S&P Journal of Commerce

Post-COVID market shocks challenge long-held container shipping truisms

The container shipping industry raked in profits of over $400 billion from 2020–2023, according to analyst John McCown. Photo credit: Ceri Breeze / Shutterstock.com.

Peter Tirschwell | Jul 3, 2024, 10:57 AM EDT

Following the upheavals since the COVID-19 pandemic, previously accepted truisms in container shipping no longer hold true.

Case in point: In an asset-intensive industry, a priority has been to keep the prime asset — the ship — in motion as a precondition for making money. But counterintuitively, it was only when ships and the cargo they carry stopped moving, or at least slowed down significantly, that carriers started making serious money. That has interesting implications.

The idea of keeping assets circulating is not just a theory for carriers. Over decades, based on the perceived need to avoid disruption at ports, carriers agreed to generous

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wage and benefit increases for US West Coast dockworkers, allowing them to earn an average of $233,000 per year in 2023 — three times the US median household income, according to the Pacific Maritime Association (PMA).

The thinking was twofold. Expensive assets such as ships only earn money when they are in motion, so avoiding disruption at almost any cost was paramount. Not unlike Southwest Airlines' 10-minute plane turnaround in the early 1970s or railroads' precision scheduled railroading — keeping assets utilized mattered. Secondly, carriers had an eye on the customer, not wanting to undermine the good service they hoped to provide.

"In order to avoid port disruption and keep cargos moving and ultimately maintain good services to customers, the carriers always try most sincerely to negotiate the terms in the contract with the dockworkers," said former Evergreen vice chairman Bronson Hsieh.

Yet spend as they might, how much the strategy succeeded is questionable because in all those years, carriers made little, if any, money. In the more than decade and a half between 2002 and 2019, container lines' average return on capital was 4.7% compared with a 10% cost of capital, according to analysts at Bernstein, as reported this week by *The Economist*. Carriers achieved an average return on invested capital of just 2.6% from 1995 to 2016, much lower than railroads or forwarders, according to a 2018 report on the future of container shipping by consultant McKinsey and cargo insurer TT Club.

Pandemic changed the game

It was only when assets stopped circulating that profits took off, thanks to containers stranded on idle ships that lined up outside of congested ports during the worst of the pandemic disruption. The container shipping industry raked in profits of over $400 billion from 2020–2023, according to analyst John McCown. Alan Murphy, CEO of Sea-Intelligence Maritime Analysis, believes carriers' profits during the pandemic exceeded the industry's total pre-pandemic profits going all the way back to Malcom McLean's first container ship in 1957.

That raises interesting questions. If carriers benefit financially from disruption, are they motivated to encourage more of it? For example, might the allure of another shock lead carriers to hold the line with dockworkers on the US East and Gulf coasts who have threatened to strike as of Oct. 1 if they have no new contract as of that date?

The answer to that question, in short, is an unequivocal “no.” While the idea that carriers might attempt to disrupt the market to line their pockets may sound appealing in a market where they typically are on the receiving end of blame — especially now when rates are skyrocketing — it would be a misreading of carrier thinking.

On the margins, carriers have learned over the past decade to influence capacity through blank sailings, but the big swings in profits all come from external shocks. Carriers are the ultimate market takers, being blown this way and that similar to a sailing ship subject to the whims of weather.

The restocking surge in 2010 and the 2016 Hanjin bankruptcy — two events that briefly boosted carrier profits — were both case studies in external factors driving the market. That is also true, of course, of COVID and the accompanying consumer spending surge, as well as the current growth spurt set against constrained capacity due to the Red Sea diversions.

A service industry

In reality, although shippers have complained for as long as anyone can remember about carrier customer service and schedule reliability, carriers actually see themselves as a service industry.

Maersk and Hapag Lloyd aiming for 90%+ schedule reliability in their Gemini alliance — versus an industry average of just 56% in June, according to the latest Sea-Intelligence calculations, is a bold play to create value for beneficial cargo owner (BCO) supply chains, as are the many investments in recent years by various carriers in logistics businesses.

Carriers realize that even though thousands of non-vessel operating common carriers (NVOs) supply significant cargo volumes and are among their biggest customers, they want to do business directly with BCOs. This year is a prime example, where carriers kept rates low during contract negotiations and are taking advantage of the tight market to limit NVOs’ named-account rates, squeezing out the middleman.

Another example is carriers’ attitudes toward container freight futures. Carriers are exposed financially to adverse movements in rates, which move with the market, yet have been unwilling to utilize futures to hedge against freight rate risk. In other words, refusing to turn their industry into a financial market versus a service industry where they create value for customers, or at least attempt to.

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