Falling to pieces

Moving Right Along

THEODORE PRINCE

Any recent flyer is sure to have noticed the lackluster quality of today’s airline food, which is the sorry result of two different trends.

First, airlines are trying to reduce expenses. They are eliminating meals altogether from some flights and cutting back on the cost of remaining meals served. Second, meals are now purchased from third-party catering firms specializing in preparing airline meals.

Deregulation forced airlines to concentrate on their core competency. In addition to divesting their food preparation, they outsourced services such as luggage-handling and reservations.

Carefully constructed, vertically integrated companies were taken apart in order to stay competitive — and profitable.

Vertical disintegration is very common when asset-based, network-operating industries enter deregulation. This can be seen not only in transportation, but industries such as utilities. It is even starting to enter the ocean shipping industry.

A dramatic example is the proposed sale of APL Stack Train Services, once the epitome of vertical integration.

In the 1980s, all the steamship lines wanted to be like APL.

They formed inland transportation subsidiaries and advertised their own stack trains as extensions of their liner vessel service. Even lines without enough volume to run dedicated trains pretended they did.

While the cash generated from the APL Stack Train Services sale would most probably be useful to NOL, APL’s corporate parent, it seems as well that this company has happened on an important discovery — it is not necessary to own the assets in order to control the service quality.

Another striking example of this trend is the division of Sea-Land into three distinct companies. According to the reorganization, international shipping, domestic trades and terminals will each now operate independently and report directly to CSX CEO John Snow.

The rumors of impending divestiture of these entities, at least selectively, have only increased.

For many industry observers, Sea-Land without its terminals is as hard to picture as APL without its stack train.

Sea-Land was an industry pioneer in developing the container terminal. The Port Elizabeth, N.J., facility was one of our industry’s most impressive innovations.

Sea-Land’s terminal strategy gave it a competitive advantage for an entire generation.

As the first line to build a container terminal, it got the best land at the best price. (As the negotiations in New York have shown, this strategy has run its course.

The port now seeks to raise the land rent from the current 1974-based price.)

The Sea-Land terminal strategy was also duplicated by many lines. Because Sea-Land started as a container shipping company in the United States, it developed its own terminals rather than depend on common-user facilities. Such became the industry model.

A line wanted its own network of its own terminals — no matter the cost. In the past 20 years, ports have invested billions of dollars to satisfy these requests.

There are other examples of the current divestiture trend.

Royal Nedlloyd, the owner of half of P&O Nedlloyd, recently sold its trucking, parcels and distribution unit to Deutsche Post. This demonstrates both the current inclination of shipping lines to concentrate on only shipping activities, and also the new trend among logistics companies to develop their own vertical and horizontal integration.

Clearly things are changing. Early on, the advent of container shipping forced lines to invest in assets to provide a menu of services (vertical integration) around the world (horizontal integration).

Asset-ownership became a means to demonstrate shipment control to customers.

Today, two things have changed that paradigm. Vessel-sharing agreements and alliances have obviated the need for asset ownership.

Lines now sell services using assets other than their own.

More important, it is now clear that the only asset of importance to customers is time-definite transit and the information supporting it.

Asset ownership has become trivial to customers. Savvy steamship lines recognize this and are divesting desirable assets before a market glut materializes or an industry downturn depresses the price they might get.

While some lines seem to be facing the future, to date most Asian lines have not yet adopted a divestiture strategy.

This correlates closely to the macroeconomic dilemmas facing the Korean chaebols and Japanese keiretsus — these lines were built on extensive economic integration and it is not easy, and sometimes not even clear, how to take the pieces apart.

Divestiture implications for the ocean shipping industry will be heavy.

Changes will not only affect lines, but also vendors, such as ports, stevedores and railroads — which in turn will see an effect on their vendor’s customers and vendors.

Ecology teaches us that a change to one food-chain component affects the entire food chain (and ecosystem). Let’s make the changes to our transportation world thoughtfully.