



Maritime

Tipping the balance – Container ship subsidies

by [Matt Guasco](#) May 03, 2018

Maersk's CEO Soren Skou commented recently on the state of container shipping noting that government subsidy helps to create over capacity and promotes competitive imbalance. Advocating a competitive approach, he stated that the market will sort out carriers with profitable business models.

A Downturn in the Market

The world container index this week dipped below \$1,200 per FEU against a high of over \$1,800 in January.

Attending a maritime conference in Singapore, Mr. Skou noted that container rates from Asia to Europe have fallen to around \$600, less than half of the \$1,400 break-even point needed to sustain a healthy trade lane. Freight rates for the U.S. trade are down 3.9% for the West Coast and 4.6% according to the Shanghai Shipping Exchange. A driving factor for poor rate performance can be linked to over-capacity in the market.

Capacity is at an all-time high

In today's highly charged market if your competitor orders new more efficient ships, you are compelled to do the same. "The LOADSTAR" reported that the world container fleet will grow by an additional 5.6% this year with the current schedule of new builds adding approximately 1.49 million TEUs to the global marketplace. Carriers are expected to scrap tonnage amounting to only 350,000 TEUs which is the

lowest amount in almost 4 years. On the global scale, cargo capacity will over shadow demand by almost 20% and this is unlikely to change in the near future.

The problem becomes leveling the playing field with regard to government subsidies for vessel construction. Last year the Korean Ministry of Ocean and Fisheries established the Korean Maritime Corporation (KMC) and infused it with up to \$4.62 billion in capital, 51% of which was funded by the government. Hyundai Merchant Marine (HMM), the national flag carrier, is of course the main recipient of the money. Hyundai and the KMC plan to significantly grow HMM's operation through 2020 by ordering 20 Ultra Large Container Vessels in the 20,000 TEU class and 11 ships at 13,000 TEUs. Total cost for the project is estimated at \$2.77 billion. This will dramatically bump up Hyundai's fleet, taking it from Alphaliner's current position of number 12 to 7th or 8th on the world container stage. As you can imagine the move does not sit well with public and privately held carriers such as Maersk, MSC and CMA which look to conventional funding in order to keep pace.

Operating at a disadvantage

As carriers seek to consolidate operations to control costs, they face increasing pressure from subsidized competitors. Cosco Shipping Holdings, for example, turned a healthy profit last year of nearly \$426 million but admitted that in addition to restructuring their business model, nearly 43% of that was the result of government subsidies. In 2017 the carrier received nearly \$184 million for operating costs, new builds and demolition of older vessels. The acquisition of OOCL added 694,597 TEU and 100 ships to their fleet solidly securing their position as the world's fourth largest carrier. By the same token Hapag Lloyd's acquisition of United Arab Shipping in May was accomplished by the issuance of over 11 million new shares equaling \$414 million. HPL ranks fifth on Alphaliner's list of the Top 100 container carriers. Like Cosco the funds were used to reduce debt and strengthen Hapag Lloyd's corporate structure. The difference is that the carrier was able to report a \$39.5 million profit through global expansion of 46 million TEUs utilizing capital backed by its primary shareholders rather than government funding.

National Pride

Admittedly there are valid reasons for keeping one's National Flag afloat. Taiwan extended \$1.9 billion in state funds last year to bolster ailing Yang Ming Lines (YML). A recapitalization plan launched late in 2016 began to turn the carrier around after the infusion of money from the Taiwanese Government. At the end of last year, the carrier reported a profit of \$10.78 million with container volume up 9% for the year. Revitalization will continue this year through the optimization of cargo, integration of technology systems, and staff training to improve knowledge and expertise according to the line. With the capital investment from the government Yang Ming's board of directors approved the ordering of 10 new ships in the 11,000 TEU Class and 10 feeder class vessels (2,800 TEUs). The New Panamax ships were to be contracted through tonnage providers upon completion. It appears however from the latest figures in Alphaliner that YML has scaled back its order book to 5 vessels with a 14,000 TEU capacity. Clearly without intervention it would be extremely difficult for Yang Ming to survive stiff competition in the Asian Trade.

Unlike its competitors, the big three Japanese carriers, K Line, MOL and NYK, chose to combine their assets in the face of steep competition in the Asia Europe and Asia U.S. trades. As of April 1st, Ocean Network Express (ONE) operates through a holding company headquartered in Japan and an operating company located in Singapore. Cash and assets infused from the three original companies will be combined with time deposits and investment securities to form the bulk of their operating capital. As part of their operating strategy, ONE isn't following the shipbuilding craze for mega container vessels. Their CEO Jeremy Nixon believes that larger ships create bigger problems. Larger ships in the range of 22,000 TEU must remain longer in port to discharge, requiring faster steaming to maintain sailing schedules. Ocean Network has 9 ships on their order books for a total tonnage of 125,766 TEUs. That roughly works out to around 13,900 TEUs per vessel.

Rationalizing Operating Costs against larger concerns

Clearly the Taiwanese and Koreans are rationalizing the expense of "floating their national carriers against larger concerns" like unemployment and their nation's heavy industries such as steel production and shipbuilding. Publically and privately held carriers need only concentrate on their "bottom line". Still, as the race to build more efficient container ships continues, greater pressure is put on the carrier to fill that additional tonnage, and rate stability will continue to suffer. As Mr. Skou pointed out, "I don't think any government needs to throw money at container shipping, building ships that are not needed. As rates flatten only those carriers with sound operating plans may survive."

The question remains, is government money infused to keep carrier's solvent money well spent?



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Upcoming Events

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| Sep
11 | 2023 IANA Intermodal Expo |
| Sep
14 | 2nd Port Development South East Asia Summit 2023 |
| Sep
25 | Business Development Mission to Saudi Arabia: Global Logistics Hub by 2030 |

Sep
28

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