The shipping tsunami

After the housing and subprime loans bubbles
we now have the container shipping bubble
The epicentre of this quake has shifted from New York to Hamburg

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Background

On 17 February 2012 the website www.manager-magazin.de announced that Hamburg-based closed-end investment fund LF 16, created by fund manager Lloyd Fonds, had declared a state of *Insolvenz*.[1] LF 16 was a specialist fund investing in the shipping sector, particularly in the purchase of vessels. Put simply, a private individual joining a fund must put up a portion of the funds needed to acquire the vessel from the shipbuilder, trusting that once it is ready to go into service its value is such as he will make a profit, if sold, or the price at which the vessel is chartered will allow him to make a profit over time. With closed-end funds it is not possible to pull out of the operation along the way, and at times of crisis funds are often forced to ask investors to undertake an extra financial effort, to prevent the whole investment from going under. “In the first quarter of 2011 alone savers had to refinance funds to the tune of 41.6 million euro in fresh cash”, Frankfurter Allgemeine Zeitung (FAZ) reported on 13 June 2012 on its website www.faz.net.[2] We might say that shipping funds are a German speciality, with Hamburg the most important marketplace. They are however the *outer reaches* of the complex system in place to finance the shipping sector, seeking to attract a broad range of investors, thanks in part to particularly favourable tax rules in Germany. Often however savers are poorly informed. The sector is unregulated, and the time period for which capital is locked up is usually 15 years. During this time capital cannot be withdrawn or cashed in, and participation in the fund cannot be negotiated, unlike government bonds. Many innocent or inexpert investors get caught in the trap.[3] This is the chaotic frontier land, while *the core of the system* consists of a small group of major banks specialising in this type of business: Royal Bank of Scotland, Lloyds Bank, Commerzbank, HSH Nordbank. This latter State-owned bank, half owned by the city-state of Hamburg and half by the *Land* of Schleswig Holstein, is the most exposed of all. It was already in difficulty in 2008, having been the first German bank to seek State aid. Since that time the owners – namely the parties governing the two *Länder* – have woken up and closely examined the bank’s management, stung into action by a press campaign and by opposition forces. Two CEOs have come and gone, one of whom is now facing prosecution.

[1] According to German legislation this declaration sets in motion an insolvency procedure (*Insolvenzverfahren*) in which steps are taken to meet the claims of creditors on companies’ assets or a state of bankruptcy is declared (*Pleite*). S. Council Regulation (EC) n. 1346/2000 of 29 May 2000 on insolvency proceedings, “Official Journal of the European Community”, 30.6.2000. On 20 June 2012, INSOL Europe has launched its proposal for revision of the European Insolvency Regulation by officially submitting it to the Commission of the European Union in Brussels, s. www.insol-europe.org. December 2012 the European Commission has adopted a complete ‘insolvency package’.

[2] *„Schiffsbeteiligungen immer tiefer in der Krise“*.

[3] Critical analyses and ‘instructions for use’ in relations with funds on the websites of specialist law firms protecting savers’ interests, see in particular *“Erster Lloyd Fonds (LF) muss Insolvenz anmelden. Totalverlustrisiko: Anleger lassen Fondsausstieg prüfen“*, at www.sommerberg-llp/sonderthema-lloyd/de, dated 28 February 2012.

Money had been lent to clients lacking in collateral, and a number of irregularities were committed. In 2009 the parliaments of the two *Länder* had however decided to grant HSH Nordbank the possibility of resorting to the guarantee fund of the *Länder* (*Zweitverlustgarantie*), with coverage of up to 10 billion euro! The seafaring-port economy is the primary source of income in the North. In 2010 and 2011 the bank, buoyed by an improving financial and shipping situation, had begun to pay back its bailout debt.[4] In mid-2012 however the combination of the Eurozone crisis, world recession and resulting crisis of the shipping sector, particularly vehement in the containerised traffic market, brought HSH Nordbank to the edge of the cliff.

On 16 July 2012 FAZ returned to the subject in an article by Christian Müßgens and Johannes Ritter, Hamburg correspondents: "the prices at which many vessels are now being sold have gone so low as to rival the prices of those being scrapped".[5] If the values of portfolio assets collapse, the fund goes bankrupt and the asset value of banks falls dramatically. In September there was talk of 266 funds in difficulty. "Handelsblatt" reports that at the Hansa Forum, held in mid-November, experts forecast that about 500 ships would not find enough investors willing to shoulder operating costs, with charter rates collapsing.[6]

On the first of December the summit of the pyramid structure finally made itself heard. In an interview with "Hamburger Abendblatt", the new CEO of HSH Nordbank, Constantin von Oesterreich, made no bones about the fact that unless the Länder's guarantee fund was resorted to, up to a sum of 1.3 billion euro for the period going to 2025, the bank would be in danger of folding, adding: "the situation might improve before 2014. But we may also have to wait until 2015 or 2016".[7]

HSH Nordbank enjoys in its business sector some of the symbolic value that Lehman Brothers had in the derivatives sector. Here we are witnessing the repeat of an old film, but the main difference between 2008 and today is that back then the paralysis struck the intangible, virtual cash circuit, whereas today it is hitting the *physical circuit* of goods, so it could be even more spectacular, more "visible", and create stumbling blocks to globalisation that are taller and longer lasting. As a major

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[4] See the bank's press release of 18.6.2011, *HSH Nordbank führt Ländergarantie weiter zurück.*

[5] „Krise der Schifffahrt trifft Anleger mit Wucht", www.faz.net.

[6] *Charter rates* are the prices that the carrier is willing to pay to hire a shipping vessel, not to be confused with *freight rates*, which are the prices sought by an operator to transport a cargo unit. The first to fall are usually the freight rates, which after a few months drag down charter rates too. The latter in turn are broken down into rates for a single journey or a very short period of time (*spot rates*) and rates established for long-term contracts (over several years) between the shipping company and the owner. The former are public, like stock exchange prices, the latter are governed by written private agreements kept well away from the gaze of rival companies.

[7] *Wir gehen nicht davon aus, dass sich vor 2014 nachhaltig etwas verbessert. Es kann also auch 2015 oder 2016 werden*

operator told "Lloyd's List": "This will be the worst crisis to hit the liner industry since the start of the container era some 40 years ago". He adds: "much of it could be blamed on the tax relief granted by a handful of governments with a focus on investing in ships".[8]

But to understand the dynamics of this crisis we need to appreciate the relationship between the ship as an industrial product and as a financial product against the backdrop of what has been called "gigantism of ships", in other words the unstoppable tendency to build ever larger vessels.

Ships as an industrial product

The common idea we have of a shipping vessel is that of a technological instrument deployed in a market that has certain supply and demand characteristics and certain operating costs, producing certain revenues. In terms of unit costs, a large ship has some advantages, so for company managers economies of scale work in this business, and the drive for bigger and bigger is correct. Not much of a discovery: the Genovese had already realised this back in the 14th century! The merchant trading going on back then was however a little different from today's brand of capitalism.

According to the latest edition of Drewry's study, the operating costs of boxships (October 2012) went from the base index value of 100 in the year 2000 to 170 in 2010. After a brief fall, they are expected to return to the same level in 2015.[9]

It might be surmised that this big increase depends from rising fuel costs. This rise in spending on fuel is generally passed down to the client by means of the well-known *surcharge*, the BAF (Bunker Adjustment Factor). As legislation on emissions is about to get tougher, in particular regarding the obligation to use fuels having a low sulphur content, which are notably more expensive in some parts of the world, the relative value of a shipping vessel is increasingly being calculated according to its fuel consumption. *As we shall see below, a ship is turning from an industrial product into a financial product.*

Whereas the operating cost of a container ship having a cargo capacity of 10 to 12,000 Teu, according to Drewry, was $13,420/day at the end of 2011, it will be an estimated $13,778/day in 2016. For 5-6,000 Teu vessels it was $9,890/day at the end of 2011 and an estimated $10,247 in 2016. Rates are more difficult to forecast. The difference between the large rise in operating costs in the period 2000-2008 and the

[8] In *Capacity cuts are just the start*, "Lloyd's List", 16 October 2012

[9] Drewry Shipping Consultants, *Ship operating costs. Annual Review and Forecats. Annual report 2012-2013* (October 2012).

modest increase from 2010 to 2016 stands out (if Drewry forecasts turn out to be correct).[10]

We do have real time information on "industrial" trends in the shipping market, regarding *rates*. Figures are however for basic rates, and do not include *surcharges*. We should always try to obtain *all-in rates* to see whether companies can cover costs and make some sort of a profit. A period of low rates due to surplus supply or to a drop in demand may bring about heavy operating losses. This was the case in 2011 and in the first quarter of 2012 due to excess supply, and in the second half of 2012 caused by a decline in demand, in particular in the Eurozone and the Mediterranean area.[11] Generally speaking, 2010, 2011 and 2012 were low-profit years (or more correctly years of disappointing operating results). While the fall in demand is not the fault of shipping companies, they are however to blame for having created a surplus offering, having put too many ships into service and thus caused rates to drop. And what is more, they continued to order new vessels from shipyards and take possession of all those ready to be launched.

This fact drew Drewry's wrath ("*the foolhardiness of carrier's strategic actions in 2011"*), and at the time companies reacted only episodically. At the outset they thought they could get away with *slow steaming*, i.e. reducing the cruising speed of ships. This did indeed lead to a fall in capacity. Then they began to cancel a service here and there, and to reduce the number of ships used for services. After that they sent a lot of stuff to be unrigged, or scrapped. On the demand side of this market the recession was beginning to bite, particularly in the Mediterranean *olive belt*, in the major shipping nations and ports of Greece, Italy and Spain. No strategic, long-term decisions were however taken. And they have carried on in this masochistic, self-harming way. Are they really so stupid, or is there something we are not privy to?

Taking the Far East-North Europe/Mediterranean trade, in early November 2012 there were 258 ships deployed on 24 different services. The average capacity of these vessels is 10,000 Teu. Figures that would appear to justify those busy digging in harbours, but the question is not so simple. "A service on the Asia-Europe trade requires 12 ships of at least 12,000 Teu each", a CMA CGM manager told

[10] Ibid.

[11] "The Mediterranean trades are in much worse shape, though, with average spot rates now down to less than $750 per teu from more than $2,000 for a brief time seven months ago", "Lloyd's List" of 3 December 2012. Two weeks later however "Lloyd's List" wrote: "Moreover, and more surprisingly, on the recessionary-plagued Asia to the Mediterranean route, spot rates recovered by 66% on the week to $1,199 per teu; an early Christmas gift for the embattled liners that were beginning to wonder how bad the damage would get in this tradelane", in *Liners in late fight back* , 17 December. Worse than the fall in rates is their volatility, making it practically impossible for a shipper to gauge costs even in the very short term.

"Containerisation International" in its 25 October 2012 issue. "This is the equivalent of an investment of $1.4 billion, but in order to be competitive you must have at least three services, thus the investment rises to 4.2 billion. Then there are the empty containers to be allotted to the vessels, 18,000 Teu each. That is another $400 million." These are big numbers. Resources that are obtainable only with the support of the banking system: 24 services costing $1.5 billion each, $36 billion on the Asia-Europe trade route! Relations with banks are thus of vital importance. For shipping companies banks look at their market share, value of assets (own fleet) and growth prospects. The market share, being the main parameter of the bank rating, can go some way to explaining the mad rush to snap up volumes and to put into service cargo capacity and hold space, even at the cost of encouraging dumping rates. Rising asset values also explain the mad rush towards "gigantism". They probably realise now, in light of evidence offered by the world recession, that these assets can fall in value very quickly, as happened to house prices during the property bubble.

Risk allocation

Peter Döhle is a business that belongs to the *non-operating ship owner* (NOO) category. Employing 6,800 workers and based in Hamburg, it manages about 450 ships, of which 320 container carriers. In practice this means that some are owned by the company – around a hundred – some are managed on behalf of an owner (*ship management*), and some are ships for which Döhle has exclusive brokerage. The flagships of the fleet are four 13,000 Teu vessels built by Hyundai in Ulsan, each having 800 *reefer* units, a top speed of 24.3 knots, fuel consumption of 272 ts, with two already delivered and a further two ready by 2013. All four are/will be put into service by Hanjin. Furthermore, four 12,500 Teu vessels, built by Samsung, with 1,000 *reefer* units each, a top speed of 24.8 knots, fuel consumption of 289 ts., put into service for MSC. Döhle is a family business, its core activity is to purchase ships and hire them out on a bareboat basis or otherwise. It may exclusively charter a third-party vessel, provide its crews, administration, servicing, etc. to third parties, and can do all of the above at the same time. The only thing it can't do is act as *carrier*, acquiring and delivering cargoes. In relations with shipyards it is either a direct client or a broker for third parties. Hamburg is the world capital of NOO companies – known in the trade simply as *owners*, while Maersk, MSC, Hapag Lloyd etc. are known as *carriers* - and that is why Germany is a world leader in terms of ownership of boxships.

The sector is however going through a delicate moment. Actions to remedy its fragmented state and consolidate the sector would require considerable support from banks. But the latter too are going through lean times. A proverbial vicious circle.[12]
The specialists of this category of shipping company play a vital role in the shipping industry, providing the world's leading companies with a degree of flexibility and the allocation of financial and third-party liability risks. Thus the large *carriers* put into service a part of the fleet that is a pure industrial resource (hired) and a part that is an industrial and financial resource (owned). However, the positive role played by these subjects, and by closed-end funds, with regard to risk allocation turns into a negative action when the ship is treated as if it were a purely financial product, transferred from one party to another – *owner, carrier, fund, bank* – like a bizarre pass-the-parcel game. If one looks at the websites of major law firms specialising in safeguarding the rights of savers who have invested in shipping funds, one can see that *owners* often sell the ship to the closed-end fund, making a considerable profit just for this operation. Naturally the fund will have to recoup the money from savers.[13]
Lloyd's List Intelligence wanted to hear what NOOs, almost all of them German, have to say. The results of the survey are contained in the Report *Spotlight on Germany*, published on 26 November. The main findings were as follows:

- Major lenders in the shipping industry are leaving the business or shrinking their portfolios.
- 84% of respondents expected insolvencies among shipping companies over the following 12 months
- Owners themselves are expecting dramatic changes

So the way the wind is now blowing, we may be in for an almighty crash any time soon.

The ship as a financial product

"The shipyards are to blame!". This reply from a couple of years ago really took me aback. I had questioned one of Italy's biggest shipping agents for its opinion on what was happening in the shipping world. After one or two other choice comments, I began to reflect on the matter, and concluded that actions in the shipping world could

[12] „The German shipping sector affected by the crisis is too fragmented, and often works unprofessionally. Banks are fearing for the money they have lent out, and are pressing for mergers in the sector", says "Financial Times Deutschland" on 4 September 2012.

[13] Regular reports on the state of funds, average yields, etc. are published by Verband Geschlossene Fonds e.V., www.vgf-online.de.

better be understood by reasoning in financial rather than industrial terms. I also saw that the “economies of scale” argument regarding the “gigantism of ships” did not lie at the core of choices being made, but was rather a pretext, concealing another type of logic. According to *DynaLiners Weekly* of 16 August, Maersk paid South Korean shipyards $190m for an 18,000 Teu Triple E-Class ship, i.e. one equipped with the very latest technologies and engines that consume as little fuel as is currently possible. In short, a real gem. $190 million is a great price. Shipbuilding industries are subsidised in a number of nations, in particular in the Far East: South Korea, China, Japan and others. Thanks to these subsidies, granted to keep up job levels or simply to maintain a national shipbuilding industry in given markets, these shipyards can offer products at prices that barely cover production costs, or may even be below cost. In Europe some shipyards are surviving in the container carrier market only because they are hyper-specialised.

Once it is purchased, the ship’s value is entered in the books at the purchase price. Its technological features – in particular fuel consumption, oil consumption, servicing and repair frequency and complexity, safety features, degree of automation of steering, controls, etc. – determine the ship’s market value a lot more than its capacity. It is not worth so much because it can carry more containers, but because it belongs to a technologically superior era.

These shipyards are rolling out new craft at lower and lower prices. Companies are buying them and enter their book value in the hope that the following year that value will have gone up, or that the value of technologically less sophisticated vessels of competitors will have gone down. The road to “gigantism” is a cut-throat business based on balance sheet values, weakening one’s rivals and raising the bar in terms of both cargo capacity and technological innovation. Going back to our previous example, of the ships Peter Döhle makes available to Hanjin and MSC: Hanjin’s 13,000 Teu vessels have a fuel consumption of 272 ts, MSC’s 12,500 Teu ships consume 289 ts, they are smaller and consume more (although they have 200 extra reefer units).

We do not have information on purchase prices, but it may be that Hanjin ships, built two years later, cost a little less. We always have to consider the situation within the framework of the *debt economy*. The financial policy of giants in the top 20 for container traffic is that of presenting a financial situation that enables them to secure bank loans in order to buy new and technologically advanced ships. This makes the company appear stronger to the bank. This purely financial outlook leads to overcapacity. Operational problems will crop up if extra vessels lead to cargo space surplus and a collapse in rates. In the meantime, there is the positive of having put into service ships whose unit cost is lower per cargo unit. The aim of economies of scale is of course to *reduce unit cost*. But the unit cost depends on a fundamental variable: the *load factor*. A 10,000 Teu ship filled to 80% capacity has a unit cost lower than a 6,000 Teu vessel with the same load factor. But what if the load factor falls to 60% due to the crisis in demand? That would be a bloodbath. The economies of scale of “gigantism of ships” are based on relative rather than absolute values. Then if both rates and demand drop, due to the world recession, ship values crash, the financial situation becomes critical, banks turn their backs on the market and the vicious circle results in a crash.

Being a shipowner has always meant having major financial resources behind you, naturally we refer here not to the owner of one or two ships but the owner of a fleet worthy of the name. Let us imagine being the owner of a container traffic company that manages dozens and even hundreds of vessels, one of the world’s top 20, the first three of which are Maersk, MSC and CMA-CGM. Their need for financial resources is great, and they become attractive clients for banks. Companies in the container sector have un unbelievable amount of liquidity. Before it loads a container onto a ship, the shipper must have deposited the value of the rate, with the *bill of lading*, into the bank, with an advance payment. Big clients, such as Kühne&Nagel, DB Schenker, DSV, Panalpina, naturally enjoy preferential banking conditions, but the “people of shippers” have to pay in advance.[14] Short-term handling of liquidity is one of the great drivers of the container business. The financing of a new service, in itself a medium-term industrial project, is usually covered by the company’s own means and by bank loans. Whatever the coverage, large container shipping companies belong to that rare breed of concerns that are *too big to fail*. Being so exposed in relations with banks, they cannot be allowed to fail. The top three in the ranking are an odd group. Maersk is basically part of an oil group that has always had a fair share of capital behind it. Its shipping activities have gradually grown within the AP Moeller group, diversified into a host of activities, from retailing to tourism. It has grown considerably in the sea terminal sector, where profits are high, while shipping lines have caused one or two problems. The group is working oil fields and extracting natural gas in different parts of the world. This produces considerable financial

[14] As traffic has skyrocketed in the new millennium, thousands of new operators have emerged, especially in the Far East, mostly devoid of financial resources, and often not knowing even the most basic of rules governing international shipping. A few years ago the port of Rotterdam reported that about 10% of containers arriving there each year did not carry correct transport documents. The introduction of the figure of “authorised economic operator” in the EU Customs Code has been a welcome filter blocking the progress of impromptu operators. For further information see “Le multinazionali del mare”, Egea Editore, Milan 2010.

resources, not so much as to be fully self-sufficient but such as to be able to negotiate with banks from a position of strength, as an oil company and shipowner. MSC is a mystery, the world's least transparent big company. It refuses to release its figures, does not confirm, does not deny. We know a little more about CMA CGM, as the press is often called upon to investigate it. Founded by Jacques Saadé, born in Beirut and a naturalised Frenchman, and now headed by his son, in spite of being the world's third largest it has been sailing in troubled waters for quite some time, possibly due to the excessive amount of take over in the period 1997-2007. It was the first company in the world to put their money into megacarriers (ULCS, Ultralarge Containership). In 2010 it found a not-so-silent partner, Turkish businessman Yildrim, head of a mining group, that rescued the company but was opposed to the purchase of 20 new ships.[15] In 2014 there are plans for an Initial Public Offer (IPO) for CMA CGM. The latest news (from mid-November) point to the company having reached a fresh agreement with banks on debt restructuring. News that must put the bank's small-scale savers in a state of panic, as they know that debt restructuring means releasing the debtor from short-term repayment obligations, passing the cost on to smaller clients. This is the same dirty work as that done by real estate firms, making ordinary citizens and manufacturing firms pay for their "heedlessness". A few days prior to the pact reached with lender banks being announced, CMA CGM reported that it was adding to its fleet three new 16,020 Teu ships.[16] Alphaliner, on 22 November, reported that the delivery of three megacarriers had been put back by CMA CGM to April 2013. In the spring the company had chartered three 13,500 vessels as it did not have enough capacity to compete with rivals on given trades. Keeping both eyes on their competitors, leading shipping companies do not realise that the recession is a reality, and that the capacity surplus may well end in disaster. Even though they are close to disaster, they carry on adding bigger and bigger ships to their fleet. There's something that's not right here.

Maersk says enough!

On 19 November Maersk's CEO, Nils Andersen, told the "Financial Times Deutschland": "What we are going to do over the next five years, we are not going to invest significant amounts in Maersk Line. We have sufficient capacity to grow in line with the market, we will move away from the shipping side of things and go towards

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[15] *Robert Yildirim, of Turkey's Yildirim Group, also confirmed that he had blocked plans last year by Jacques Saadé, the Lebanon-born founder of the Marseilles-based line, to buy up to 20 large, new ships for use after the Panama Canal expands in 2015*, "Financial Times", 27 February 2012. Yildrim took his share to 30% a few months ago, evidently after having been assured by the French government that CMA CGM would not have been allowed to fall, see on this point his interview at http://www.youtube.com/watch?v=SVo5ZSwIwws.

[16] *"CMA CGM introduces world's biggest box ship"*, "Lloyd's List", 9 November 2012

the higher profit generators and more stable businesses. Maersk Line will then account for 25-30 per cent of capital, so as to set aside 50% for the remainder. In coming years we shall not be going to shipbuilders with new orders, the twenty 18,000 Teu ships already ordered will be sufficient". This news spread like wildfire. Two days later, interviewed by CNN, Andersen confirmed that the company intended to shift resources to more profitable businesses, such as oil and gas and terminals, but also that they would continue to protect their leadership in the shipping market. He added that Europe was the biggest stumbling block in the world economy, but believed that in the second half of 2013 container traffic volumes to and from Europe would begin to grow again.

Andersen can soften the blow as much as he wants, but the message has been sent out. However you interpret it, it is an unmistakable signal. The problem is that the disastrous impact of "gigantism of ships" will be felt by all of us living in countries based on seafaring and port economies.

The Alix Partner study

In October the company Alix Partner published a study giving an overview of the situation, entitled *Sailing in a Sea of Red. The Alix Partner Container Shipping Study*. The verdict leaves no room for doubt: only two out of the sixteen companies reviewed posted positive operating results. Thrilled by the growth in traffic along the two main trades, Transpacific (Asia-US) and Far East-Europe, shipping companies have acquired additional cargo capacity, and the resulting surplus in supply has led to a crash in rates. In 2012 alone 59 new vessels having a capacity in excess of 10,000 Teu came into service. Finally a blow to "gigantism of ships": the aim of making fleets more uniform for the two most profitable trades with capacity levels in excess of 10,000 Teu, with companies introducing rigid operating modules that can turn into a mortal trap: "the trades seeing the greatest growth are the so called 'emerging-to-emerging' routes involving the North-to-South trades. However these trades carry only one-fourth of the volume of the main trades. Efficient operation on these developing trades is better suited to the smaller, more flexible vessels – the type of vessels from which carriers have been shifting away".

In 2011 the losses of the sixteen companies analysed in the study were an estimated $6bn. Total indebtedness was double that of 2007, reaching $90 billion (excluding operating losses). ABOUT HALF THE COMPANIES REVIEWIED ARE UNABLE TO COVER

INTEREST PAYMENTS. And the Altman index, showing the risk of insolvency, highlights a situation of extreme distress.
So companies are short of liquidity, and have to resort to bank loans. Many banks however have removed themselves from the business, or have reduced their degree of exposure in the shipping sector, here we are talking about Royal Bank of Scotland, Lloyds Bank, Commerzbank and HSH Nordbank. To get out of the mess they find themselves in, companies are causing further damage, resorting back to the most basic of services and transferring the consequences of their contradictory actions to their clients. The study states: “Improving profitability is a must. But because of the structural overcapacity plaguing the industry, carriers have decided that the quickest way to reach that goal is to take costs out of the current service offering, leading to a “*back-to-basics*” mentality around client service. Very basic service offerings dominate in many cases, and the value-added “bells and whistles” that can differentiate one line from another have all but disappeared. The unintended consequence: the overall financial risk to shippers has increased as services have been cancelled or modified and as carriers seek to implement capacity utilisation measures that privilege better-paying cargo over shippers that lock in rates too far below market.”
These opinions may not be one hundred per cent correct, indeed the authors themselves warn against their comments being taken as the gospel truth, since the situation is evolving on a daily basis. But I believe they are in line with many other signs and information from the market, and with the general conclusions of my book “Le multinazionali del mare”. The predictions I made in it have indeed come to pass.
This study, actually a White Paper, concludes with suggestions for five urgent actions: aggressive cash management, drastic shrinking of all non-core activities, business plans very much focused on achievable goals, optimising returns on invested capital, immediate debt restructuring with a bank covenant policy (“even if financial restructuring is not required, negotiate with the banks!”).
I cannot say whether this advice will be of use to the sick patient. I might simply note that the 2008 crisis showed how difficult it is for multinationals to change the way they go about their business and make their judgements. They know they are moving towards the edge of the cliff, they can see it coming, but are unable to steer the ship away from the abyss. But they also know there is always someone that steps in to save them just in time.

Supply chain disruption

At the beginning of this year DHL Deutsche Post published a study that sought to be broad in scope, entitled *Delivering Tomorrow. Logistics 2050. A scenario Study*. The study involved universities, enterprises, opinion leaders and DHL top management from around the world. There is no doubt that DHL is currently one of the leading lights of *contract logistics*, and is attempting to imagine what the future will be like. Climate change plays an important part, as one of the study's main questions is: must we carry on attempting to optimise supply chains or must we pour all our efforts into risk management systems, or measures to be taken in the event of serious disruptions to business operations? Hurricane Sandy, for instance, created a host of problems along the eastern coast of the US, with thousands of containers with bills of lading for New York, according to *Lloyd's List* of 14 November, having to be unloaded elsewhere, the port of destination being unavailable. In cases such as this the receivers or the shippers, depending on the contract, have to pay to recover the goods and take them to the right delivery point.

The DHL study did not suggest the imminence of an economic collapse of shipping companies, yet the very fact that *risk management* can be put forward as the number one priority of logistics says a lot about the state of uncertainty in a world that is usually so sure of itself, where everything has to work like clockwork. But let us try to imagine what would happen if one of the world's 20 top container shipping companies were to go the same way as Lehman Brothers. We would witness a cataclysm not of the intangible world of money but of the "physical" circulation of goods. We can already see what is happening in China to get an idea of the movements that are rocking the logistics boat: in the Chinese market shipping prices have begun to fluctuate wildly, as a manager of Hellmann Worldwide Logistics told *Lloyd's List* on 23 November. The whole country is shaking due to rising inflation, falling demand, worker unrest and so on. The services provided by the sunk company would quickly be taken up by hungry competitors, but the shock would still reverberate for quite some time.

Consequences for seaports

Over the past ten years European ports at least have been beguiled by visions of the future dominated by "gigantism of ships". Receiving bigger and bigger ships on longer and longer quays and in deeper and deeper harbour waters has become something of an obsession. It has caused decision makers to lose sight of other priorities and to be hostages to a simplistic and almost blind faith in the unstoppable growth of traffic and ship size. They have probably misplaced their sense of reality, we might say ever since the events of 9/11. Since then the world has gone off in another direction, with unforeseen events – climate change for one – regional or planetary crises, a sort of dance of the dragon that is becoming ever more volatile and unpredictable. Resigned to the prospect of an unalterable future moving inexorably towards “gigantism”, decision makers have turned ports into never-ending construction sites having systems that are less and less flexible and that are costing taxpayers more and more.

In a study looking at investments in the 5 northern ports of Rotterdam, Antwerp, Zeebrugge, Hamburg and Bremerhaven, published in the autumn of 2012, Flemish consultancy firm Adstrat Consulting showed the damage that can be caused by over-investing in harbour works. Those faring worst, Antwerp and Zeebrugge, have a rate of utilisation below 50%, and further capacity increases mean this rate will drop further, the result being chronic losses. Who is going to pay for these losses if not the taxpayer? The average utilisation rate for the container terminals of these 5 northern ports will be an estimated 66% by 2015! Which operator could cope with such a situation?[17] So the paradox is that new, poorly planned investments lead to higher shipping costs (with clients moving away from these ports), while ports are being built that are attaining acceptable profit levels. Even Bremerhaven, the port having the highest utilisation rate of the above five, is in danger of succumbing to the competition of the new port of Wilhelmshaven, Jade-Weser Port, which in turn, having started operations with a delay due to serious building flaws, is faced with a crisis-hit market scenario, and is unable to attract enough clients to justify the enormous costs covered by State funding.

In Italy and in the Mediterranean area, on the other hand, the race towards “gigantism” is leading to some very absurd situations. Colossal projects that will be difficult to realise are discussed for months, demanding extraordinary resources from the State and denying governments, which to be honest are short of ideas themselves, the chance to plan for the future.[18] In Venice, Ravenna, Ancona, Naples, Civitavecchia, Livorno and Genoa, works are being performed to deepen harbour waters, with ambitions that are sometimes realistic and other times outlandish. Of these ports, only Genoa might expect to regularly receive ships over 12,000 Teu in size, as the ship searches for goods, not depth, and because the loading and unloading of an

[17] Reasoning in “industrial” terms, if a plant works well below its full capacity it loses money; in financial terms the situation is a little different. If a concession holder doubles a terminal’s surface area thanks to taxpayers’ money, it is very happy to register a much higher book value for the concession, paying a higher rental, but still earning without having done a thing. It will also have raised its prestige with banks, since its ability to guarantee credit repayment has risen.

[18] The Monti government must have very confused notions if it is considering projects for the construction of new transhipment ports.

ULCC is not viable below a certain volume threshold. And none of these ports, except for Genoa, has a hinterland capable of generating volumes of this size. Gazing intently seawards, in the hope of seeing the approach of a megacarrier, decision makers have forgotten to look at what is going on behind their backs, in this case further inland, the real lifeblood of a port. The more efficient the railway services of the port, the larger the *catching area*. In 10 years Italian ports have seen railway traffic dwindle by 50%.

Not even Genoa will manage to move ULCC traffic if it fails to upgrade its railway services. From the VTE, the terminal of Voltri, no more than 24 trains a day are able to enter or leave. And there is no guarantee that, once they have reached their destination, they will be able to go everywhere, not even in the Milan area. Terminals having a certain capacity are a scarce resource. Only La Spezia and Trieste have significantly raised their rail traffic quotas: La Spezia has 24% of this traffic, and at the end of 2012 Trieste will have more than 3,900 intermodal trains. Venice, its rival in the Upper Adriatic, has none.

Upgrading and expanding ports is not wrong, but it is wrong to do so under the spell of the “gigantism of ships”. It is wrong to raise capacity without having reached out to potential markets inland or forged alliances in the supply chain. It is wrong to focus on containerships and cruisers, forgetting all the rest. But I will be dealing with these subjects and the relationship between ports, “gigantism” and the shipping crisis in another article.

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