SINKING OR SUNK?

According to ESPN, the worst play of the recently completed NFL season was the Thanksgiving Day "butt fumble" engineered by New York Jets quarterback Mark Sanchez. Despite having a career in which he has thrown more interceptions than touchdowns, Sanchez was awarded a huge contract before the season started. If nobody trades for him, the Jets are committed to paying him $8.25 million next season.

James Surowiecki, a business writer for The New Yorker, has identified the Jets’ dilemma as the “sunk-cost effect.” Because the Jets are unable to change the contract, logic would dictate they should ignore the sunk cost and do what’s best for the team. Sunk costs, however, are frequently tough to ignore.

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That’s not the case in today’s liner shipping world. Most carriers are ignoring the sunk cost of their massive vessel investment. Until recently, new generations of container vessels were designed faster and larger than their predecessors. Larger vessels meant fewer port calls and more direct routings. This enabled carriers to compete with faster transit times and lower slot costs. In this arms race, a 12-day transit from the Pearl River Delta to Los Angeles became the standard. Some carriers were developing plans to break the “20-day” transit barrier for an all-water China-New York service through the Panama Canal.

Times have changed. With the price of bunker fuel more than $700 a ton, and a glut of vessels emerging from shipyards, many carriers seem to consider vessel costs as sunk and are focusing on reducing fuel expense by implementing slow- and super-slow-steaming. The result is longer vessel strings. Traditional trans-Pacific deployments of 35- or 42-day round trips utilizing five or six vessels have been replaced by deployments of 42- or 49-day round trips using six or seven vessels. Longer services have been seen similarly proportional increases.

The result of all this has been a recent rise in Suez deployments to the U.S. East Coast. Common wisdom historically placed the break-even point for Suez and Panama services somewhere around Singapore or the Indian subcontinent — even though the physical midpoint is around Vietnam. Suez services from South and North China are now common, however.

In an industry as financially challenged as shipping, utilizing vessels with even a slightly higher slot cost is viewed as unilateral disarmament. The strategy has become to have the largest, and lowest-cost, vessels on every string. The introduction of new mega-ships capable of carrying more than 12,000 20-foot-equivalent units in the Asia-Europe trade has resulted in an availability of 8,000- to 12,000-TEU ships that used to sail these services for redeployment.

The question is how to deploy them to North America, the only market large enough to absorb them. Some have been deployed in the traditional trans-Pacific routes over the West Coast. The “short” transits of five- to seven-week round trips on this route, however, result in disproportionately more time spent in port than when these ships served the Asia-Europe trade in 12- to 15-week round trips.

The linehaul economics of these vessels only work when they aren’t in port. Panama Canal transit isn’t possible until the third set of locks is complete, which leaves the Suez Canal option. Use of these large ships greatly reduces the set of viable East Coast ports, many of which have been “betting it all on Panama.” Larger vessels mean even fewer port calls — and the likelihood of wasted public investment. The risks for some ports — Miami, for example — are even higher because they’re not a realistic first port call for Suez services. Some ports, such as Halifax, find themselves in the opposite situation, of course.

What are the service implications? APL, a traditional service leader, offers 23-day transit from the Pearl River Delta to New York through its West Coast intermodal option. (Ten years ago, this was a 17- to 19-day transit.) It also offers ocean transits of 31 days via Suez and 33 days via Panama. Shippers must balance these differences. It doesn’t appear that rates vary significantly by route. What differentiates the services is the availability of space.

Although most exports can absorb longer transit times, imported consumer goods and auto parts can’t. Shippers enjoyed years of rate wars, however, and some are now troubled by the increased transit times created in response to the poor profitability those pricing battles created. Many importers have increased West Coast transloading as an alternative.

Ocean pricing has never been seen as cost-based. It’s always reflected market conditions, with extremes driven by the most aggressive parties. In this period of sunk costs, shippers and carriers may both experience a sinking feeling.