The perfect storm battering shipping firms

In a globalised world, ship owners invested like crazy. But while they're reeling from financial losses, the cost of chartering a vessel has plunged.

When Hanjin Shipping Co filed for bankruptcy in September last year, scores of ships, thousands of crew, and cargo worth billions of dollars were left stranded at ports around the world.

The failure of the world's seventh-largest container shipper affected countless global corporates, many of which were reliant on the ships as part of their global supply chains.

While some are hoping Hanjin's demise is a '*Lord of the Flies*' moment, where one company dies and the others survive, others regard it as the omen of a bloodbath to come.

Maritime transport is the backbone of international trade and the global economy: about 80% of global trade by volume and more than 70% of trade by value are carried by sea and are handled by ports worldwide.

Despite this, 11 of the 12 biggest shipping companies reported huge losses last year, with many teetering on the edge of bankruptcy.

So what's behind the recent spate of financial difficulties in the shipping industry, and what does it mean for global trade?

AXA's head of marine for Singapore, Sundeep Khera, describes the current state of the industry as a "perfect storm".

"When rapid globalisation unleashed demand for ships carrying goods, [the] majority of ship owners invested heavily by placing orders for new ships, trying to beat competitors and gain market share," explains Khera, a former ship's captain who also leads AXA's marine cargo practice in Asia.

"While these new ships with larger capacity were being delivered, global trade sagged [and] hence a downturn arrived simultaneously.

"To add to this, there has been a shift in manufacturing where multinational firms are increasingly building factories in local markets."

In other words, the ships are bigger and there are more of them, but less cargo needs to be carried.

"Shipping companies grew faster than globalisation justified," Khera says.

In fact, the average size of container ships has increased by 90% in the past two decades and total fleet capacity in 2015 was four times that of 2000, according to the Organisation for Economic Co-operation and Development.

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On top of this, a drop in oil prices has led to sharp cutbacks in oil industry investment – from exploration to field development and production – leaving many supply ships, rigs and shipyards without orders or contracts.

"The worst-hit sectors in the shipping industry at the moment are offshore, container liners and dry bulk, with the tanker market already feeling the heat," Khera says.

ROCK BOTTOM

All of this means that the price for chartering a ship has fallen through the floor.

In 2008/09, ship owners could charge up to \$20,000 a day. A few months ago, the price was about \$3,500. Naturally, this has left many ship owners unable to service their loans.

"Record numbers of vessels are in lay-up, with charterers slashing rates or terminating charter parties altogether," explains Teo Ti-Pin, head of enterprise risk and planning at shipping company EMAS Group.

The need for a keener focus on risk management in these troubled times has become acute.

In Ti-Pin's words, the "volatility and cyclicality of the shipping industry make risk management a key driver in the effective management of the strategic and operational deliverables of the business".

"Prudent cash-flow management is critical in the shipping industry and has proved to be one of the key factors to surviving the unexpected, prolonged downturn," he says, adding that EMAS Group has proactively engaged its partner banks and implemented mitigation measures to tackle the prolonged downturn.

Moreover, he stresses the importance of a solid insurance programme.

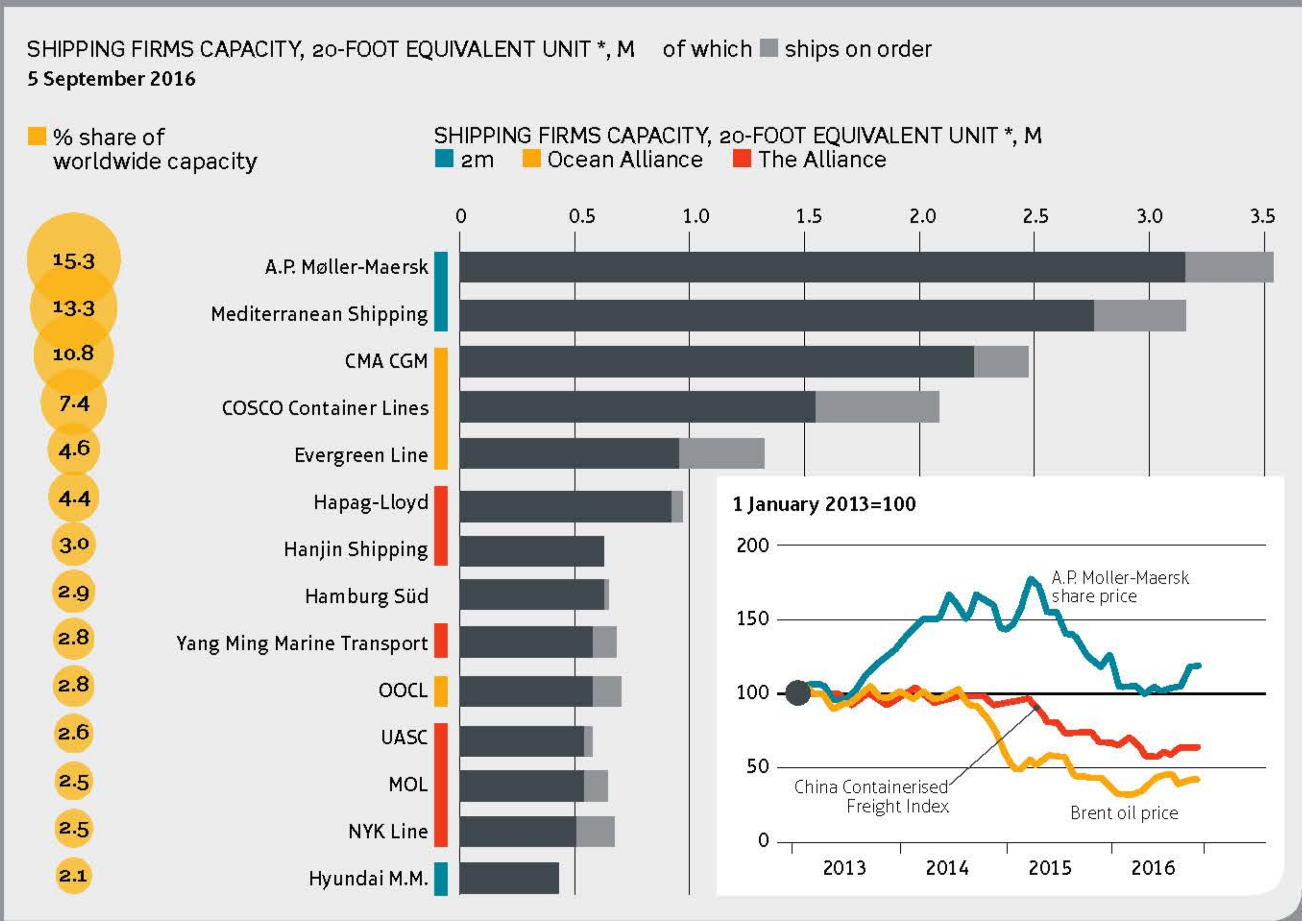
"Insurances like loss of hire, mortgagee interests insurances help to protect the vessel operators and lessors," he says.

And on the positive side for insurance buyers, there are still savings to be had.

According to Aon's 2017 market outlook, "premium reductions continue to be achievable," with a number of new entrants expected to enter the market.

The report notes: "Despite the pressure on rates

ALL AT SEA: THE SHIPPING CRISIS IN FIGURES



Source: Alphaliner; Thomas Reuters * Standardised volume measure for container-ship capacit

and the opportunities to expand into new product offerings, the bulk of market appetite is expected to remain for stock throughput, commodities and project cargo."

According to XL Catlin's Asia-Pacific marine head, Mike Davies, added-value services offered by insurers – across underwriting, claims, risk engineering and legal functions – "will also influence the decision of clients and brokers on their insurance carrier selection".

But the Aon report also highlights a potential protection gap for many clients.

"For example, while a traditional cargo policy would cover loss or physical damage to goods through a supply chain, difficulties arising from Hanjin's insolvency have highlighted the inability of traditional products to indemnify the financial loss caused by delay or non-delivery of goods where physical damage is not present," it says.

The broker's head of marine for Asia, Peter Hulyer, says the insurance market has products available to cover the risks mentioned, but the uptake has been relatively slow due to the underwriting details required to assess the exposures.

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He says ship owners have three choices for insurance procurement in this competitive market:

- Focus on premium reduction, either from existing or new insurers or a combination of the two,
- Broadening existing cover, buying ancillary covers (such as delay insurance) for a similar premium to existing, or
- A combination of the two, which will depend on loss record, attractiveness of risk profile and capability of the insurance broker.

ON THE PRECIPICE

"If premium savings are paramount, as it is for many owners in the current shipping market, then Aon recommends that owners should not compromise too much, and they should ensure that they maintain broad cover, a trusted claims leader and first-rate security, as these could pay dividends when a serious claim arises, and for those on the precipice may help to ensure survival," says Hulyer.

And if the Hanjin bankruptcy wasn't the *Lord of the Flies* moment some seem to think it was, shipping companies will want to make sure they're properly covered.