Dealing with distress

Liner industry management needs effective breakout strategy to navigate through economic downturn.

BY THEODORE PRINCE

While “Mayday” may signal ocean distress, it has nothing to do with the month of May. It is derived from the French m’aidez (help me.) Interestingly, May 1 marks the fourth anniversary of the Ocean Shipping Reform Act (OSRA) of 1998. One industry insider recently observed that, regardless of its origins, Mayday would always serve to remind him of the harm done to the liner industry by this legislation.

It is clear that the liner-shipping industry is in less than robust health. Neptune Orient Lines recorded a net group loss of $330 million in 2002, one of the largest ever in the liner shipping industry. But many point out that the industry is prone to cyclical profits and losses. While this may be true, profitable periods are getting shorter and losses are getting scarier.

To many industry personnel, the problem is strictly one of supply and demand — too much of the former and not enough of the latter. Confidential contracts have made negotiations extremely frustrating for carriers. Even in lanes with healthy demand, the traffic flow imbalance makes empty returns an overwhelming challenge. Remarkably, vessel acquisition continues unabated. Even though 2002 was a financially difficult year for the industry, new ship orders continued at a breakneck pace. In fact, there was more capacity ordered in 2002 than in 2001.

Many liner-shipping companies consider the industry simply to be facing traditional “boom-and-bust” challenges. Barring some return to regulatory protection (and monopoly licenses) merely waiting out the downturn is a risky strategy, but an alternative plan evades us. Previous corrective strategies have come and gone by us.

Lines have long sought strategic control of some unique aspect of product delivery as a means to develop some sort of sustainable advantage. APL’s intermodal network in the 1980s gave them a leg up, but other carriers found a way to replicate — and sometimes exceed — APL’s advantage. Some lines thought that they could move ahead with an extensive office network in China, but any superiority they achieved by doing so is now irrelevant.

Better marketing was viewed as a method of managing a diverse portfolio of customers and service offerings. Economies of scope and scale were expected to drive profitability through global expansion. Liner shipping is a complex industry. Costs and revenues are shared among many parts of the enterprise. Fixed infrastructure may support multiple customers, and products and revenues from one may depend on others. But true marketing sophistication is missing in the industry, and it has been replaced by pricing, publicity, and statistical analysis. Most lines lack the accounting systems and sophistication to understand fully the financial underpinnings of the business.
Recently, liner companies felt that developing specialized, “value-added” solutions would ease their profitability woes. Almost every major line lays claim to having some sort of logistics service, but many simply pretend to have such capabilities. This one-stop shopping for shipping trend has merely expanded the scope of commodity-based pricing, because only a few lines truly have customized solutions. Lines selling logistics often conflict with truly non-asset-based logistics providers.

Two books especially might be considered mandatory reading for liner industry leaders seeking to improve their lot. The first is Execution, by Larry Bossidy and Ram Charan. The authors maintain that too much time is spent on strategic thinking and management techniques — and not enough on execution. The authors suggest that all organizations heed three building blocks to prosper.

The first building block outlines seven essential behaviors for a leader, pointing out that micromanagement of details is not execution. Instead, leaders must insist on truth and must understand day-to-day realities without relying on filtered information. They are then in a position to focus on a small number of priorities and follow through on accomplishment.

The second building block involves enabling cultural change. In this context, culture is not beliefs and values (like integrity), but rather which behaviors are appreciated and rewarded. It is suggested that employee development, promotion and compensation be driven by true execution results — not seniority, comfort or tradition. This is closely related to the third building block — having the right people for the right jobs. Unfortunately, the liner-shipping personnel pool is shrinking. While some quality talent remains, it is not being replaced. There is a general flight, as employees abandon the industry, which generally lacks a clearly defined — and desirable — career path.

Although liner shipping is a global industry, carriers seem to revert more and more to the natural tendencies of their (national) ownership to withstand financial strain. That is why the other book I recommend reading is The Real Warren Buffet, by James O’Loughlin. According to the author, almost 40 years ago, Buffet realized he needed a unique vision to run his enterprise — management would act as owner. Invested capital should earn a return greater than that which individuals could earn on their own.

This may sound obvious, but Buffet discovered in the 1960s that misalignment of corporate practices and customer requirements was fairly frequent. Buffet determined that a negative force, which he named “institutional imperative,” was the underlying cause. Many of these institutional forces affect liner shipping today. And many of them reinforce the necessary building blocks outlined by Bossidy and Charan.

Let us first consider inertia. Companies frequently resist any change to their routines. Liner shipping management often rises through the ranks, and their companies may be part of integrated industrial companies. Methods are often well established and a mandate for change may not always be apparent or welcome. It is often noted that the shipping industry still employs the best practices developed by the Phoenicians more than 3,000 years ago.

Buffet’s second imperative recognizes that most change initiatives are doomed to failure. Projects materialize and soak up whatever funds (and time) are available. This is similar to the recognition that work expands — or contracts — to fill whatever time (or money) is available (For proof, consider the industry’s history of failed projects in information technology and customer service).

The third imperative recognizes the personal foibles of senior management. Any personal whim, however ill-advised, is quickly supported by surrounding management. Pet projects are often justified with detailed studies by acquiescent consultants and investment bankers. Not many companies in our industry have bought their way to success — yet strategic acquisitions and initiatives continue.

The fourth imperative recognizes that behavior — good or bad — will be imitated — by its peers. Not many (if any) shipping companies have the courage to be first, but they seem to
fall all over each other to be second.

In considering the future, the transportation industry must treat its past as prologue. Economic cycles are inevitable — and liner shipping companies will generally rise and fall along with them. A company’s infrastructure remains regardless of the fate of its owners. To date, we have not articulated an effective breakout strategy to accommodate the economic downturn. In its absence, the forecast likely calls for increased industry distress.

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