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Competitive Issues Among Liners in the Shipping Industry

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Abstract:
The challenging business environment affects every player, industry, and sector, including the liner shipping industry. The need to stay competitive is high on liner companies' priority list. Furthermore, many liner companies have started to consolidate by either horizontal or vertical integration. In 2012, the government of Malaysia implemented the Competition Act 2010 (CA 2010). Later, in 2017, exemptions were awarded to liner companies to enable them to overcome the challenges in the business environment. Prior to this, a few liner companies were found guilty of price-fixing and were subsequently fined. This paper aims to examine the issues facing liner companies in the shipping industry.

Keywords: *Cost Efficiency, Effectiveness, Performance, Sustainability*

I. INTRODUCTION

The shipping industry has a dominant role in the international trade activities of Malaysia. Almost 80% of these trading activities take place at shipping ports. The international shipping industry is experiencing intense competition because of slow market conditions. When supply exceeds demand, business tends to slow down. Financial crisis not only affects the world trade but the shipping industry as well. Apart from that, the current international business environment seems to be influenced by the trade wars happening in Asia. These trade wars have caused weariness among business leaders. To enhance the economies of scale, numerous liner carriers have started to re-strategize their business. Many of them have formed alliances, mergers or acquisitions to survive in the shipping industry. This will result in a major shift in economic regulations [1]. Hence, this study aims to examine the issues faced by liner companies in the shipping industry.

II. LITERATURE REVIEW

A. *Overview of the shipping industry*

Shipping companies are experiencing financial difficulties. They are facing falling demand and increasing operational costs, and thus, need to react accordingly to stay competitive [2]. Despite the hardships, many shipping companies have increased the size of their ships in hopes of attaining positive economies of scale [3]. Such bigger companies are instigating the move to reduce freight rates with the aim of capturing a larger market share. The impact of lowering freight rates seemed to have a limited effect on larger companies with the capacity to meet the competition. In contrast, smaller companies feel the crunch and have tough times ahead. The instability endured by shipping companies is connected to the instability of the freight rates and bunker fuel prices.

Many liner carriers have begun to re-strategize their business and have established alliances, mergers or acquisitions. Strategic alliances formed between liner carriers are a type of horizontal integration. Such alliances aim to improve the capacity

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utilisation rate of these carriers on specific shipping routes. Membership to the alliances carries limitations concerning using non-member carriers. Furthermore, members also have an agreement regarding terms for severance or withdrawal through advance notice. Fifty percent of the global trade was controlled by six alliances towards the end of the 1990s [4]. Liner companies seemed to go down the fusion pathway when they recorded losses. For example, “"Compagnie Maritime d’Affretement” (CMA) “Compagnie Geneale Maritime” (CGM), “Maersk”, and “Mediterranean Shipping Company”(MSC) suggested the P3 alliance in 2014. Then, two new alliances were forged between 2016 and 2017, namely, Ocean, which consists of CGM CMA, Evergreen, China Ocean Shipping Company (COSCO, and Orient Overseas Container Line, and “THE”, which has K-Line, Hapag-Lloyd, Nippon Yusen Kabushiki Kaisha (NYK) Mitsui OSK Line (MOL) and Yang Ming [9] as its members. Along with the existing “2M” alliance (Maersk and MSC), these three alliances, comprising the top 10 container shipping lines including the K-line (14th biggest in the world), jointly control 77% of the world liner ship capability [6]. Therefore, only 23% of the market share is left for the remaining shipping lines [7]. In the regional perspective, control of most East-West trade (93%) is held by the three alliances. The Ocean alliance controls an estimate 34% of the total trade in the East-West routes. This is followed by “2M” which controls 33% and “THE” alliance controls 26% [8].

Since 2016, an upsurge in alliance formation has been noted and this phenomenon arose as a way for the container shipping industry to deal with the market slump and low financial returns that have been ongoing since the 2008 financial crisis. In the last decade, the container shipping industry met a grave inequality between supply and demand. This has unfortunately affected the industry’s lucrativeness, weakened freight charges and tight wages. A weak worldwide trade and reduced need for ships concurred with the over supply of ships. Moreover, the existing supply and demand imbalance was made worse by the delivery of huge container ships ordered years earlier.

Hanjin, a container line from the Republic of Korea, faced bankruptcy in 2016 and this incident sparked the inclination to form mergers. When Hanjin filed for bankruptcy in 2016, shipping line “CMA CGM” obtained “American President Lines” (APL), while “China Shipping Container Lines” consolidated with “China Ocean Shipping Company”.

The purpose of creating such alliances was to increase the profitability of liners and improve fleet utilization. By forming alliances, container lines can boost rates, income, and financial returns because they can merge operations, enhance supply management and fleet utilisation, pool cargo, improve economies of scale, lower operating expenses, and share resources and networks. With increased size, container lines can provide an extended variety of services and perform technological upgrading. Moreover, alliances permit container lines to be global players besides decreasing operating costs via asset sharing.

A reshuffling of prevailing alliances and creation of new ones have been regularly happening in the container shipping industry. Nevertheless, in recent times, the size and scope of the restructuring are unparalleled. In early 2017, there were three international alliances that controlled the main East-West container routes.

On the other hand, non-member container lines will meet a progressive hard business relation. Some companies have asserted that they might have to form alliances with one of the key strategic players in the container shipping industry. Meanwhile, some opined that independent container lines will carry on their operation in niche markets. Nonetheless, there is proof suggesting that small container lines doing business in niche markets faces competition from the major alliances.

Besides container shipping companies, the formation of alliances also benefits the shippers. Among the benefits are fewer variations in freight rates, increase

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in efficiency and range of services provided by container lines, and reduced rates and prices when shippers enjoy the successful transfer of cost savings made by the lines to them. In addition, mergers that form stronger partnerships among member companies enable the creation of measures that protect the shipping industry, which includes the shippers. For example, an emergency fund for alliance members is created to help face bankruptcy.

Shippers need continual access to regular and diverse container-shipping services, besides having options of container lines to select from. In that, the "United Nations Conference on Trade and Development" (UNCTAD) has determined that the companies supplying such services has increased. This is seen between May 2017 and May 2018. This has counteracted the impact of acquisitions and mergers. For instance, the number of operators servicing some small island developing nations has been steadily declining [4].

The present market concentration level indicates a market structure that represents a loose oligopoly. Since the merging of container companies is predicted to go on, fear that markets will be more concentrated exist, which can subsequently reduce competition, constrain supply. There could be possibilities of abuse of power among the market leaders. They may raise the rates and prices.

The applicable authorities must constantly observe container market concentration level and possible power misuse by big container lines. The authorities must also examine the related impact on smaller players and probable consequences affecting charges on the cargo. The 7th session of the "Intergovernmental Group of Experts on Competition Law and Policy of UNCTAD" was conducted in Geneva, Switzerland, in July 2018. In this session, "UNCTAD" was urged to carry on with its analytical work on international maritime transport, that included observing and examining the impact of cooperative arrangements and mergers on freight rates and shipping services' frequency, efficiency, reliability, and quality.

It is necessary to evaluate the impact of mergers and alliances and of vertical integration within the industry and to tackle possible adverse effects. To do this, there is a need of cooperation among the parties involved especially the government, the liners, shippers and also the port authorities. To assess the effect of vertical integration, choice of ports of call, organisation of container shipping networks, and distribution of costs and benefits between container lines and ports must be emphasised, besides looking at approaches to container terminal concessions, as container lines are also inclined to possess stakes in terminal operations.

B. Competition laws in the shipping industry

Malaysia's "Competition Act 2010" (CA 2010) (implemented with effect from 1 January 2012) introduces the open market or free trade concept under the "ASEAN Economic Community" (AEC). An open market policy represents an economic system without barriers to free market activity. In an open market, the goal is to offer a much freer pathway from tariffs, taxes, licensing needs, subsidies, unionisation, and other rules or practices which affect the usual operation of the free market. It enables the market, whereby prices are governed by supply and demand, in which barriers to entry and trading without limitations in a specific area are non-existent.

In Malaysia, the CA 2010 and Competition Commission Act 2010 are the two generic laws that regulate anti-competition conducts. Both laws function to fulfil the rising demand for competition in the present era of globalisation and trade market liberalisation, especially pertaining to "AEC's" roadmap. In general, the laws are framed to make sure companies operate in the free market economy without limitations or market distortion, which

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allows the market to function at an optimal level, hence, benefiting the consumers.

In addition, the “Malaysian Competition Commission” (MyCC) has granted a block exemption for liner shipping agreements in relation to the “Vessel Sharing Agreements” (VSA) and “Voluntary Discussion Agreements” (VDA) made within Malaysia or that will affect liner shipping services in Malaysia [10]. The “Block Exemption Order” (BEO) commenced on 7 July 2017 and would be valid for two years. It is subject to the condition that there will be no element of price-fixing, price recommendation or tariff imposition on transport users. Furthermore, the BEO does not exempt or provide immunity relating to any abuse of a dominant position under Section 10 of the CA 2010. As such, parties to a liner shipping agreement found to abuse their dominant positions in the liner shipping market can still be found liable for infringement. The BEO permits liner shipping operators to provide, according to individual confidential contracting, their own service arrangements, based on certain conditions such as prohibited horizontal and vertical agreements that may distort or restrict competition.

C. Cases

Five companies received a financial penalty amounting to RM 645,774 from MyCC for the violation of Section 40 of CA 2010 [11]. Based on the investigation conducted by MyCC, regarding depot gate charges, the companies were found to have consented to raise the charges levied on their customers from RM 5 to RM 25, besides fixing a rebate of RM 5 for hauliers. This act would substantially prevent, restrict or distort competition in the market for the provision of empty container storage, and maintenance and handling services within a 5 to 15 km radius of the Penang Port. According to MyCC, these companies not only entered into a vertical agreement but also a horizontal one, and this violated the CA 2010.

D. The Law

The aim of CA 2010 is the creation of healthy competition that would result in stimulating productivity and innovation, therefore, forming an extensive selection of better quality and reasonably priced products for consumers. This act concerns every commercial activity occurring within and outside of Malaysia that can impact the competition in the Malaysian market. It offers a regulatory framework comprising power to investigate, adjudicate, and impose penalties on offenders of anti-competitive practices/conduct under the competition laws.

III. Conclusion

The shipping industry is critical to the growing trade activities. Players in the liner industry need to find out ways to stay competitive in the dynamic business environment. For example, liner operators need to apply cost-saving techniques to be efficient and effective [7],[12]. Although certain exemptions have been given, proper monitoring is still needed. On the other hand, traders should not bear the brunt of the actions made by liners. Thus, further studies in this area are much encouraged to ensure traders do not suffer. Besides that, establishing a framework of competition law is necessary. Nevertheless, there is also a need to assess the effects of these regulatory frameworks [13]. In Europe, the consolidations among the liners have increased their efficiency [14]. Perhaps, there is a need to compare between Asia and Europe, for there could be differences in terms of the business environment.

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