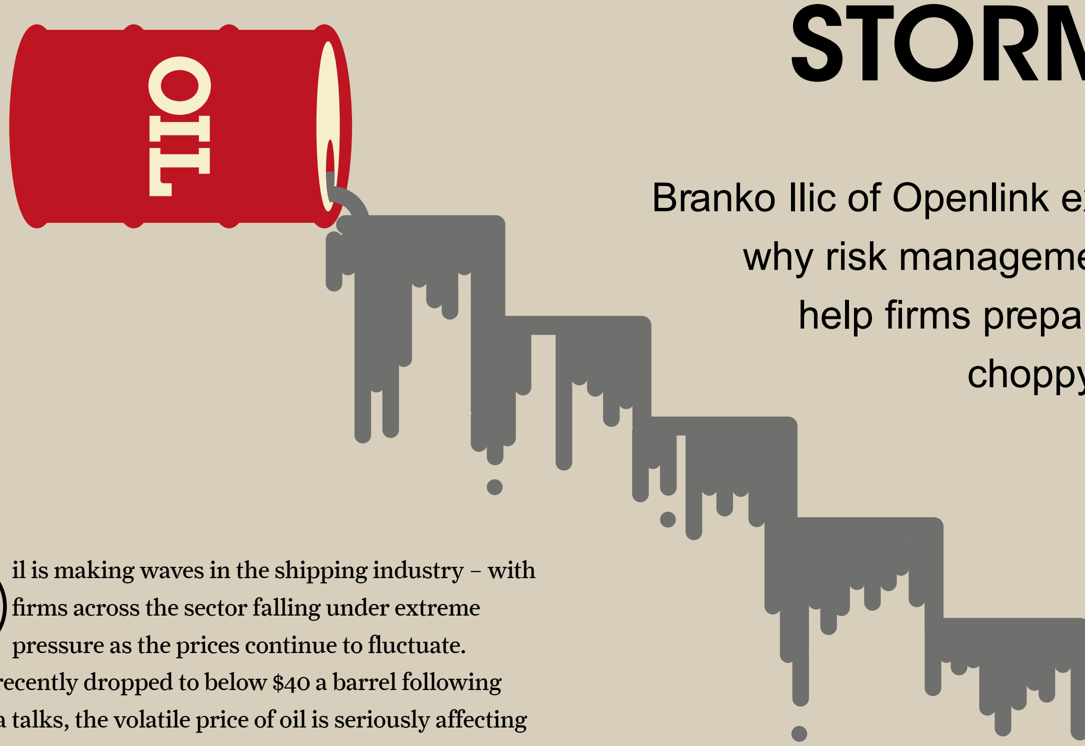
Analysis

CAN THE SHIPPING SECTOR WEATHER THE MACROECONOMIC STORM?



Branko Ilic of Openlink explains why risk management can help firms prepare for a choppy future

Oil is making waves in the shipping industry – with firms across the sector falling under extreme pressure as the prices continue to fluctuate. Having recently dropped to below $40 a barrel following the Doha talks, the volatile price of oil is seriously affecting bottom lines. Therefore it is clear that for shipping firms to navigate their way through these uncertain times, strong risk management will be key.

The industry is a very different place to what it was five years ago, as falling oil prices have triggered a shift in mentality around the type of contracts firms lock themselves into. Suppliers are reticent to tie themselves into long-term agreements as demand cannot be guaranteed and volatile prices can make an un-utilised ship extremely costly. Ship owners, on the other hand, are always looking for ways to enter into long-term deals so they can hedge and lock in future profits.

> **"With oil prices currently fluctuating, larger firms will trade most of their ships as they have a greater capacity to take on risk"**

The type of owners who would do this depends on the risk appetite and the size of the fleet of the firm in question. With oil prices currently fluctuating, larger firms will trade most of their ships as they have a greater capacity to take on risk as well as trade a lot of derivatives around ship positions. For example, a firm with a big fleet would most likely try to lock in a percentage of their portfolio and then trade the rest of its assets on the spot market to make gains from any spikes. In contrast, more traditional ship owners are perhaps less familiar with the complexity of derivatives. Therefore, they are more likely to get all their ships fixed out long term.

“For shipping firms to avoid being stuck in the shallows, they must shore up their approach to risk management”

However, having a strategy to take advantage of oil price volatility is not the only thing to consider about the problem – as shipping firms must also monitor the global monetary policy environment. Negative rates in countries such as Japan and Demark are potentially distorting the shipping market and slowing growth. Many in the industry have argued that negative rates are having adverse effects on shipping as it is hampering growth. Furthermore, the negative rates are preventing consolidation, in a period where more and more firms are forming partnerships in an attempt to reduce costs. In such an asset-intensive industry, with falling profit margins, consolidation is arguably vital for survival for many firms hampered by overcapacity, pricing pressures and long-term financial losses.

The result is clear: a more complex market with higher levels of volatility equals greater potential risks. For shipping firms to avoid being stuck in the shallows, they must shore up their approach to risk management by ensuring they have the right trading and risk management systems in place. Any system needs to cover both physical and financial contracts so that shipping firms can get a fully aggregated view of positions and risk, as well as potential profit and loss. After all, no firm wants to run unnecessary risks by staying rooted to the same old approach to risk management.

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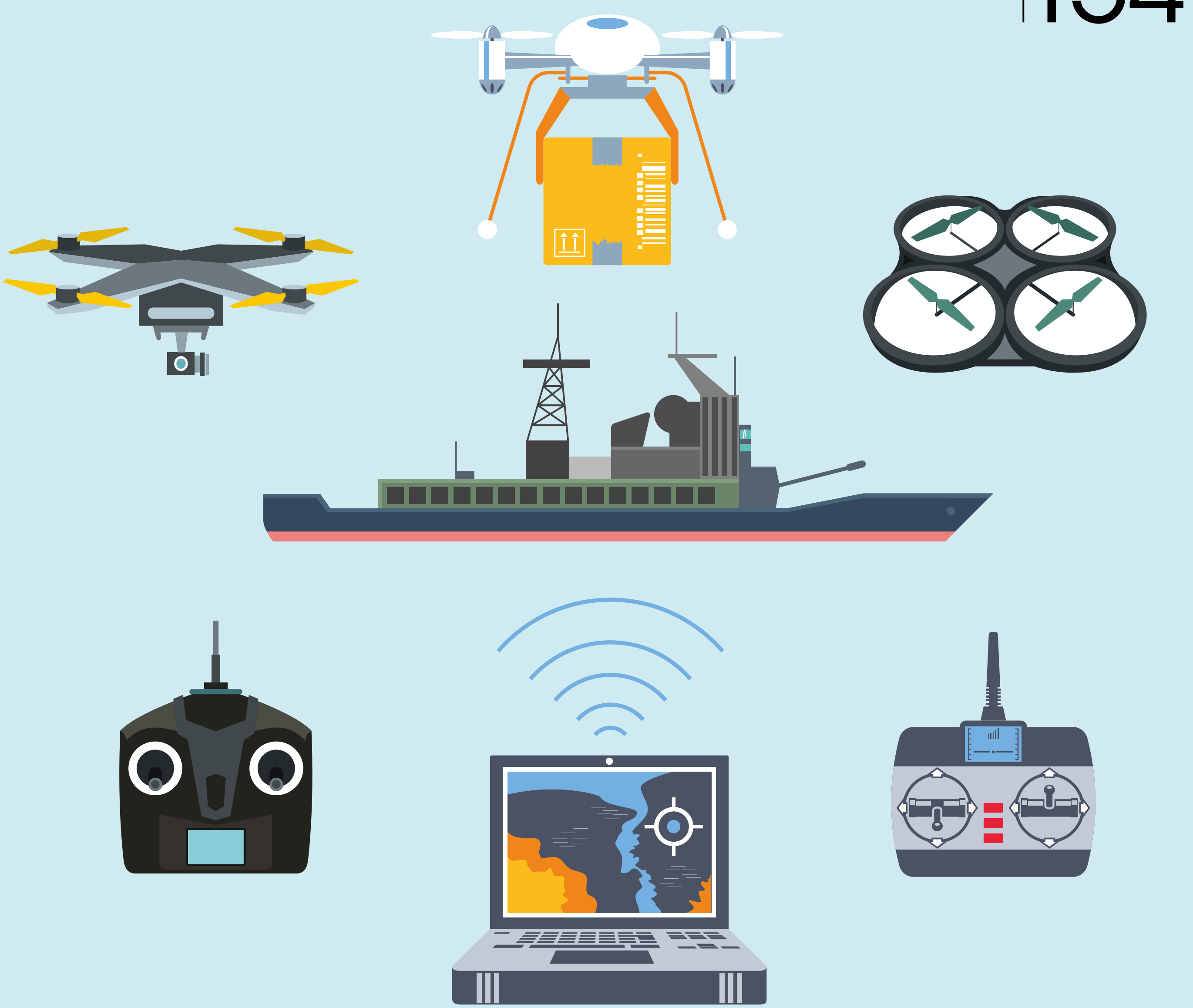

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