Rate Rollercoaster and Capacity Constraints on the Seven Seas

Seven Strategies for your Ocean Freight in Turbulent Times

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The wild rollercoaster ride of sea freight rates currently taking place in the Far East and Trans-Pacific has never been as extreme as it is today:

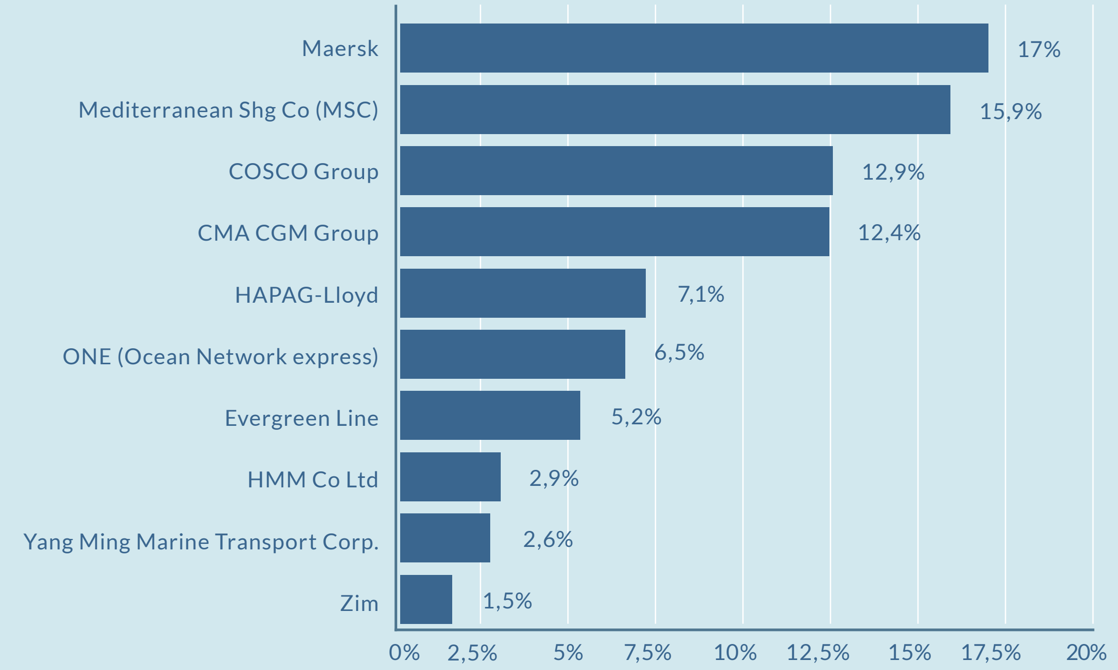
- Standard ocean freight rates, which normally cost between EUR 1,500 to 2,000, are increasing to **up to EUR 10,000 per 40-foot container and more!**
- Contracts that would still be valid for six or twelve months are unilaterally cancelled by the shipping lines.
- A six-fold increase in rates from one day to the next is often the result.
- Sometimes exorbitantly high surcharges are demanded if one wishes to be placed on one of the primary capacity lists to be handled (which, however, in no way equals a sailing guarantee!).
- Not infrequently, even forwarders are overwhelmed with the current situation and pass on such additional costs to you, the customer, without improving the situation for you

Hence, often for as little as 10 containers surcharges in the six-figure range and for 100 containers surcharges in the seven-figure range will be imposed!

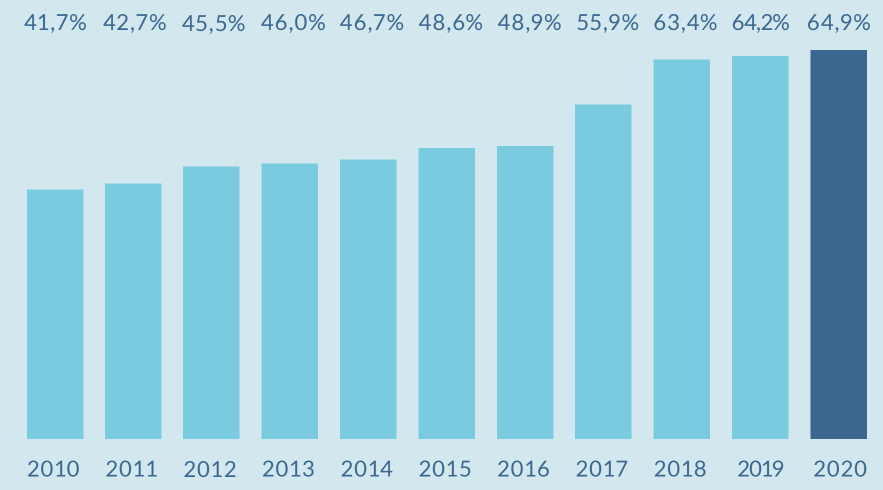
In order to better understand what is going on at the moment and to find out how you can specifically solve it, we first have to look at the positions of the various parties involved in this unique market.

On the one hand, there are the container shipping lines: An oligopoly in which the top five account for a good 65 per cent of the market volume and whose market share has increased massively over the last ten years. The shipping lines are extremely *asset heavy* and - after a break of about five years – have outdone themselves in recent weeks in placing orders for new ships with a slot capacity of up to 24.000 TEU per new-built vessel. Typically, however, delivery takes up to three years after the order has been placed.

On the other hand, there are shippers that have the choice of either shipping containers with the forwarder or directly with the shipping lines, hence bypassing the forwarders.



SHARES OF THE MARKETS REFERENCE: STATISTA



SHARES OF THE MARKETS OF TOP-FIVE-CONTAINER SHIPPING COMPANY REFERENCE: ALPHALINER

In terms of their market positioning, the forwarders could not be more opposed to the shipping lines than they are at present: They are **part of an extremely fragmented market in which the top five account for less than 10 percent (!)** of the world market.

Moreover, they are strongly *asset light*, which means that not a single forwarder owns even one ship with which it is able to cover its own container transport needs.

Rather, the freight forwarders take on the role of a middleman, as they are situated between the customer and the shipping line as far as arranging the physical transport is concerned. Their position is similar to that of an online platform for arranging air travel, which stands between the airline and the customer.

The “Amazon Effect” in the Logistics Industry

The infamous “Amazon effect” has now also hit the logistics industry. As shipping lines are increasingly confident that the key assets (such as ships and terminals) in the supply chain are under their control, they are keen to cut out the freight forwarder as a middleman in order to have direct access to the customer and control the entire process.

However, freight forwarders currently still offer a wide range of services that some shipping lines do not yet offer (e.g. customs clearance, LCL and so-called Buyers Consol).

In order to close this “portfolio gap”, the leading shipping lines in particular have integrated a large number of classic forwarders into their respective groups over the past twelve months (see MAERSK with Damco and CMA with Ceva) and bought additional expertise (e.g. MAERSK bought a customs clearance agent).

Another very important component in this market development is a massive increase in demand from China, which is not least due to the fact that people around the world are increasingly doing their shopping online during the Corona pandemic. A significant proportion of the affected goods come from China. So certainly, part of the rise in freight rates is due to the sharp increase in demand. But that is not even half the truth!

“Golden Age” for Shipping Lines

Over the last five years, almost all shipping lines have incurred high losses and have now recognised the favourable situation that plays into their hands: A massive increase in demand for shipping space within a short period of time and **no possibility whatsoever to increase freight capacities.**

In contrast - taking capacities out of the market - is easily doable in the short term. This was especially the case in 2020, when the share of so-called *blank sailings* was up to 30%!

To be blunt, the shipping lines are now saying the following: “Dear shippers, please deal directly with us. You don‘t need a forwarder anymore, since we are the ones who can provide you with shipping space.”

It‘s a bit like booking a flight directly with British Airways and not via a platform on the internet that connects you with the cheapest airline. If everything goes smoothly with the booking platform, there is no problem, everything has gone perfectly. But anyone who has ever tried to make a subsequent change to their flight booked in this way has to contend with incomparably greater adversity than if they had booked with the airline directly.

What can you do to manage the Situation better?

1. CRITICAL ANALYSIS OF THE VOLUMES OF THE LAST TWELVE MONTHS

What were peaks, what is the container mix, what are the main routes, and what is the volume split per service provider? Tenders are often issued for all routes, although it is far more attractive for freight forwarders and shipping lines alike to offer them for individual top routes with a long freight rate validity (“lots of volume, very few routes”) and charge for the rest on a spot basis. In addition, the service provider split can be mismeasured, so that by having too many service providers you have less leverage to change the behaviour of the respective shipping company that ultimately ships the volume.

2. REVIEW OF THE CARRIER MIX USED BY THE SERVICE PROVIDER AND YOURSELF

Whether you currently ship containers with a forwarder or directly with a shipping line: What carrier mix do they operate with? 90 % of all imported containers from the Far East are loaded with two or more lines on one service (so-called vessel sharing). How can you verify and measure the reliability? What are the conditions for accepting container bookings?
If you have been working exclusively with forwarders up to now, now is the time to critically weigh up whether you might invite shipping lines to your tender process as well! They prefer continuous volumes and offer you a number of advantages, especially if you have a very large volume with a small spread over individual trade lanes. You will also be rewarded with significantly greater capacity security and higher rate stability.
The flip side of the coin is that in the event of poor performance due to contractual peculiarities such as minimum volume agreements during the contractual term, you can only fall back on other service providers under more difficult conditions. This must be taken into account and thoroughly weighed up in the selection process of the service providers.

3. REVIEW OF CONDITIONS AND SANCTIONING MEASURES

As far as freight tenders are concerned, we unfortunately still observe that the focus is far too often only on rates. However, it is **often the terms and conditions that hide most of the additional costs**, due to which you as a customer have little or no recourse against your service provider in the event of a problem. You should change this as soon as possible, for example by drawing up and mutually agreeing on an effective, tailor-made “Service Level Agreement” (SLA).

4. REVIEW THE INCOTERMS

In times of such an extreme rate merry-go-round as we are currently experiencing, it is of great economic benefit to load containers from the Far East exclusively via FOB (Free on Board). Although this entails a somewhat increased effort in handling, **you alone** have purchasing sovereignty over the sea freight rates and - even more importantly - the control over capacities and transit times, because you and not your overseas supplier, selects the transport service provider. With the other common term CFR (Cost and Freight) you are dependent on your supplier and capacity they procure. These are then hidden in the product price. In addition, it is not uncommon for Chinese suppliers to collude with Chinese freight forwarders on the local side. This leads to high non-transparent surcharges, which are also included in the product price!

5. ALTERNATIVE MODES OF TRANSPORT

For a long time, transport by rail from China was faster but much more expensive. It is advisable to check how this has changed and whether it is worthwhile to transport valuable and urgent products transported by rail. However, depending on the provider, you may not be able to have any or only an extremely limited range of dangerous goods transported by rail. Besides, this improves - even if only to a small extent - the CO_2 balance of your supply chain. Intelligently combined with conventional sea freight, however, rail is a real value add for your supply chain.

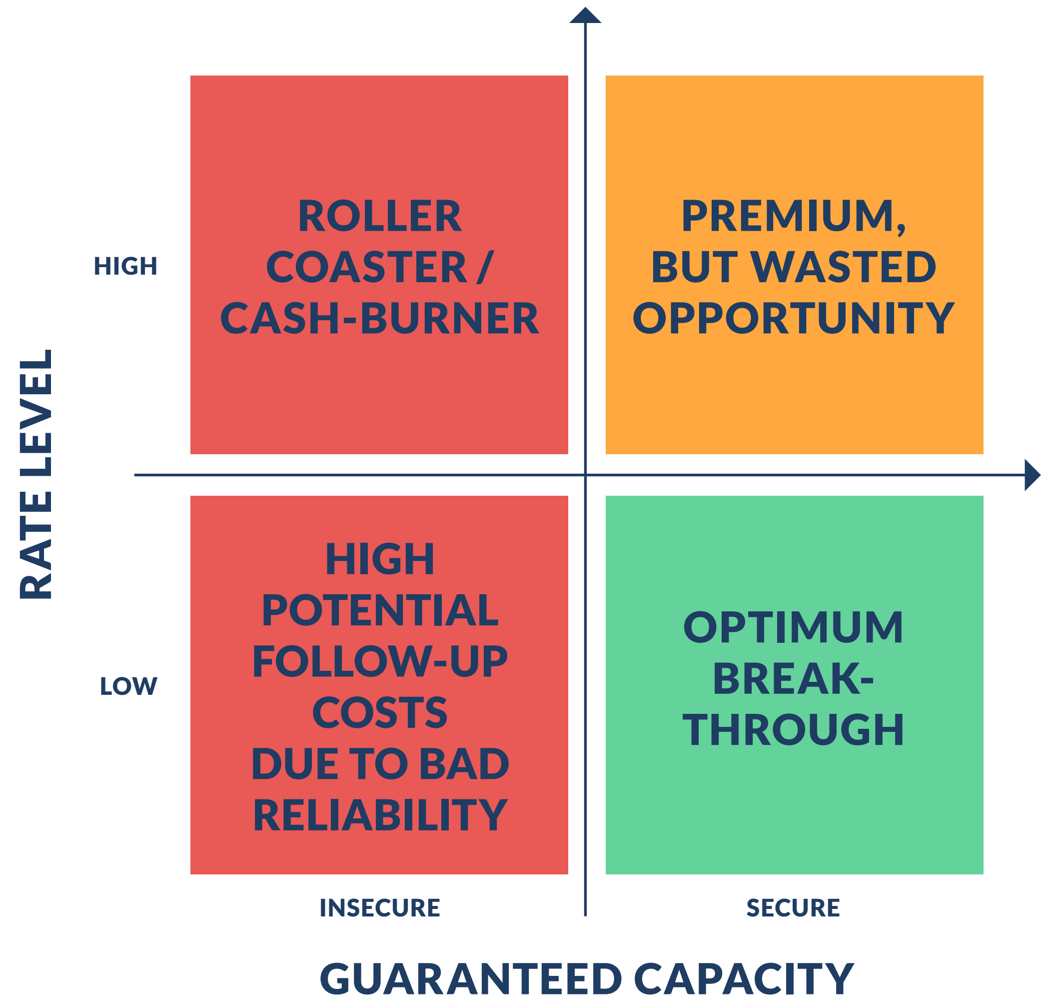
6. CAPACITY WINS!

More importantly than the rate is securing capacity. In general you can negotiate capacity much easier directly with shipping lines than with forwarders. This is especially true for imports from the Far East, since 90 % of all transported containers are handled by two or more shipping lines on the same service.
The critical question is: How are the costs to be borne in the event of incorrect loading? What sanctions are available to you as a customer?

7. AND AS A LAST RESORT: PRICING MEASURES TOWARDS THE END CUSTOMER

The last effective instrument – especially if you import low-priced goods – is, in the worst case, to adjust your prices to your end customers. The probability is extremely high that your competitor will also have no other option. In this case, both your sales and your customer service are being challenged: They have to discuss the situation with their end customer in an empathetic and trusting manner and adjust the conditions.

Conclusion



The Chinese New Year will take place on 12 February 2021. Therefore, it is important to act as quickly as possible. It is uncertain whether the situation will ease again quickly afterwards. And since it is also unclear at what level freight rates and capacities will settle again, it is time to take clever action to reduce the rate surcharges or to secure the required transport capacities elsewhere. **Therefore, take the initiative and get an expert on board to support you in this unprecedented challenge!**

To prevent sustained rate and capacity uncertainty from becoming the *new normal*, it is essential to critically rethink your purchasing strategy **NOW** and counteract it in the long term with quick and effective tactical measures, firstly in the short term and finally with strategic initiatives for the long term.

Let us discuss how we can improve your situation and how you can benefit from our decades of experience in the ocean freight market.

Every single container that causes such an exorbitantly high five-digit surcharge or is being rolled to another ship without you being able to be compensated for, is one container too many!

Do not hesitate to contact us!

The Expert

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Alexander Nowroth is Managing Partner of LEBENSWERK CONSULTING GROUP, headquartered in Düsseldorf, Germany. He looks back to an international career in the shipping and logistics industry that has taken him to senior positions in Germany, South Africa and Australia.

He enables well-known corporations and medium-sized companies to reduce global transportation costs, while increasing service levels and reliability along the entire supply chain. His passion is to build long-term successful partnerships between shippers and service providers in order to create win-win situations, also in light of sustainability targets. In addition, he is a guest lecturer for an Executive MBA program.

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