OSRA and all-water service

The Panama Canal has received a lot of deserved attention lately. While much of the discussion has centered around control and operation of the canal, there is also a renewed focus on steamship lines using the canal to transit between the U.S. East Coast and Asia.

Many are surprised at these developments, but a brief review of factors influencing deployment decisions, helps define the liner shipping industry in the aftermath of the Ocean Shipping Reform Act.

The primary element is customer demand. Steamship lines have begun to understand they must sell what customers want – rather than convince customers to buy what they produce. Customers require cost-effective and time-definite transit. In some cases a tradeoff must be made between transit time and rates.

The passage of OSRA introduced confidentiality into the dealings between lines and customers. As contract carriage replaced common carriage, conferences disappeared. Such rate-setting organizations used to establish a rate utilized by all conference lines and a specific customer.

To maintain, rate discipline, prices could vary only minimally. So cargo moving over the U.S. West Coast from Asia with a 16-day transit time was charged the same as cargo with a 30-day transit between the same origin and destination. Any reductions in rates for all-water transit through the canal that did exist weren’t significant because lines insisted that cost of additional vessels offset the rail intermodal expense. There was also a desire to protect West Coast rates at all cost.

Customers using all-water service have many different characteristics. Much of the market is mass retailers with East Coast distribution centers. In the past, this cargo might have moved over the West Coast by rail intermodal, or it might have been deconsolidated at a distribution center and moved by domestic truckload or intermodal.

The cargo is of two types. Seasonal cargo – such as Christmas decorations – is shipped throughout the year because it is impossible to produce and ship the necessary amounts in just a few months. Since the commodity may be stored for an extended period, transit time is not an issue for at least 10 months of the year.

For year-round cargo, moving all-water is a trade-off between time and money. From Hong Kong to New York, all-water transit runs 26 to 32 days compared to 17 to 23 days over the West Coast. Unless the cargo is high value, the transportation savings will more than offset the increased inventory carrying costs. Despite being commonly considered the same, transit time and reliability are distinct. As long as the all-water transit time remains constant, the customer can expect time-definite delivery year-round. (Many steamship lines still don’t understand the difference. One new entrant is very proud that it offers the fastest all-water service.)

In fact, all-water service may be more reliable. Customers today are overly familiar with the problems of doing business over the West Coast. Labor disputes, trucker problems, congestion concerns and the never-ending fear of railroad failures have caused some customers to seek all-water alternatives. And incentives to develop all-water services do not lie entirely with customers. Steamship lines have lots of reasons to introduce these services. Most relate to economies of scope and scale.

To decrease unit costs of production, lines seek increasingly larger vessels. Almost every major trans-Pacific carrier has announced plans for new ships. At time of delivery, they are already limited in their abilities to serve the business. For example, a line may place its new 6,000-TEU vessels in the Asia-Europe service, shifting 5,000-TEU vessels already there to the trans-Pacific, which will, in turn, throw off the 3,000-TEU vessels.

Seeking a place to deploy those smaller vessels, lines increasingly turn to all-water service, which is also driven by economies of scope. Lines must be able to offer global service. Though there are many rumors about which lines are imminent merger or takeover candidates, every line believes it can stay independent. That means each must offer service in all possible tradelanes.

Another benefit exists for the lines. By offering an all-water service to and from Asia a line can support low-value exports from the East Coast. Commodities such as waste paper, forest products and clay cannot support the cost of intermodal movement to the West Coast, but moves off the East Coast make some economic sense. A few lines realize that their import-export balance is better on all-water services than with West Coast trans-Pacific, and this can drastically change the profitability of a vessel rotation.

Let’s recall that almost 10 years ago, the all-water service was considered obsolete. The greatest factor influencing its role has always been and will remain the locus of trade. If China remains a major trading partner, all-water should stay viable. For now, the resurgence of all-water indicates market forces at work, and that is what OSRA intended.

Ted Prince is a principal with Translogistics LLC in Richmond and a former chief operating officer for “K” Line America Inc. He can be reached at ted.prince@translogistics.com.