DOG DAYS OF SHIPPING

IN ANCIENT ROME, the period between July 24 and Aug. 24 became known as the “dog days.” The hot weather was associated with the “Dog Star” Sirius, whose rage the Romans sought to appease by sacrificing a brown dog.

In 1813, John Brady’s “Clavis Calendaria,” an “analysis of the calendar,” characterized the dog days as an evil time when “the sea boiled, the wine turned sour, dogs grew mad, and all other creatures became languid, causing to man ... burning fevers, hysterics and phrensies.” Brady’s work gave rise to the concept of “mad dogs and Englishmen.” How might he have described the liner shipping industry this summer?

On the surface, industry news is encouraging. Following a disastrous 2009, all major liner companies made money in 2010. But only one-in-four made money if results for 2009 and 2010 are combined. Although it’s too early to predict a recurrent financial downturn, some leading indicators aren’t encouraging.

Over the past 10 weeks, we have seen reductions in vessel strings in the trans-Pacific and Europe-Asia trades. Last year’s profitability was driven by a less-is-more mentality, and vessel capacity was reduced to ensure market equilibrium of supply and demand. Expecting a resurgent 2011, many lines re-injected capacity to capitalize on a market — which disappointed.

Supply and demand may worsen in six months. According to analyst Braemar Seascope’s latest cellular fleet data, more container ship capacity will be deployed in 2012 than ever: 230 new vessels with a combined capacity of 1.55 million 20-foot equivalent units will increase global capacity by almost 10 percent. A third of these vessels will be introduced in the first quarter alone.

Such an increase represents the largest since 2007. It’s worthwhile to consider the industry’s attitude just four years ago. In August 2007, the Hong Kong Shipping Gazette hosted an industry forum to consider impending market trends. At the time, all the participants went to great lengths to explain why over-capacity wasn’t going to hurt the market. In fact, some predicted a capacity shortfall as early as 2009.

Drewry Shipping Consultants recently predicted freight rates would decline more than 21 percent on the main east-west trade lanes this year, despite strong volume. Even a peak-season surge would be insufficient to raise rates, and lines could be expected to post significant losses this year because of an “inability to run their business models profitably,” Drewry said.

Contrary to traditional economic doctrine, this economic distress is occurring in a period of historically high market dominance. The top 20 carriers now control 84 percent of total industry capacity, “their highest level ever,” according to research analyst Alphaliner. Unlike what occurs in other modes, market dominance hasn’t manifested itself in pricing power.

Outcomes are uncertain. Some wonder whether consumer spending, the underlying trade driver, will return to the glory days of 10 percent annual growth. There is also a question as to whether China will remain the world’s factory, or if sourcing will move to other locations such as India, Mexico, Central and South America, and East Africa. Some of these locations obviate the need for ocean transport, while others call into question the utility of large vessels.

The industry is undergoing management changes at an unprecedented rate. “K” Line recently appointed its third president in a little more than two years. APL’s management has been transformed with the departure of NOL Group CEO Ron Widdows. Maersk CEO Eivind Kolding is calling for immediate industry transformation.

Many are watching the industry reaction. Will widespread cost cutting — the traditional response to downturns — result in further customer dissatisfaction? Will North American lines finally eliminate “free” chassis, avoid “expensive” intermodal and sacrifice whatever customer service is left?

Logistics capital and strategy has deconstructed the value chain in ocean shipping. The highest returns on capital are for non-vessel-operating common carriers (50 percent) and terminal operators (30 percent). The remaining sectors are financial laggards. It’s impossible to make money in equipment leasing, inland delivery and vessel operations without an extremely low cost of capital.

Liner shipping traditionally has been the purview of large, integrated multinationals. Many are financially opaque and have criteria for success other than traditional profitability. These externalities have prevented widespread industry consolidation that otherwise might have occurred. Further financial turmoil finally might overcome institutional inertia and result in a dramatically transformed industry.

The dog days might be with us for a while.

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