Challenges and Prospects in Shipping Finance

by

Professor Costas Th. Grammenos

INTERNATIONAL ASSOCIATION OF MARITIME ECONOMISTS

ISMIR, 2004
Regulatory Factors Causing Structural Changes in the Shipping Industry

• Oil Pollution Act 1990 (OPA)
  - Unlimited Liability
  - New Design Provisions
  - Phasing out Single-Hull Tankers over a 20-Year Period

• International Safety Management code (ISM)
  - Improving Safety of Seafarers
  - Protecting Property
  - Preventing Marine Pollution

© C. Th. Grammenos
Structural Changes in the Banking Sector

Capital Adequacy Rules 1993
- Minimum Risk Asset Ratio 8%

Expected Capital Adequacy Rules 2006
- Not Finalised
- Assessment of Risk
- Measurement of Risk (standardized and Internal Rating Approach)
- Required Economic Capital
- Higher Return on capital Employed

Shipping vs other sectors

© C. Th. Grammenos
Structural Changes in the Banking Sector (continued)

• Mergers and Acquisitions in the banking sector
  - larger financial institutions

• Interest in financing large shipping companies
  - lower perceived risk
  - relatively stable performance
  - higher profitability

© C. Th. Grammenos
Structural Changes in the Banking Sector (continued)

• Avoid smaller shipping companies due to
  - higher perceived risk
  - relatively unstable performance
Capital Markets

Public Equity (for growth companies)

- Equity capital increases, but
- Small capitalisation
- Small percentage of shares to the public/limited liquidity
- Shipping market volatility/volatile cash flow
- Underperformance of shipping stocks

Private Placement (for capital gains)
- Capital increases, but Investors locked in
Capital Markets

High Yield Bond Issues (Non investment grade)

• Bullet Repayment

• Savings can be invested into new projects

But

• Cash flow volatility

• Defaults
Other Examples of Structural Changes

• British Fleet
  - Bulk
  - Passenger
  - Liner

• New Shipping Model (1950s & beyond)
  - Single Vessel Company
  - Bank Finance
  - Time Charter

• Eurodollar market
Structural Change in Shipping Companies: consolidation in Bulk Shipping

Pools - Alliances - Mergers and Acquisitions

ROCE = Earnings before Interest and Tax / Capital Employed
Objectives in Fleet Renewal and Expansion Schemes

Small Companies

- Better fleet utilisation
- Improving chartering activities
- Economies of Scale
- Appropriate timing of sale and purchase
Objectives in Fleet Renewal and Expansion Schemes

Large Companies

- Increasing market share
- Improving customer relations
- Fixing COA
- Better fleet utilisation
- Improving financial flexibility
- Reducing cost of finance
- Economies of Scale
To Recapitulate

Structural changes such as

- OPA 90; ISM

New Bank Capital Adequacy Rules

- Consolidation in Shipping and Banking leading to larger shipping companies and to wider use of various finance sources.

Small companies may attract the interest of specialised funds/institutions