Meli marine essay

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Meli Marine is a leading player in the container shipping industry on intra-Asia routes and has built a strong presence in the market and demonstrated very high operating margins and operating ROA from 2002 – 2007 compared to its main competitors. As Meli Marine's CEO, David Tian seeks to steer the company towards expansion in 2008, with an option to acquire 16 vessels from Teeh-Sah Holdings. With these ships, he plans to expand to the trans-Pacific market. However, we believe this deal will not be in Meli Marine's best interest at the moment, and the company will be better off without the acquisition. 2. Prelude to Acquisition Consideration

Market Attractiveness: Trans-Pacific route appears attractive as number of shipping lanes has grown by 48. 9% between 2002 and 2007, and projected to grow by 42. 9% from 2007 to 2012. Loyal customers have also approached David expressing interest in staying with Meli should they provide trans-Pacific operations. Therefore, this market can potentially be a big revenue driver if Meli's assets are properly aligned to capitalize it.

Benefits of Diversification: Trans Pacific route, particularly outgoing flows to North America, could offer diversification of income source to Meli Marine in periods when Intra-Asia's demand is weak. Moreover, in most cases of macroeconomic downturns, countries such as Asia in 1990s will resort to export-push policies to stimulate the economy and a race to affordable transport options; these could enlarge the volume of outgoing freight flows.

Tit-for-Tat Strategy against Competitors' Cascading: On a macro level, an expansion move to Asia-NA route will be a strong hit on their competitors "

on their profit pool", and also serve as a possible strategic tool to thwart competitors' threat of cascading.

Improve Churn Rate of " Feeder Only" and " Both Services" Customers: Offering addition services of shipping to the Asia-North America market may reduce churn rate through benefiting the customers by creating greater convenience and increased speed of delivery (from reduced number of transfers and changeovers, and uniformed tracking).

3. Problems with Expansion into Asia-North America Market

Cost Incompatibility: The acquisition of Teeh-Sah's vessel assets does not look favourable from a cost standpoint. In the industry where container carriers are largely price-takers, profitability depends heavily on reducing cost and gaining cost efficiencies. Arguably, much of Meli Marine's turnaround under David Tian was also due to its cost restructuring. Meli Marine thrived under David because it gained cost flexibility, with it owning just 30% of total fleet capacity.

The decision to own less fleets gives Meli a cushion in the face of industry cycles. It reduces downside risk and gives Meli more ease in adjusting capacity to meet changing demands because of the medium term nature of the contracts. Acquiring the fleets may undo the cost-saving strategy that Meli has benefited from since 1990s. In conclusion, currently, Meli is not yet in the best position to enter this route.

Niche Incompatibility: Meli Marine's niche is the delivery of a narrow set of commodities which include perishables, chemical commodities and halal

products heading to Muslim customers in Malaysia, Indonesia, and India. In the NA market, demand for halal products is traditionally known to be smaller than in Asia, and perishables may not be suitable for long distance shipping. Thus, not only would Meli be venturing beyond its niche expertise, they would also indirectly face demand uncertainty for their services.

Unfavourable Economies of Scale: The demand for shipment to Asia from North America is much lower than the supply due to global trade imbalances as seen in Exhibit 1, where 70% of the Asia-North America trade comes from Asia compared to 30% from North America. Meli Marine’s vessels could thus potentially return from North America half empty. Furthermore, the price they get from this capacity is also less optimal as seen in exhibit 7, where North America to Asia rates are only about 70% of rates charged for Asia to North America. Given the significant risk of drops in volume and price, Meli Marine may not be able to achieve economies of scale nor break-even should such a scenario occur.

Less than Optimal Ship Size: The vessels that Meli Marine planned to purchase were on average 4, 500 TEU in size. This is smaller than the ideal size of 10, 000 TEU for Asia-North America route. The supersize ships were better able to achieve economies of scale through spreading the fixed cost over a larger shipping capacity. In this manner, due to a lower cost, competitors may be able to successfully undercut Meli through lower pricing. Thus should Meli Marine enter this market, they would begin with a cost disadvantage compared to their competitors. As further elaborated in Appendix B2, the long-distance of Trans-Pacific route also makes it

unfeasible for Meli to replicate its successful operational strategy that it has implemented in Intra-Asia.

Backlash from Competitors – Feeders Line Mainline Operators: Expanding Meli's service to cover the Asia-NA line will likely strain its relationship with existing ' feeder line' channel partners (MLOs). The MLOs may stop partnering with Meli for other routes. Further, going head-to-head against established MLOs may intensify the threat of cascades. Also, if the influence of MLOs on current customers is larger Meli's, the MLOs may coax Meli's customers to switch to other Liner service providers. Such customer exodus will put at stake two customer segments with combined 28% size and overall higher contribution margin that Meli's ' Liner Only' segment. Ultimately, this move could undermine Meli's profitability if Meli's branding and persuasion over customers are weaker than its channel partners.

Uncertain Demand: It would be hard to predict the demand for Meli Marine in the Asia-NA market. With little branding, little experience in operating over longer distances and a fierce competition against bigger vessels, Meli Marine may find it hard to gain market share and to recruit new customer pool in the Asia-North America market.

Lack of Diversification Value: Moreover, the case for diversification does not seem compelling if one accounts for the sources of demand variance. In this regard, it may be useful to separate the Asia-NA route to its 2 components: flow from Asia → NA, and NA → Asia. Diversification of route may provide cushion against a weak demand within Asia (intra-Asia) However, weak demand within Asia (due to weak economies) would theoretically reduce

demand of goods from NA → Asia, thus put into question the assumption that diversification of route can protect against downside risk from macroeconomic conditions.

Poor Macro-Economic Climate: the macro-economic factors of 2008 were not ideal. With the global financial crisis looming in the horizon, the container shipping industry will inevitably suffer from a significant drop in global demand, as it swings in the past. Coupled with the existing excess of supply, this drop in demand will expose Meli Marine to unnecessary bottom line issues, should they decide to purchase the additional vessels.

Recommendations

Trans-Pacific market is undoubtedly a huge source of potential revenue, but the time is not right for Meli Marine to enter, even just for strategic reasons. Instead, they could use their excess cash to try expanding vertically into other services with higher margins, like terminal operations and inland delivery, building around their current strategy (see Appendix B2). Such a move can further boost their operating margin and absorb up to 30% of total cost. By extending its service to terminal operations and inland services in spoke cities, Meli also stand to gain from monopolies of the terminals and from gaining a lucrative 25% and 34% ROCE in these parts of value chain. During this time, they can strengthen their branding and loyal relationship with customer base on the feeder services, thereby reducing the threat of MLOs backlash. Also, they can keep their eyes on the market and look for cheaper vessel deals from smaller players going out of the business, and expand at the first sign of economic recovery. Appendix