The OSRA experience

Two years have passed since the Ocean Shipping Reform Act went into effect on May 1, 1999. The U.S. Federal Maritime Commission is conducting a survey of the transportation industry to evaluate OSRA’s impact (see story, page 6). Release of the findings is expected later this year.

Industry observers mostly expect the results of the survey to closely track previous studies. The National Industrial Transportation League, one of the major proponents of OSRA, found shippers “cautiously optimistic” about the legislation, with points of concern centering around industry consolidation and the continued presence of discussion groups, which establish voluntary guidelines for rates and service.

Although labeled “deregulation,” OSRA was not deregulation as we knew it with other modes. The ability to set rates without regulatory review and approval was granted in the Shipping Act of 1984. OSRA enabled parties to establish confidential contracts. This provision hastened the end of conferences, forcing steamship lines to ponder fundamental changes in the commercial basis.

Prior to OSRA, lines practiced cost-driven-pricing. Rates were established based on the cost of services provided. After OSRA, customers established what they considered to be the market rate for the services — subject to supply and demand. Lines were forced to engage in price-driven costing and take cost saving measures.

Today, lines are addressing basic expense issues. For example, equipment expense is under scrutiny. Severe equipment imbalances — characteristic of several trade lanes — are being evaluated. Empty containers stacked at depots remind us that it is now almost cheaper to buy a new container in China than to reposition an empty back there for reloading.

The Transpacific Stabilization Agreement, a discussion group of 14 major steamship lines in the eastbound Pacific trade, began imposing a $60 chassis fee earlier this year. This represents a partial unbundling of equipment expense to the customer. It also makes the resulting North American ocean rates more comparable to other trades, where the steamship line does not provide chassis — leaving that responsibility to the customer and trucker.

To reduce expense, steamship lines continue to invest in information technology. Some companies use the old standards of electronic data interchange, phone and fax. But more and more capabilities are being delivered over the Internet. A wide spectrum in Internet services is available. Services range from the most basic, providing general corporate information, to somewhat sophisticated (providing access to vessel schedules and tracking information) to fairly complex (a few lines allow the ability to book loads and release bills of lading).

Ocean carriers tend to move as a herd. Integration of the Internet into business is no exception. Two consortia have been established to provide neutral platforms for industry access. Late last year, five carriers announced the formation of INTTRA. Earlier this year, nine other lines formed the Global Trading Network (GTN). These efforts recognize the significant expense and effort in undertaking world-class electronic commerce initiatives.

There is another aspect to the technology initiatives. Some steamship lines are trying to expand into value-added services. These supply chain services depend on sophisticated information technology, as well as a great amount of customer integration. A customer that has gone through the time and effort of integrating a logistics provider will not easily consider converting to another provider. Such customer “switching costs” make the logistics business more easily retained than traditional ocean transport. There is also some belief that the logistics business is more profitable.

Much is being made of the financial condition of ocean shipping companies. Last year, many carriers reported strong financial results. This was largely due to strong Asian trade growth and the resurgence of other — but smaller — markets. While lines were unable to uniformly impose rate increases such as those they had obtained for the previous two years, they evidently were able to avoid giving back the increases. In addition, the trade imbalance allowed lines to operate an import-empty traffic cycle, which was more profitable than import-export.

Last year, TSA lines announced their intention of another rate restoration to take effect this May. The consensus of shippers is that this was mostly posturing and that service contract negotiations have been very favorable to shippers. There are two reasons for this result — supply and demand.

The supply side is affected by the unprecedented amount of capacity entering the trade. Last year, annual capacity deployed in the eastbound Asia/North America trade exceeded 10 million TEUs. Capacity growth is expected to continue. In 2000, there were almost 1 million TEUs of vessel capacity ordered for delivery between 2001 and 2004. Most of this new capacity is in post-Panamax vessels. In the next 12 months, it is estimated that almost fifty new vessels of 5,500 TEU size will be delivered. Many industry observers expect new capacity to exceed trade growth.

Demand is driven by the economy. Transportation is often seen as a leading indicator of recession and recovery. The slowdown in consumer spending may therefore dramatically impact the import trade. (Although there is some hope that a weaker U.S. dollar could increase exports, the economic problems in countries such as Japan weaken such a theory.)

Some economists wonder whether the United States is experiencing a new business cycle. Under the traditional model, economic growth continued until inflation raised prices — whereby the Federal Reserve System would raise interest rates and bring the economy to a recession. The Fed would then cut interest rates and the cycle would begin anew. The new business cycle is characterized by a lack of inflation and business over-investment. Recovery of the economy is therefore dependent on business resuming investment after absorbing the existing overcapacity. (This model could also apply to the liner shipping industry.)

Earlier this year, a flurry of rumors surrounded the alleged arrest of vessels operated by Cho Yang. The rumors turned out to be untrue, but industry observers remain attuned for signs of financial difficulty — and further merger and acquisition.

The legacy of OSRA may well turn out to be the further advancement of the ocean shipping industry, which serves the global economy, into the mainstream of that same economy.

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