Shipping Strategy

With roughly three-quarters of the earth’s surface covered with water, it is needless to say that shipping plays a major role in world trade. In fact, it is one of the most international industries, and has an impact on each and every one of us every day. Ships transport the food we eat, the clothes we wear, the cars we drive, the materials used to build our homes, and the fuel that heats them. Yet traditional shipping companies – ones that combine various aspects of shipping under one organizational roof – are on the decline. They are gradually being replaced by new, more specialized companies with more strategic clarity and managerial focus. In Shipping Strategy, Peter Lorange draws on his extensive experience in the shipping industry to show how companies can adapt to the fast-moving and volatile world of maritime business by devising strategies for future success, including specialization and innovation.

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Shipping Strategy
Innovating for Success

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Contents

List of figures page ix
Foreword xiii
Acknowledgements xix

Part I World shipping: the context 1
  1 Drivers of change in the shipping industry 3
  2 Major shipping markets 15
  3 Shipping freight rates 31
  4 Shipping industry clusters 62

Part II Strategic archetypes in shipping 77
  5 Specialized strategies 79
  6 Owning steel 112
  7 Using steel 142
  8 Operating steel 170
  9 Innovating around steel 175

Part III The firm’s portfolio strategy 185
  10 Portfolio management 187
  11 Risk and revenue management 215
viii CONTENTS

Part IV  In conclusion 233

12 Two unique issues in shipping – family and governance 235

13 In the end … a question of management capabilities 248

Epilogue 260
References 262
Index 266
Figures

2.1 Price of oil per barrel ................................. page 17
2.2 Very large crude carrier (VLCC) earnings vs. oil price 17
3.1 Bulk freight rates ........................................ 32
3.2 Panamax bulk carrier earnings ......................... 32
3.3 Suezmax tanker earnings ................................ 33
3.4 Chinese iron ore imports by source, 1997–2007 ... 34
3.5 Port delays .................................................. 38
3.6 Order book-to-fleet ratio (dry bulk, tanker, and fully cellular containership fleet) ........ 39
3.7 Freight market behavior as a consequence of fleet employment rate ....................... 40
3.8 Capesize bulk carriers – expected freight market behavior ........................................ 41
3.9 Major bull market every thirty years? Commodity cycles .................................. 45
3.10 Vessel earnings (Cape, VLCC, and 4,000 TEU – one-year time charter rate) .......... 46
3.11 Rate of growth of trade (measured in tonne/mile or TEU/mile terms) .................. 47
3.12 Gross freight earnings by vessel type, 1960–80 .................................................... 50
3.13 Typical shipping market freight rate development ................................................. 51
3.14 Abnormal shipping market freight rate developments .......................................... 52
4.1 Share of revenues invested in R&D compared with level of innovativeness in five national maritime industries .................................................. 66
4.2 Personnel mobility within the Dutch maritime cluster ............................................ 67
4.3 The relationship between preferences for keeping headquarters in the home country and satisfaction with public policy ........................................ 68
4.4 Maritime clusters (European Union) ................................................................. 69
4.5 Global market capitalization 72
5.1 Conceptual model for shipping strategies 81
5.2 Four archetypes of specialist firms 85
5.3 The specialist movement within the shipping industry 87
5.4 Owning steel, using steel, operating steel, innovating around steel 90
6.1 Container supply/demand balance 119
6.2 Crude tanker supply/demand balance 119
6.3 Segmentation of ship types 121
6.4 Shipbuilding activities in Germany 122
6.5 Ships on order per country (of control) 122
6.6 Containerships in existence by country of ownership, 2006 123
6.7 Shipyard capacity by country 123
6.8 Major yards: capacity growth – ships delivered 125
6.9 Newbuilding prices 126
6.10 Matching demand and supply 128
6.11 Top twenty liner companies – new orders at March 10, 2008 130
6.12 Market share (%) of the five largest container ship lines 133
6.13 New ships on order as % of existing fleet (including ships chartered in) 134
7.1 In/out and long/short strategies (various market assumptions) 144
7.2 Buy/sell/place second-hand ships and newbuilding orders 144
7.3 DFDS overall strategy 166
7.4 DFDS ownership share per ship type (%) 167
8.1 Proportional distribution of operating costs for bulk carriers 171
8.2 Proportional distribution of operating costs for tankers 172
9.1 Slow steaming: vessel power vs. speed 179
9.2 CO₂ emissions per unit load for various types of transportation (comparison by transport mode) 180
10.1 Peter Georgiopoulos’ sphere of shipping companies 189
<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.2</td>
<td>Risk/return tradeoffs in shipping (based on time charter rates for the period 1980–2002)</td>
<td>192</td>
</tr>
<tr>
<td>10.3</td>
<td>Risk/return tradeoffs in shipping (based on time charter rates for the period 2003–2007)</td>
<td>193</td>
</tr>
<tr>
<td>10.4</td>
<td>Portfolio, owning ships/infrastructure firms – Seaspan example</td>
<td>196</td>
</tr>
<tr>
<td>10.5</td>
<td>Seaspan’s stakeholder-based portfolio strategy</td>
<td>197</td>
</tr>
<tr>
<td>10.6</td>
<td>Portfolio – using ships – Clarkson Shipping Hedge Fund example</td>
<td>199</td>
</tr>
<tr>
<td>10.7</td>
<td>Growth vs. yield in the public market since 2002</td>
<td>200</td>
</tr>
<tr>
<td>10.8</td>
<td>Portfolio – innovating around steel – Marsoft example</td>
<td>201</td>
</tr>
<tr>
<td>10.9</td>
<td>Portfolio shipping firm – owning, using, operating, innovating</td>
<td>202</td>
</tr>
<tr>
<td>10.10</td>
<td>Container terminals business model</td>
<td>210</td>
</tr>
<tr>
<td>10.11</td>
<td>From customer relations niche specialist to infrastructure low-cost specialist</td>
<td>213</td>
</tr>
<tr>
<td>12.1</td>
<td>Public vs. private company ownership</td>
<td>236</td>
</tr>
<tr>
<td>12.2</td>
<td>Family business vs. publicly traded firms – two different systems</td>
<td>237</td>
</tr>
</tbody>
</table>
Foreword

With roughly three-quarters of the earth’s surface covered in water, it is needless to say that shipping plays a major role in world trade. In fact, it is one of the most international industries, and it has an impact on each and every one of us every day. Ships transport the food we eat, the clothes we wear, the cars we drive, the materials used to build our homes, and the fuel that heats them. Nowadays, however, shipping is largely out of sight and out of mind. Shipping facilities are usually beyond city limits, fenced in and unapproachable. Outsiders are not meant to go there, so most of us have no idea what goes on. But in my view, managers in a broad variety of mature industries can learn a lot from understanding and tracking developments in the shipping industry.

The general image of shipping is one of permanence and predictability as ships ply traditional routes with their cargoes, linking industries and consumers. But in reality the industry has experienced extraordinary changes over the last few years. The global landscape is shifting, with emerging nations driving global demand, and, until recently, the industry had been enjoying an unprecedented period of sustained profitability and increased investor interest. Many new fortunes were made – and lost – during these exceptional times. With its heavy exposure to global market mechanisms, the shipping industry is both unique and fascinating, attracting some of the world’s most risk-taking and charismatic entrepreneurs and fortune-builders.

These changes have been accompanied by a dramatic increase in the ship freight derivatives business, so-called forward freight agreements (FFA) trading. It is estimated that the volume of FFA trading for dry bulk shipping from mid-2007 to mid-2008 might be at virtually the same level as physical trading in ships. Derivatives trading has become critical in several of the business segments in shipping, almost
notably in the dry bulk segment but also in tankers. The container shipping segment, on the other hand, has not so far become subject to derivatives trading.

Over the last few years, there has been a strong influx of capital, largely from sources that were previously not generally available to this industry, such as general investors, asset management funds, and bank financiers. Coupled with this, there has been an equally strong influx of new professional talent, many with very different backgrounds from those traditionally found in shipping. At the same time, experience and shipping judgment still count. Additionally, hedge funds and financial brokers showed increasing interest in shipping derivatives following the rise in freight rates caused by economic growth in China and elsewhere. To sum up, this is an exceptional time for the shipping industry.

As a result, the level of shipbuilding was at a record high with tonnage output rising fast. Many foresaw an oversupply of shipping capacity in the near future, or even another industry depression, perhaps similar in magnitude to that of the 1980s. However, the financial crisis in 2007–8 has created new shortages of capital and widespread uncertainty about the future of the economy. What can we learn today from the way shipping markets have behaved in the past? How deep will the dip be, and how long will it last? And, perhaps most importantly, how can shipping companies respond proactively to the vast array of challenges they are now facing?

For companies that aspire to be global winners, specialization may be the answer. This seems to be the case for most, if not all, mature industries. Perhaps the major insight of this book is the call for strategic clarity, by distinguishing between four primary archetypes – owning steel, using steel, operating steel, and innovating around steel – that is, between owning ships, chartering ships, trading in the markets, ship operations, and innovations related to the technical as well as commercial aspects of shipping. I shall discuss the critical success factors behind the strategies for each of these archetypes. My claim is that the hour of integrated shipping companies is
largely past and that the future trend is toward firms that are decomposing the value chain and focusing on one aspect, or possibly two, through autonomous units. The result is less complexity, less coordination, less bureaucracy, and more strategic clarity and managerial focus. Still, there will be a need for an overall portfolio strategy, and the management of overall risk to the shipping corporation is becoming more important than ever – all of which I will discuss in this book.

I sold my own shipping company, S. Ugelstad A/S, in January 2007. While I benefited from the strong market by obtaining a satisfactory price for my company, the major rationale for selling was that I began to feel increasingly uncomfortable attempting to combine various aspects of shipping under one organizational roof. With varying degrees of success, I tried to combine owning, chartering, and innovating. As the sole owner – and the one ultimately responsible – it became an increasingly complex situation for me to handle, so I sold the firm. However, my interest in shipping – broadly speaking – remains the same. I am engaged in various investments, many involving holding ownership stakes in ships. By freeing myself from direct company ownership, I have been able to diversify my holdings rather than being caught up in the increasingly tangled reins of an integrated shipping company.

So, who is this book for? The target reader is clear – the sophisticated shipping industry practitioner. There is a lot of sophistication among most shipping industry executives today. Accordingly, this book attempts to develop the most relevant critical success factors for the shipping business in general, as well as for the various key shipping strategies that can be identified. For each strategy, I shall attempt to identify the most relevant drivers, including the most pressing implementation challenges, critical risk/return considerations, and performance measures. I shall also indicate ways of benchmarking a specific category vis-à-vis other industries, past history, etc. There are a number of unique challenges that will make this book valuable to savvy shipping executives:
I see a specialization trend within the shipping industry into more clearly focused businesses, namely:

- owning steel/ships
- using steel/ships – chartering/trading ships
- operating steel/ships
- innovation around steel/ships.¹

This book deals with how to develop effective strategies around each of these focused businesses. It concentrates on the main shipping business segments – tankers, bulk carriers, and container ships – and less on specialty ships, including ro-ro/ropax ships, ferries, cruise/passenger ships, and others. This is an intentional choice, to maintain a reasonable focus.

At the same time, the new reality is the development of effective overall portfolio strategies, with particular emphasis on managing overall exposure to risk. This book covers approaches to these challenges.

Financial understanding is becoming more and more of a must. But what does competent financial management entail?

Derivatives trading – FFA contracts – in shipping is increasingly prominent – certainly when it comes to the dry bulk markets, but also for tankers. This means that a new set of trading-related capabilities is needed.

Underlying all of this is a keen understanding of the market mechanisms in shipping. Growth in demand, i.e., in world trade, is the key driver for this but the supply side is important too. How can we better understand the growth outlook? When shipowners put up too many new buildings, supply will outstrip demand and rates will fall. How can we learn from key developments in markets in the past?

The shipping industry is becoming more and more professional. But what does this professionalism involve? What are the key agenda items for today’s successful shipping executives?

¹ I do not use the term “steel” literally to indicate ships built solely from steel. I include ships, notably fast ferries, cruise liners, and so on, that are built from composite materials and aluminum.
When considering key success factors, we must make a distinction between commodity shipping and specialty shipping. For the former, low costs are critical and the financial aspect – to enjoy the lowest possible capital cost – is increasingly important. It is essential to understand the basic shipping markets well enough to be able to decide on appropriate “in/out” and “long/short” decisions. In contrast, the customer is the focal point in specialty shipping, which is a customer-based business. To succeed, you need to understand your client.

Another critical question is how fast a specialty shipping business niche will evolve into merely another commodity business. Imitation is inevitable and barriers to new entrants typically low. How effective is each particular shipping market then?

I should state at this point that I have possibly not been entirely objective when it comes to discussions drawing on Marsoft or Seaspan as examples: I am a board member and outside director of both of these companies. However, to my best ability, I have tried to be objective and balanced.

At the time of completion of this manuscript in mid-2008, the shipping markets had been experiencing an unprecedented period of growth – over an equally unprecedented period of time – almost five great years! There were, however, clouds on the horizon. Newbuilding orders, relative to existing fleets, were growing rapidly and financing was becoming more difficult to obtain. During the latter part of 2008, the shipping markets did indeed collapse. The fall was more dramatic – faster and deeper – than anything ever experienced in the past. The shipping industry was perhaps in a deeper crisis than ever before in its history.

So, what can a book on shipping strategy offer during these difficult times, particularly when the book was essentially written during the earlier period of extreme optimism? While I have made some adjustments to the text, the book’s production schedule would not allow for an extensive rewrite. However, it is important to note that this should not diminish the book’s value. The basic “messages” remain more valid today than ever.
Pursue highly focused business strategies for shipping companies, with heavier emphasis on understanding the relevant underlying critical success factors within each specific shipping business segment.

Be cognizant of the need to manage overall risk through a more robust, overall corporate portfolio strategy.

The level of the professionalism of management practice within the shipping industry can certainly be further advanced. Paradoxically, times of crises tend to enhance such managerial breakthroughs. I hope that the book might have a positive impact on this as well.

All in all, my sense is that this book is timelier than ever. I have also added a brief epilogue, which further reflects on the unprecedented changes that have recently had an impact on the shipping industry. An open-minded, flexible view is now called for.

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