CONTAINERS:

2023-2024 OCEAN FREIGHT CONTRACT NEGOTIATIONS

October 2023

upply

Changed conditions for 2024 container contract negotiating round

The new container shipping contract negotiating round is getting under way. Should shippers sign up quickly or bide their time? Here are some considerations to be taken into account.
The new contract tendering round has begun in the container shipping sector on a market which is very different from that of last year. In autumn 2022, freight rates had already started to decline but the scale and speed of their descent since then has caused surprise. **In 2023, the expected economic recovery did not take place.** Inflation and more difficult borrowing conditions affected demand from households and companies alike and prospects for 2024 remain gloomy. What transport purchasing strategy should shippers adopt in this situation? Our aim in this article is to give shippers some ideas which will help them to position themselves advantageously when they come to conclude long-term contracts - mainly for one year - with the shipping companies.

1. THE LESSONS OF THE LAST NEGOTIATING ROUND

Last year, we recommended shippers to wait before engaging in the 2022-2023 negotiating round, given that a fall in freight rates seemed inevitable. Month after month, the downward trend was confirmed. The fall in cargo volumes, along with the arrival in service of new and bigger ships, forced freight rates down.

The market offered shippers such favourable conditions that many did not even feel the need to issue tenders in late 2022 and early 2023, satisfying themselves rather with a spot market which was highly attractive from a financial point of view and offered the widest possible range of services. The regularity of service which characterised the pre-Covid period was no longer available, but most shippers learned to live with this new state of affairs, which is to say with regular shipping services which were actually operating on a semi-regular basis.

2. DO BENEFICIAL CARGO OWNER SHIPPING CONTRACTS STILL MAKE SENSE?

During a webinar on the transatlantic trades organised by the Journal of Commerce in early September 2023, Pasquale Formisano, MSC vice president responsible for the Europe-North America trades, was scathing about the unreliable nature of shippers' forecasts regarding their annual cargo volumes. The subject is an important one from the point of view of contractual relationships, since rates and volumes are necessarily connected. If TEU volumes for a given period are not in line with forecasts, shipping companies will consider that they are within their rights to alter their services and the rates they charge for them.

In practice, renegotiations and commercial arrangements take precedence over legal action during contract periods but this raises a fundamental question. If it is known in advance that contract terms will not be respected by either side, why go through the fastidious process of tendering? **The big forwarders, who have well understood this quirk in relations between the shipping companies and shippers - also known as beneficial cargo owners or BCOs - are able to offer big shippers long-term contracts which are more attractive than those offered by the traditional shipping companies.** Unlike the latter, the big non-vessel operating common carriers (NVOCCs) can sell below cost. They have the resources to do so at the moment and can, in theory, offer superior performances.

Things become even more interesting when account is taken of the fact that, during the pandemic, the costly obligation imposed on forwarders to meet shippers' performance expectations was no longer legally enforceable. It was replaced instead by a more flexible notion based on a shared economic balance between the contracting parties. In other words, NVOCCs no longer have to pay out of their own pockets for air transport to ensure that merchandise is delivered on time in the event that one of their maritime service providers fails to perform to expectation.

Some NVOCCs are currently offering certain big shippers very aggressive rates for one-year contracts. The reason for this is simple. It is virtually certain that cargo volumes in 2023 will be low and shipping capacity abundant. It is, therefore, the right moment to shop around for the best terms for 2024.

We are in a market in which, counter-intuitively, shippers can get better bargains by going through an intermediary rather than by dealing directly with the shipping companies. Pasquale Formisano was careful not to raise this issue during the JOC webinar, even though MSC is particularly well placed to benefit from this trend by virtue of its strong links with the NVOCCs.

3. ARE "FOB CHINESE PORTS" CONTRACTS UNDER THREAT?

Until now, Chinese industrial groups have paid little attention to the strategic interest of having contractual control over their exports via Incoterms. The situation is changing rapidly, however, under market pressure and CIF contracts between Asia and Europe are on the increase.

This development is the result of China's wish to assert its economic sovereignty, as is further demonstrated by its choice of routes which go through European port terminals which are under Chinese control. MSC's current interest in the port of Hamburg is no coincidence. The number one container shipping group wants to contain Chinese expansion. On 13 September, it offered to buy a 49.9% stake in Hamburg logistics operator HHLA. The operation was announced just two months after Cosco Ports took a 24.99% stake in Hamburg's Tollerort container terminal.

4. OUTSTANDING QUESTIONS

Very early this year, the leading international forwarders and global shipping companies set about **securing cargo volumes on a long-term basis**, even though a number of questions remain unclear.

- Are the shipping companies' efforts to reduce capacity likely to be durable?
- The European Union's Emissions Trading System (ETS) will come into operation from 1 January. How will this be organised?
- The shipping companies have started to announce that they will be introducing specific surcharges on a per container basis when the ETS comes into force. Will shippers accept them?
- Will shippers want to see these surcharges included in freight rates or will they want to negotiate them separately?

Forwarders and shipping companies which are able to give shippers good guarantees on these questions will have a head start in the race for cargo volumes.

5. MARKET SPLIT

In a market which has largely lost its bearings, there is a real risk that there will be a split between shippers who are buying purely on a price basis and those who are looking for quality of service and a good environmental performance.

- Buying purely on the basis of price means deliberately ignoring the costs incurred by service providers and accepting haphazard quality of service. This is the maximum risk strategy, driven sometimes by a spirit of revenge, after a pandemic period during which shippers were relatively badly treated by the shipping companies.

- Opting for quality of service and the restoration of transit times, on the other hand, means being careful to provide a just remuneration of the services provided by the shipping companies, so as not to jeopardise their survival. This is in shippers' long-term interests.

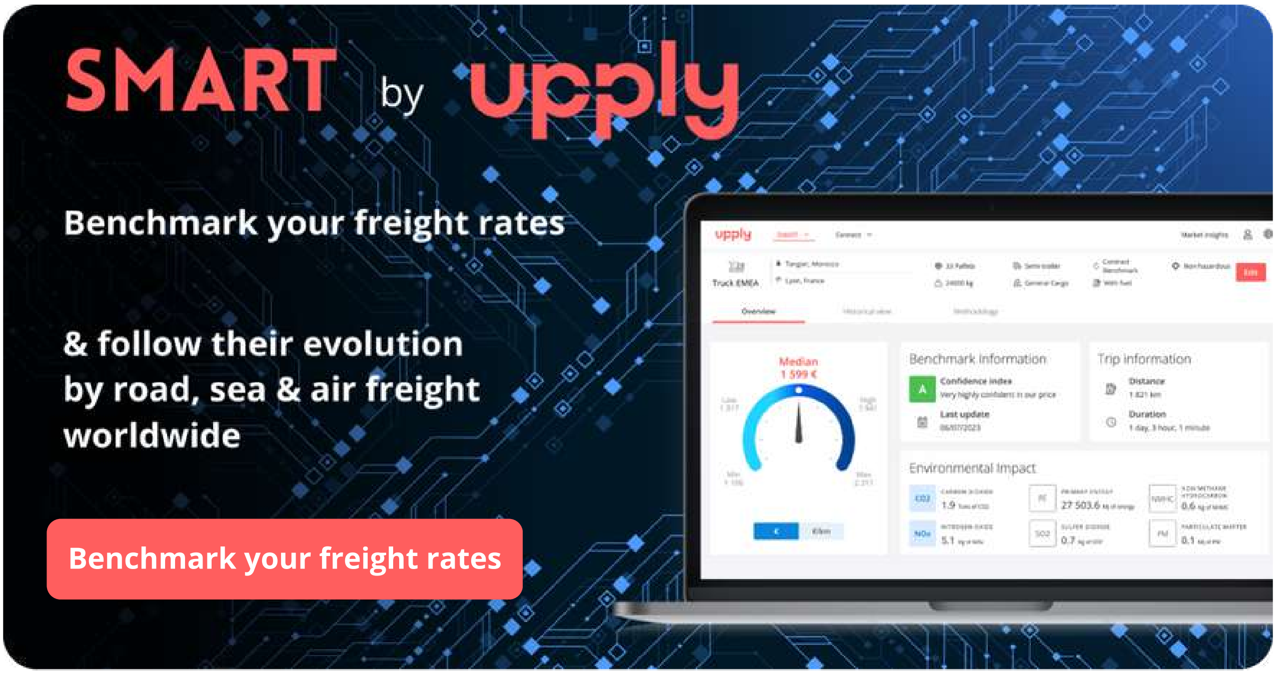
The fact that the two container shipping market leaders, Maersk and MSC, will start operating totally independently of each other again in 2024 will naturally push shippers to opt for one or the other of these two approaches, provided that there is a clear difference in the quality of service offered by the different shipping companies. This is not currently the case.

CONCLUSION: NEGOTIATE QUICKLY OR WAIT?

Taking account of the business climate, the fall in freight rates and the newfound aggressivity of the big forwarders, it would seem logical to recommend shippers to get into the contract negotiating round early, without forgetting to play the forwarder card when this is advantageous.

AUTHOR

Jérôme De Ricqlès
Ocean Shipping Expert at Upply



© All rights reserved. No part of this publication may be reproduced in any material form including photocopying or storing it by electronic means without the permission of the copyright owners, Upply. This report is based upon factual information obtained from a number of public sources. Whilst every effort is made to ensure that the information is accurate, Upply accepts no responsibility for any loss or damage caused by reliance upon the information in this report. This is not a complete analysis of every material fact regarding this company. The opinions expressed here reflect the judgment of our analysts at this date and are subject to change.

Photo credit: Getty Images, Canva