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Winning Global Supply Chain Advantage

Banking and Shipping – An Interesting Parallel

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Generally shipping has been a relatively placid business. Ships plod oceans, taking days to reach their destinations. Meanwhile, shipping managers had ample time to make the all important decisions around buying and selling of shipping space.

The rates after all varied within a relatively narrow band. On top of it, the shipping companies always seemed to have the power in the container trade. They were organized in liner conferences (legalised cartels), they had far more information during the negotiation game (information asymmetry) and anyway, many of their customers did not seem to care because they could pass on the high rates to their own customers (inelastic demand due to derived nature of it).

All this has now changed!! Firstly the volatility has increased massively. Secondly, the large freight forwarders (NVOCCs) are now almost as big as some container lines.

Thirdly, with the focus on the end-to-end Supply Chains the costs matter a lot, both to the NVOCC, for whom it might be a matter of Survival, and to the final customers who are now focused more than ever before on their Shipping costs

Why is all this relevant? Because, the shipping industry is still running like the banks used to run before the savings & loans debacle of the 1980s.

Let me explain. Banks used to borrow money on short-term deposits, and lend it on long-term mortgages. In the middle they used to keep enough margins to be able to absorb any minor interest rate fluctuations. That was great except for the time when interest rates moved massively in relative very short periods. Banks had to borrow short term at much higher rates than the mortgage rates they were getting on the long term fixed mortgages. In the language of finance, there was significant mismatch between the duration of the assets and duration of the liabilities. The rest is history.

Now it appears that the same history is about to repeat itself in shipping. Let us consider the position of a large NVOCCs. They negotiate annual contract with the liner conferences, the terms of which are more or less fixed for nearly 12 months. On the other hand, its customers are made up of people who negotiate contracts on voyage basis to up to 3 year with the large fluctuations in rates that we currently see. There is almost no way of making sure that the NVOCC would always make money on its contracts.

It appears that the NVOCCs today are taking the same gamble that the banks were taking in the 1980s. With the same hope too! That somehow in the end it will all even out, leaving them with a reasonable profit.

And many times it does too. NVOCCs are after all quick to raise rates when their costs (driven by the lines) go up. On the other hand, they do manage to hang on to the high rates when shipping line's rates are declining (as is happening now).

However, it is only a matter of time before one of them in the intense heat of competitive fury, fixes a reasonably long-term global service contract with a large corporate at a rate that leaves it exposed to rate fluctuations.

So what is the solution?

After the S&L debacle banking industry evolved a range of solutions. Variable rate mortgages, duration matching techniques, other sophisticated analytics, sophisticated industry regulators, guarantors were all part of that solution for the banking Industry.

For the shipping industry range of equally diverse and sophisticated solutions might be necessary in the long run. But the first step to solving a problem is to define it precisely. Let's take the first step before it is too late.