ALLIANCES IN THE SEA SHIPPING MARKET: BENEFITS AND RISKS FOR WORLD ECONOMICS

***Kotlyarov, Ivan D.,** National Research University Higher School of Economics, St. Petersburg, Russia.*

ABSTRACT

Various forms of partnership of business entities are widespread in the economy. One variety of this partnership is competitive cooperation or coopetition (from the words «cooperation» and «competition»), where competitors without stopping real competition for the consumer, are joining forces in the industrial, scientific, technical, financial and other sectors to reduce costs and improve customer service. The most striking result of this collaboration for all its members is the emergence of a unique competitive advantage over other market players outside the partnership (alliance). The objective of the author is to investigate competitive cooperation at the cargo shipping market as a certain form of partnership, using analysis, evaluation method and economic approach. The author analyzes the differences of competitive cooperation from other forms of business organization. The risks are shown, which are associated with development of alliances at the container shipping market as well as with dual role of such economic unions, when at the same time with maximization of benefits partners have undue pressure on consumers and limit the competitive industry environment. The story of the project of alliance P3 et al., followed by 2M and O3, leads to the conclusion that at international container shipping market there is an objective need for consolidation of operators. However, carriers, cooperating on one or a limited number of routes, don't interact on other key routes, where new alternative alliances emerge. Consolidation of carriers should not be too comprehensive (to prevent emergence of a dominant player, able to impose its will on a global scale). The presence of national regulatory authorities, linked to certain centers of the world economy, protect the interests of these centers, and thereby contribute to the preservation of competition in global markets.

Keywords: maritime transport, economy, container traffic, competitive cooperation, market cooperation, cartel, alliance.

Background. *Various forms of partnership of business entities are widespread in the economy due to the fact that they allow to make better use of resources and / or increase the collective market power. One variety of this partnership is competitive cooperation (in English, the term coopetition – from the words «cooperation» and «competition») is a form of horizontal market cooperation, firms -competitors without stopping real competition for the consumer, are joining forces in the industrial, scientific, technical, financial and other sectors to reduce costs (by savings, eliminating redundant departments etc.) and improve customer service. As Claude Ménard indicates, it is about creating a pool of joint assets [1]. The most striking result of this collaboration for all its members is the emergence of a unique competitive advantage over other market players outside the partnership (alliance). Moreover, note that this partnership form is not monolithic and includes a variety of embodiments which differ in particular, in the degree of integration of participants.*

Objective. *The objective of the author is to investigate competitive cooperation at the cargo shipping market as a certain form of partnership.*

Methods. *The author uses analysis, evaluation method and economic approach.*

Results.

Cooperation is not against competition

Competitive cooperation should be confused neither with the cartel agreement, nor with the business combination in the form of mergers (or acquisitions).

An important difference from the cartel agreement is that the alliance of competitors aims to increase their internal efficiency (cost savings and productivity gains) and profit growth due to the increase of value for the consumer. The sources of the efficiency are simultaneously optimization of business process, uniformity of actions in a certain area, and the preservation of competition for the consumer – in other words, there is a soer of coexistence of cooperation and competition in the interaction of alliance members. A cartel means collective dominance at the market, elimination of actual competition and gaining profit with the obvious loss to the consumer. In addition, the cartel is usually of hidden, informal nature, because cartels are generally prohibited by law, while the alliance operates openly.

Mergers and acquisitions involve full integration of assets of merging companies under a single structure (which becomes the owner of all assets merged) with the creation of a single, more or less pronounced management hierarchy and the formation of a uniform policy in all areas. In the case of such a competitive cooperation this does not occur. Firms forming an alliance retain legal independence and there is no exchange of property. They only cooperate in certain areas and coordinate the use of productive assets (including allowing partners to use them) to improve the efficiency of their activities.

The principal difference between a competitive cooperation, which allows to oppose it to the cartel, and combination of companies (in the form of a merger or acquisition), consists in the fact that both the cartel and the association of companies are focused on the elimination (explicit or implicit) of competition between its members, but alliance aims to optimize the use of resources and the preservation of competition.

However, this theoretical opposition does not always take place in practice. First of all, it is natural that the alliance also seeks to conquer a dominant position at the market (i. e. capture of market share of other companies, not participating in the alliance), and the competition between the partners is softer, smoother (due to the presence of cooperative relations) than between alliance members and external companies. In addition, the alliance and the organization of member firms are not rigidly opposed to each other – among them there are a number of transitional forms in which elements of partnership or merger can appear.

Because of this, there are situations where the alliance can actually eliminate competition between its members and use market dominance to pressure consumers to maximize their benefits and further restrict competition. In other words, a cartel is formed under the guise of the alliance.

Risks of forcing competitors out

As far as can be judged, such a situation could arise at the sea shipping market. Note that this market in general is characterized by the restriction of competition permitted by law, a clear manifestation of which are liner conferences- independent associations of ship owners serving the same route (line) on the agreed schedules and fares. In other words, the cargo shipping market is not subject to antitrust regulation, as cartels legally exist there (liner conferences in their classical form fully meet the definition of a cartel). However, such linear conference aim not so much at the profit-maximizing of participants, but at elimination of price wars, destructive for the industry (which can lead to the bankruptcy of a number of operators and the reduction of transport facilities available to customers) [2]. In fact, here we speak about protection of the industry from excessive competi-

Table 1

Comparative analysis of the nature of the cartel, horizontal mergers or acquisitions and competitive cooperation

Comparison criterion	Cartel	Merger or acquisition	Competitive cooperation
Purpose of creation	Increment of market power	Increment of market power, optimization of the assets' use	Optimization of the assets' use
Competition between participants	Eliminated by the adoption of the General Regulations of activity at the market	Suppressed administratively	Remains
Source of benefits to participants	Uniform price level, division of markets, etc.	Cost reduction, controlled prices	Cost reduction, increase in the value of the product offered to a consumer
Mechanism of formation	Explicit or implicit contract governing the sales activities of participants	Merging assets of participants in a single property complex through foreclosure or association	Contract, creating accessible to all participants a pool of assets, and regulating rules for its use

tion under conditions of excess capacity, which is required for its normal functioning [3].

But, anyway, historically cartel forms of organization have been characteristic of cargo shipping market, and therefore the risk that the formation of a strategic alliance will eventually lead to development of a cartel is very high. Moreover significantly the scale of the activities of operators increased. Instead of being local operators serving a line they have become global companies engaged in work on a number of areas that are crucial for the world economy.

At international cargo shipping market in 2014 it was planned to form a strategic alliance of three largest container operators – Maersk Lines (Denmark), Mediterranean Shipping Company (MSC, Switzerland) and CMA CGM (France). The created alliance was named P3 Networks.

It was assumed that competitors constitute an alliance, organize a general independent center of the joint ship traffic (which will increase the effectiveness of control), but, each participant will retain the function of marketing and customer service (i. e. the competition for customers will remain). In other words, P3 was supposed to be operational, rather than commercial partnership, alliance, and not a cartel. In addition, improving the efficiency of alliance members was planned to be provided by switching to larger capacity container ships (thus reducing unit costs) and optimizing network routes (to reduce fuel consumption and reduce downtime) [4]. It is obvious that coordination of operations was an important condition for the implementation of those measures.

It is worth noting that due to the projected decrease in fuel consumption the alliance not only planned to reduce their costs, but also pointed out the reduction of CO_2 emission as an important social effect. Thus, the project in its original form was a classic model of the competitive cooperation – it offered the pooling of resources to improve performance while continuing to compete for the consumer.

However, in contrast to the «normal» alliance, when the parties coordinate their actions in the current mode or through bilateral / multilateral contractual arrangements, P3 meant much deeper integration of the participants through the creation of a single operation center (moving from a simple competitive alliance to a horizontal integrated structure with centralized management, the right to control assets – even if only in one area), and the deeper is the union, the higher is the degree of coherence, the higher is motivation for cooperation and the lower is the interest in preserving competition.

However, the preparation for the project, which was to begin in 2014, showed that the alliance (which owns 42% of large container ships of the world; thus the project of its creation differs from traditional liner conferences, which controlled the smaller market shares) used its market power not only to offer customers the optimum working conditions, but also to dictate prices. In particular, having received permission for its creation of the regulatory bodies of the EU and the US the alliance increased prices by 40% in the strategically important for the global maritime industry direction – from Asia to Europe [5]. In other words, the partners began to coordinate not only the transportation, but also pricing policies, thus even more eliminating competition between the allies and deepening their coordination.

All this means that the alliance P3 showed signs of a strategic alliance (in transport activity organization) and a cartel (in collaboration with clients).

Functioning of a newly-created model could be associated with other risks to the global transportation industry. In particular, smaller companies would be forced out of the market, the existing balance between the tramp and liner carriers would suffer, some ports could be excluded from the global transport system (if they do not fall into the route network of the alliance) [5].

Antitrust authorities had to prevent the realization of those risks. At the same time, however, it should be understood that the controllers are not perfect and not impartial, they defend the interests of their states. It is unlikely that these risks were not apparent to the antitrust authorities of the US and the European Union. It turned out to be a little awkward for them to oppose the creation of the alliance, since P3 could force Chinese and Far Eastern container carriers out of the market, and thus create obstacles for China and, on the contrary, create conditions for securing European leadership at the global container shipping market.

But the global scale of the P3 activity meant, in particular, that it had to obtain permission to its constitution in those countries, which were planned to be covered with the services of the alliance. And if, as has been said, the alliance was approved in the United States and the European Union, it failed to get the consent from the regulatory bodies of China. Ministry of Commerce of China blocked the idea of the project (largely in response to the demands of the Association of Chinese cargo owners) [6], to prevent restriction of competition, so that all three members of the alliance abandoned their plans. In fact, an attempt to eliminate competition at the cargo shipping market failed due to competition of regulatory bodies.

However, the prohibition of the alliance P3 by the Chinese regulatory authorities failed to eliminate the desire of the world's leading operators of the market for the alliance. In a short time, Maersk and MSC announced the project to create a new alliance, called 2M [7]. Its key differences from the P3 project were the lack of a separate management structure and a smaller market share as compared to P3, (estimated – 28% against 40% of the market overall, a breakdown by individual market segments is presented in Table. 2). It will be a pure agreement on the joint use of vessels (Vessel Sharing Agreement), concluded for a period of 10 years, i. e. a strategic alliance designed to optimize the use of transport facilities and improve services while preserving competition for the customer.

However, although the market share of 2M is actually less than a share of P3, its size (especially for the most important global trade direction between Europe and Asia) is large enough to put pressure on the market that gives rise to justified fears of customers that competition between participants of 2M will not

Table 2

Market share of alliances 2M and O3 in key areas [8]

Direction	Market share 2M,%	Market share O3,%
Asia-Europe	35	20
Transatlantic route	37	7
Transpacific route	15	13

be fair, and this alliance will also represent the latent form of the cartel [8].

CMA CGM, not included in 2M, formed another alliance, known as Ocean Three (O3), with a Chinese carrier China Shipping Container Lines (CSCL) and the operator of Saudi Arabia United Arab Shipping Company (UASC) [9] (the shares of this alliance in major market segments are presented in Table. 2). This alliance also does not imply the creation of a central coordinating body.

Conclusions.

The story of the project of alliance P3 organization, leads to the following conclusions:

1. At the international container shipping market there is an objective need for consolidation of operators, which would allow them to reduce costs and to improve the efficiency of their assets. This is confirmed by examples of alliances 2M and O3, which almost immediately were created to replace the failed project P3. In addition, before the expected start of P3 two alliance of carriers were created – CKYH (consisting of Cosco, K Line, Yang Ming and Hanjin Shiiping, and which was joined in 2014 by Taiwanese company Evergreen), and G6 (American President Lines, Hyundai Merchant Marine Co Ltd, Mitsui OSK Lines, Hapag-Lloyd AG, Nippon Yusen Kaisha (NYK Line) and Orient Overseas Container Line Ltd) [10–12].

The need for unification, as the example of liner conferences shows, exists historically due to the presence of excess transportation capacity. However, the conferences bring together carriers on one or a limited number of routes, not affecting other key routes, which leads to the creation of new alternative alliances. In fact, integration into one of the alliances becomes necessary for the survival of the operator, since nowadays it is impossible to operate on a global scale alone.

2. Consolidation of carriers, objectively required for cargo shipping market, should not be too comprehensive (to prevent a dominant player, able to impose its will on a global scale) or too tight (so that to prevent emergence of a cartel or an integrated structure under the guise of a partnership), otherwise it might cause a response from the other players of the market, and the regulatory authorities. The project of alliance P3 did not meet this condition.

3. The presence in the global cargo shipping market of several national regulatory bodies enables to avoid its excessive consolidation due to the presence of contradictions between their interests. In fact, the regulatory authorities are linked to certain centers of the world economy, protect the interests of these centers in the face of competition between them, and thereby contribute to the preservation of competition in global markets.

REFERENCES

1. Ménard C. The Economics of Hybrid Organizations. Journal of Institutional and Theoretical Economics, 2004, Vol.160, pp.345–376 .

2. Kirillova, E. V. Antitrust exemption in the liner shipping [*Antimonopol'noe osvobozhdenie v sisteme lineynogo sudohodstva*]. Modern directions of theoretical and applied research. International Scientific and Practical Internet Conference, 19–30 March 2013 [*Sovremennye napravleniya teoreticheskih i prikladnyh issledovaniy. Mezhdunarodnaya nauchno-prakticheskaya Internet-konferentsiya, 19–30 marta 2013 g.*]. http://www.sworld.com.ua/konfer30/602.pdf. Last accessed 20.11.2014.

3. Munari F. Competition in Liner Shipping // The Hamburg Lectures on Maritime Affairs 2009 & 2010. Hamburg Studies on Maritime Affairs, 2012, V.23, pp.3–27 .

4. Girenko, R., Kotelnikov, S., Reyt, G., Flyamer, M. The sea runs high [*More volnuetsya*]. Ekspert, 2014, Iss. 6. http://expert.ru/expert/2014/06/more-volnuetsya/. Last accessed 05.06.2014.

5. Tihonov, S. Container wedge [*Konteynernyj klin*]. *Ekspert*, 2014, Iss. 20, pp. 79–80.

6. Blocking by regulators of «P3 Network» induced Maersk to the creation of alliance with MSC [*Blokirovka regulyatorami «P3 Network» pobudila Maersk k sozdaniyu al'yansa s MSC*].*Maritime News Russia*, 2014, 10 July. http://www.morvesti.ru/detail.php? ID=27149. Last accessed 26.08.2014.

7. Knowler G. Maersk and MSC to attempt new east-west alliance. Journal of Commerce. – 10.07.2014. http://www.joc.com/maritime-news/container-lines/2m/maersk-and-msc-launch-global-vessel-sharing-deal_20140710.html. Last accessed 19.01.2015.

8. Paris C. U. S. Federal Maritime Commission Approves 2M Shipping Alliance. Wall Street Journal. – 09.10.2014. http://www.wsj.com/articles/u-s-federal-maritime-commission-approves-2m-shipping-alliance-1412842825. Last accessed 19.01.2015.

9. CMA CGM signs three agreements on the biggest worldwide maritime trades with China Shipping Container Lines (CSCL) and United Arab Shipping Company (UASC) // CMA CGM official Web site. 09.09.2014. http://www.cma-cgm.com/news/565/cma-cgm-signs-three-agreements-on-the-biggest-worldwide-maritime-trades-with-china-shipping-container-lines-cscl-and-united-arab-shipping-company-uasc-. Last accessed 19.12.2014.

10. Su A. Evergreen Marine joins CKYH alliance // Taipei Times. – 21.02.2014. http://www.taipeitimes.com/News/biz/archives/2014/02/21/2003583975. Last accessed 26.08.2014.

11. Wackett M. CKYH regroups with Evergreen to fight the P3 and G6 – will CSCL be next to link up? The Loadstar. 20.02.2014. http://theloadstar.co.uk/ckyhe-regroups-evergreen-fight-p3-g6-threat/. Last accessed 26.08.2014.

12. FMC approves Ocean Three but Lidinsky calls for investigation. Port Finance International. 22.10.2014. http://www.portfinanceinternational.com/categories/regulation-policy/item/1800-fmc-approves-ocean-three-but-lidinsky-calls-for-investigation. Last accessed 19.01.2015.

Information about the author:

Kotlyarov, Ivan D. – Ph. D. (Economics), associate professor at the department of finances of National Research University Higher School of Economics, St. Petersburg, Russia, ivan.kotliarov@mail.ru.

Article received 17.10.2014, revised 06.02.2015, accepted 30.12.2014/10.02.2015.