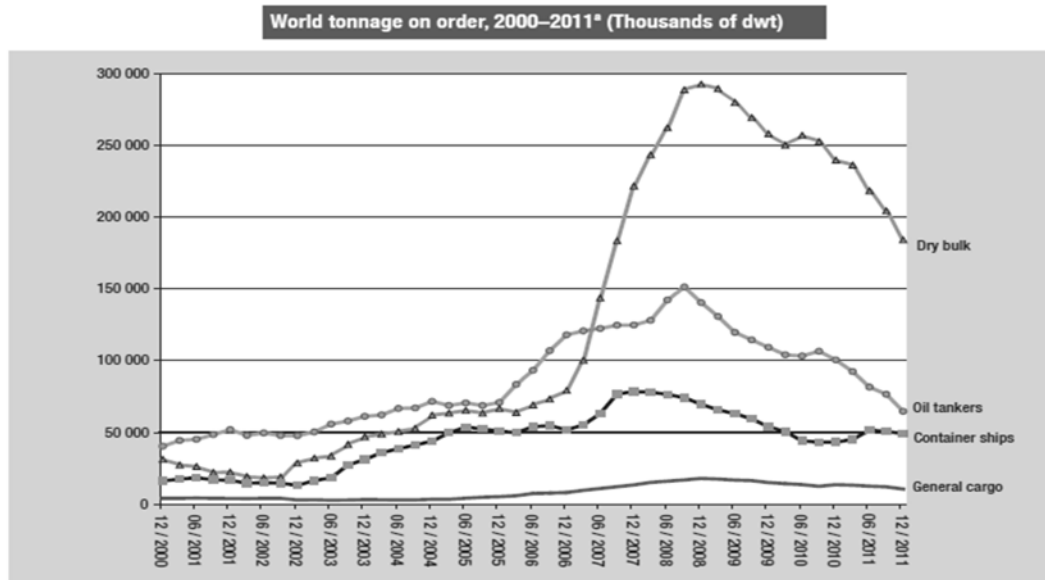


Fig-1: World Tonnage of Order

Source – UNCTAD, Review of Maritime Transport 2012

Alphaliner statistics show that world No.1 liner Maersk and No.2 MSC, between themselves accounted for more than half of the total new capacity in past one year. At the beginning of 2011, Maersk Line announced that it had ordered twenty 18,000 TEU "Triple-E Class Ships". Also, with a view to achieving economies of scale, the No.3 liner CMA-CGM reportedly is in negotiation with shipyards in Korea for enlarging 5 ships from their original specification of 12,800 TEU to a new specification of 16,000 TEU.

Evergreen, the only line which had not invested in ultra-large container ships till recent times,

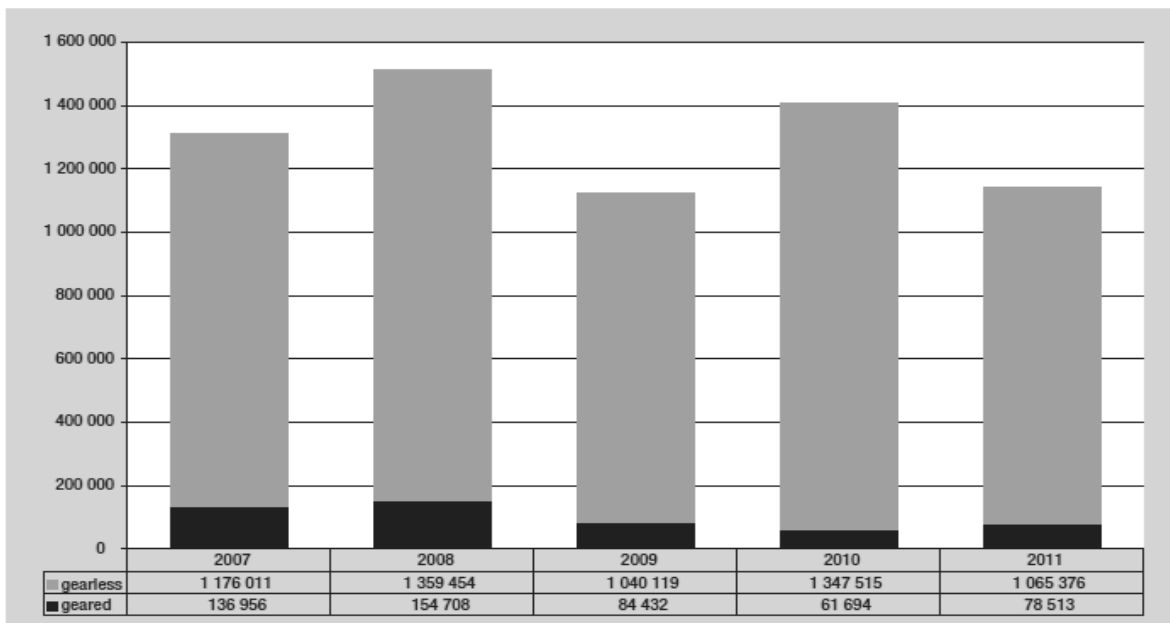
has also placed an order for 10 vessels of 13,800 TEU each in early 2012.

2. Terminate or Postpone Orders to Slow Down Capacity Release

Although the major shipbuilders are reluctant to cancel or postpone deliveries, almost all shipping companies restructured, to the possible extent, the order book in 2009. Many deliveries were postponed but cancellations were few. The chart below shows the trends in delivery of ships. dimensionality and factor structure across countries.

Table-1: Trends in deliveries of container ships

Trends in deliveries of container ships (New container ships, in TEU, 2007–2011)



Source – UNCTAD , Review of Maritime Transport 2012

In this context it is worth to mention Maersk Line’s chief commercial officer Mr. Lucas Vos’s words here (Container Shipping & Trade, August 2012). “If I look at our order book now, it is about 18-20% of what we currently have on the water, and that is healthy. Earlier in the year (2012) we decided not to take the third option on the third batch of the Triple-E vessels, so we are going with 20 of that size of vessel rather than 30. That also gave a signal to market that we are happy with the market share that we have. We are going to defend that, but it is not our ambition now to grow a lot more than that. I think that if we had ordered that third batch of 10, that would have given an inconsistent sign because it would have implied growth. Even with the vessels that will be delivered, we can absorb that extra capacity without growing our market share.” he said.

3. Slow Steaming for Capacity Absorption and Bunker Cost Savings

Various degrees of slow steaming have become standard practice for most container services as a way of controlling escalating fuel cost at a time when demand has stagnated and deliveries of new vessels have created surplus capacity. The global containership fleet has been reducing sailing speed from 24-25 knots to 21 knots (slow steaming), 18 knots (extra-slow steaming) and to 15-16 knots (super-slow steaming) so that it will be necessary to deploy more number of vessels to meet the same demand or to maintain the same frequency. *Alphaliner* estimated that by December 2011 around 7 million teus had been absorbed, which otherwise would have been a surplus, through this measure.

Slow steaming also helped the liners to make huge savings on the bunker cost when the international fuel cost was rocketing up. As per reports, the bunker cost (380 cst) was under USD100/ tonne in July 2009, which had gone up to USD714 by 2012 beginning! As of now, the main parameter which determines the sailing

speed of a vessel would be the fuel consumption and therefore the operational cost.

Using the slow steaming technique, in 2011, Maersk Line launched Daily Maersk programme providing customers with a 'conveyor belt' service between selected ports in Asia and Northern Europe. This new product was born out of necessity – to cope with the rising bunker cost and to soak up the extra capacity due to new vessel deliveries.

The thrust behind Daily Maersk is 72 vessels operating a daily service between six ports in Asia (Ningbo, Shanghai, Yantian and TanjungPelepas, LaemChabang, Jakarta) and three ports in Europe (Felixstowe, Rotterdam and Bremerhaven) - a giant ocean conveyor belt for the world's busiest trade lane! As per the Line's website they have transported over 2,00,000 containers with 98% reliability for the first year of operation. The main attraction of the programme is that the timely delivery promise is backed up with monetary compensation. If cargo arrival is delayed by 1-3 days, Maersk will pay USD 100 per container to the customer. If delayed by four days or more, the pay back is USD 300 per container!

4. Temporarily withdrawing existing Tonnage from the service

Continuing growth in global container capacity coupled with sluggish volume forced liners to lay up ships to manage capacity. As per UNCTAD report in early 2012, about 5% of the container ships were idle which included 6 ships larger

than 10,000 TEU. Lines are taking different approaches to confront losses. The Malaysian shipping company MISC closed down its container activities completely in early 2012. Some other liners skipped several individual sailings and suspended many services as a measure to manage over capacity.

In early 2012, Maersk had skipped several individual sailings of their Asia – Europe services. Also they have completely stopped booking on their Europe – Asia trade in March'12. By this measure they have withdrawn about 20% of their capacity from the Asia – Europe trade. In June'12 MSC stopped accepting booking on the Europe – Asia trade for a 3 week period. COSCON , YML, K Line and Hanjin too withdrew capacity (NE1,NE4,MD1 services) from the Asia-Europe trade. Moreover, Evergreen and Hanjin confirmed that they will no longer be launching a new service in this trade, instead they would prefer to maintain the existing services.

This measure along with several general rate increase (GRI) attempts helped liners to keep up the demand in the struggling Asia-Europe , east & west haul, trades. The following table (Table-2) shows the general decline in total TEU.

Table-2: Vessels laid-up as on July 7, 2012

TEU size range	Total No Of ships	Total TEU	Capacity % change
<=1,000	52	75,707	3.1%
1,001-2,500	100	161,892	21.9%
2,501-4,999	65	212,502	11.0%
>=5,000	5	32,556	25.8%
Total	322	482,657	14.0%

Source : Containerisation International, August 2012

5. Demolishing Older Vessels to Alleviate Overcapacity in the Market

Carriers preferred to demolish vessels rather than selling it for other owners as the second hand owners would be competing for same cargo in the market. Also, as the new vessels are more cost and energy efficient, many vessel owners found it more profitable to sell older ones for scrap instead of continue to employ them at a loss.

As per *Containerisation International* (August,2012), about 62 container vessels with a combined slots count of just over 1,33,112 TEU had been sold for scrapping in the first 6 months of the 2012. Prevailing practice in the trade is that the container and general cargo ships are kept in business upto the age of 30. Majority of ships which demolished recently were around 25 years of age. However, lack of employment prospects is forcing the owners to sell younger ships for demolition. In May 2012, a

13-year old ship was sold for demolition, making it the youngest vessel scrapped since the economic crisis in 2008.

Most of the ship recycling takes place in Asia, India leading with 33%of GT demolished, followed by China (23.9%), Bangladesh (22.4%) and Pakistan (13%). India is specialised in scrapping of container and other dry bulk cargo vessels. (Source – UNCTAD , *Review of Maritime Transport, 2012*).

The following figure shows the trends in demolition.

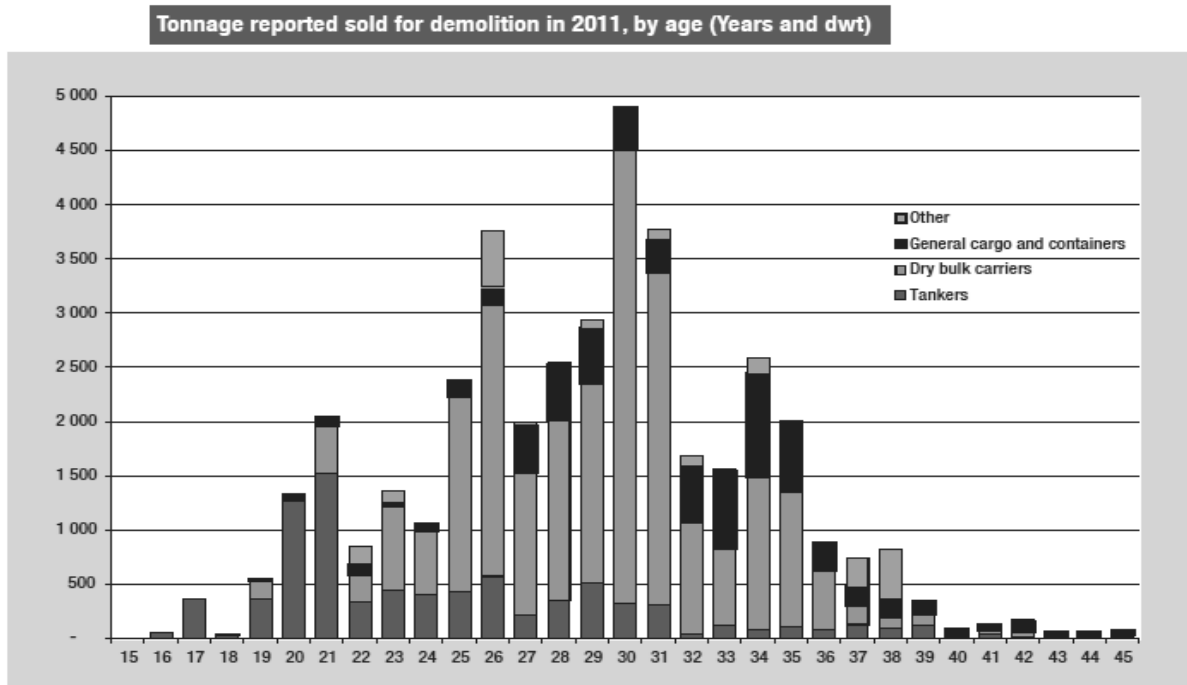


Fig-2: Trends in Demolition
 Source – UNCTAD , *Review of Maritime Transport, 2012*

6. Regrouping of Liners for Consolidation and Restructuring of Capacity

The investment in large capacity ships accelerated competition among the liners. High volume routes, in particular the Asia – Europe trade route, experience heavy competition as operators placed their biggest ships in these routes for economy of scale. Furthermore, with a predicted growth rate of 25% for the above-8000 TEU vessels in 2012, large scale capacity will continue to enter this market segment. (Source – UNCTAD's *Review of Maritime Transport 2012*)

As a result, shipping lines formed alliances to share costs, to ensure optimum utilisation of capacity and streamline their operations. All major lines have in recent years increased vessel sharing arrangements with other carriers. Classic example of this trend is the partnership of world No.2 liner Mediterranean Shipping Co (MSC) and No.3 liner CMA-CGM. This partnership covers the Asia–Europe, Asia-Southern Africa and all South American Services. Both

companies are known as strong independent liners, especially MSC, which grows organically and maintained its family ownership throughout the crisis period. With this unexpected announcement they literally stunned the observers!

Similarly the G-6 Alliance formed by merging the Asia-Europe services between The Grand Alliance (Hapag-Lloyd, NYK and OOCL) and The New World Alliance (HMM, APL and MOL) . And Evergreen joined force with the CKYH (COSCO, "K" Line, YML , Hanjin) Alliance to cope with the increasing competition. The Chilean carrier CSAV in 2012 increased their share of jointly operated services from 30 % to more than 90%. Below table (Table-3) shows westbound vessel capacity of individual line's as well as new alliances' from Asia to Northern Europe as on 01st April 2012.

Table-3: Vessel capacity analysis – Europe Trade

Alliance/Carrier	Vessel capacity (TEU)	Market Share
CKYH	2,223,080	20.9%
Evergreen	557,255	5.2%
CSCL	497,114	4.7%
CKYH/Evergreen/CSCL	3,277,449	30.8%
Maersk Line	2,203,117	20.7%
GA & NWA (G6)	2,173,786	20.4%
MSC	1,189,603	11.2%
CMACGM	1,049,404	9.9%
Total MSC & CMACGM	2,239,007	21%
Zim Line	425,888	4%
UASC	327,584	3.1%
Total	10,646,831	100%

Source : Containerization International, May 2012

As per latest UNCTAD report, feeder operators have also created alliances to better defend themselves against competition from the larger shipping lines.

Several industry experts suggest that such mergers among shipping lines would be good for profitability. However, these groupings will make it difficult for the medium to small individual lines with comparatively smaller vessels to remain afloat and competitive.

Conclusion

The global economic and financial slow down along with continued growth in fleet capacity and sluggish freight volume hit container trade hard.

Financial performance of many liners shown signs of improvement in 2012 but is still far from satisfactory. As per the trade experts, significant improvement in demand growth in 2013 is not expected, whereas, the supply of new super-generation vessels will continue to exceed demand growth, even though carriers have taken various measures to control the capacity growth.

The rising bunker prices and other operating costs continued to threaten carriers' much needed financial recovery. According to many financial statements, fuel costs are about 60% of voyage cost of the liners, needless to mention the increased bunker price rubbed more salt into the already bleeding wound. This in turn lead to adoption of strategies like deployment of energy efficient megaships, super slow steaming, vessel lay-ups and demolition of even younger vessels.

Another major problem for the industry is that the new generation mega vessels have only limited deployment options. They are mainly restricted to the Asia-Europe trade, which

continues to struggle due to the sovereign debt crisis in Europe and other difficulties facing the advanced economies.

However, the carriers have continued to revamp the service strings and omit sailings to protect the revenues.

Thus the container trade plagued by overcapacity and poor financial performance is still sailing through troubled waters. To tide over the situation, carriers need to adopt one or all of the above strategies with much greater vigour and aggression.

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