SHIPPING AND STRATEGY: ARE THEY POLE APART?

Just as Peter Drucker can be credited with creating the brand and 'Management', Michael Porter can be credited with creating the brand 'Strategy'. Both these areas of human thought were largely unexplored in an explicit manner before these men started writing about them and popularised them.

Strategy as a field of exploration, started with simple postulation of generic competitive strategies of cost leaderships, differentiation or niche strategies in 1985. Since that time the field has grown rapidly. Boston Consulting Group's growth-share matrix Scale-curve analysis, Booz Allen and Hamilton's Product Life Cycle and McKinsey's 7-S model firmly established these firms as the leaders of strategic through in the commercial world. Over the last 20 Years, both the academic and the commercial world have exercised a great deal of mental muscle to come up with better and better strategic models, solutions and methodologies.

For some reason, though, the shipping industry has remained suspicious and aloof from all this development. Why? And is that good or bad for the industry? Those are two questions that need to be answered.

What do we mean by the above statement? Strategy is a methodical approach to gaining and sustaining long-term competitive advantage.

Very few, if any, shipping companies do this. They are quick to copy each other in a race to lowest costs, a race to the shipyards, or a race to the lay-up. As one investment banker quipped 'Perhaps with the exception of the airlines, no other industry spends such a lot of money with this little thought.'

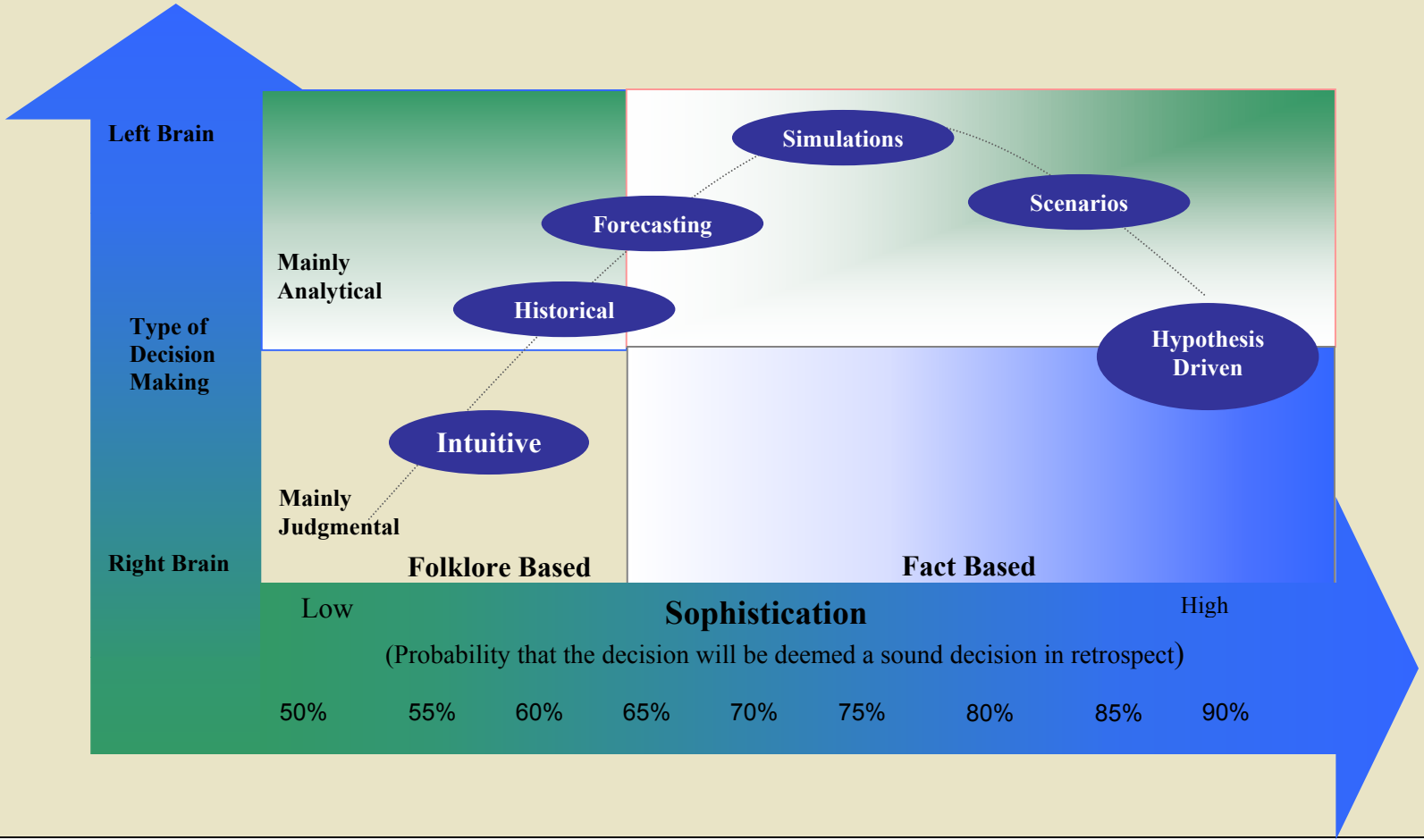
At a very basic core every decision maker relies on his/her intuitive judgement to make a decision. This is perhaps the start of strategic thinking. In terms of advent of strategy, this indeed, is the first step shown in the figure. At this stage decisions are made in the mind. The decision making process is largely opaque – all the factors, all the data, all the trade offs reside in the decision maker's mind. Many times the decision maker may not be even able to explain how he/she made that decision. They might just say " It is my gut feel". Lots of great decisions are made this way. But many of the greatest disasters are too.

Moving forward from intuitive decision-making, the decision maker relies on

The historic demand and supply data to make judgments on the future course of action. The assumption is that history will repeat itself. While it is useful to some extent, this approach is clearly akin to driving forward while looking in the rear view mirror. The dangers of such an approach are self – evident.

A step better is forecasting. Most shipping companies rely heavily on forecasting. There are as many forecasting algorithms as there are recognised statisticians. One thing they all have in common is - most forecasts are mostly wrong. So why use forecasting at all? Because the associated statistics gives us enough data to do something better then forecasting: simulations.

Shipping companies are starting to embrace simulations. Value-at-risk (VAR) models are based on such simulations. Simulations define the outcomes from a particular course of action in probabilistic terms. This is a very powerful breakthrough.



Strategic Thrust	Key Elements of Methodology	Example	Pros	Cons
Intuition	• Absorb as much information on the issue as is available, • Access situation, • Decide on the potential course of action, commit half heartedly to it, • Watch for early results, • Change direction as necessary	• Military Officers, Pilots and ship captains are trained for rapid decision making • Fire and other rescue teams • Suitable for most situations where the decision maker has faced exactly the same decision criteria several	• NO paralysis by analysis • Saves times-especially in situations where time is of the essence.	• Can easily read to wrong decision (several key military decisions of many wars were proven to be wrong in retrospect). • Can easily lead to overconfidence; situation may have changed without the decision maker's knowledge.
Historical Supply Demand Analysis	• Dig out historical supply demand data • Make a judgment about future course of action based on data • In the next period reason out success and failures, and do the same all over again	• Most economic analysis is based on historical demand-supply analysis.	• Quick way of considering the key facts • Useful for static, stable markets.	• Very few markets are stable enough for historical analysis to be sufficient for decision-making.
Forecasting	• Take historical data, • Use one or more forecasting algorithms to forecast the future base on historical data, • Make judgment about future course of action based on based on forecasts, • In the next period reason out success and failures, and do the same all over again	• Demand forecasts for most goods and services are the bases for most Sales and Operations planning. • Suitable for several other tactical planning situations where	• Reasonably good for tactical decision making	• More forecasts are notoriously inaccurate. If someone could accurately forecast the future they could make a killing on the stock market. • Over-reliance on forecasts and inadequate use of associated statistical information is a common problem in business.
Simulation	• Take historical data, • Use one or more forecasting algorithms to forecast the future base on historical data, • Create a probability distribution of future data based on forecasting algorithms or uncertainty in the input. • Use probability distribution function to assess risk reward trade-offs for future courses of actions, • Decide on a future course of action offering the most attractive risk reward trade-off, • Repeat the cycle in the next period	• Value at risk modeling to measure and manage risk of portfolio management situation ranging from banks, trading and commodities to shipping. • Modeling of uncertainty in any business situation can be done by simulations-such as demand planning, operations planning production planning etc.	• Most decision-making is under uncertainty simulation are Excellent tool to model uncertainty. • Allow the decision maker to gauge the probability of various possible outcomes, and from these make a trade-off between the reward they seek and the commensurate risks.	• Sometime the information is too hard to interpret or act upon. • As with all Modeling, the results reflect the inputs. The dictum GIGI (garbage in garbage out) equally applies here. • Results may not be conclusive enough to be actionable.
Scenarios and War gaming	• Make an effect to think about various possible scenarios related to all PARTS (Players, Added value, Rules, Tactics and Scope) of the business situation. • List of main courses of action and their probabilistic payoffs based on forecasts. • List potential responses of other players to each of these courses of action and their respective payoffs. • Construct a decision tree, which allow the decision maker to think forward and reason backwards. • Choose the option that gives the best-expected payoffs.	• Actual war gaming exercises use scenarios planning extensively • Game theory applications have ranged from frequency spectrum auctions, to public policy planning and negotiable in political and commercial world. • Long term Strategic planning frequently entails extensive use of scenario planning.	• Forces the decision maker to think about the unthinkable, and plan for it. • Very powerful tool to analyze systematically several steps ahead.	• No matter how hard one thinks it is impossible to make a list of everything that you don't know. • Can be very time consuming • Consensus may not emerge even after protracted discussions.
Hypothesis driven strategy (Aristotelian Approach)	• Brainstorm for hypothesis generation on key business issue. • Collect necessary and sufficient data to prove or disprove the hypothesis. • Conduct necessary and sufficient analysis to prove or disprove the hypothesis. • Decide on a future course of action based on results of previous steps, • Prepare detailed implementation plans including timeframes, milestones, responsibilities, and tracing mechanisms. • Implement and track	• Universally deployed in scientific studies and universities. • In commercial world, applications can be seen at top-tier consulting companies and their clients. • Most effective decision makers use this approach in disguise.	• Fast, actionable, and reliable. • Fact based. • Good mix of analytical rigor and intuitive mastery. • Robust, well documented methodology. • No jumping to conclusions (that might prove to be enoneous in the hindsight). • No churning the ocean with endless data collection and analysis.	• Usually take longer than intuitive decision making. May not be suitable when there is no time –e.g. insolvent companies.

Even more powerful would be its application to real options analysis – situations that shipping companies face almost on a daily basis. However, that is an area which shipping companies have not yet explored.

Scenarios analysis or war gaming is the next step in the evolution of strategic thought. This technique introduced from the military world to the business world by the likes of Shell, has been very powerfully utilized to simulate holistic thinking.

This technique is also advent of the strategic thought; all earlier techniques were primarily analytic technique. As the name implies this technique incorporates the principal of looking ahead and reasoning backwards (all the way to conclusion). However, this technique can quite often overwhelm the participants, especially when no consensus emerges.

The most sophisticated decision methodology known at present hypothesis driven approach – is barely used by few shipping companies. This technique is an art in itself, when properly deployed can produce fast, robust and actionable decisions. It involves starting with a brain – storming exercise to generate hypothesis about the current state of affairs (akin to a doctor creating hypothesis around what ails a patient). This is followed by data gathering and analysis – only to the extent it is necessary to confirm or disconfirm the hypothesis. Based on the results, future course of action is decided. This rigorous, scientific approach can be extremely powerful if the discipline of the methodology is adhered to. However, it is quite easily slip into sloppy ticking the box approach of maintaining from our substance.

It is quite clear from the foregoing that the shipping industry - though steward of huge amount of global capital – is particularly cavalier in its approach to strategy setting. Why?

Insular nature of industry: For a long time our industry has believed that there is a certain black art to managing ships – something that mere landlubbers would never understand. This has led us to stay clear of most of the fads fashions of boardrooms on other organizations, saving our industry a lot of money and frustration. But, at the same time this insularity has also meant that, barring technology, we are one of the last industries to apply innovative business practices originating elsewhere. While we might be wrapped up in our own greatness, the world is fast overtaking us. Evidence today is that the current boom is benefiting the shipping services companies – from logistics, 3PL, 4PL shipping banks to ancillary industries a lot more than the shipping companies themselves.

Overwhelming cost focus: During each depression (the dreaded D word) our industry gets focused – and rightly so – on cost cutting. Nothing unusual in that. However we are slow to adjust to the boom era where different strategic focus is needed to capatalise on all the opportunities. We have conditioned ourselves to believe that after each short bout of sunshine there is going to be another long dark night, and we must save up for that. With sound strategy this need not be the case for the business innovators in the industry. Look at shining examples in the other so-called sunset industries – LNM Steel in steel manufacturing, BHP Billiton in mining. Dell in PC assembling, Toyota in the car industry. All these companies not only survive depressions – they thrive in adversity thanks to their keen strategic focus.

Lulled by traditional economics: Ships, being large floating units of capital, are very easy to count and classify. Demand and supply Are extremely easy to account for. This leads us to believe that it is equally easy to predict (which is true to some extent in case of supply. After all, order books of most shipyards are transparent to a large extent). Most shipping companies appear content with trying to be tipsters in the game of managing supply to their advantage in face of an anticipated demand. Strategy games are much more than those zero – sum games. They

Fitness to understand all the PARTS (Players, Added Value, Rules, Tactics, Scope…) and swing these to our advantage.

Is it necessary to acquire a keener strategic focus? Absolutely. To escape the cycles of boom and bust, to drive in adversity, and to be equal partners in the global commerce, our industry innovators need to think and act as the same level as industry innovators in other global industries. Perhaps the current boom, cross-fertilization of ideas with Wall Street and global approach to supply chain management would address some of this insularity. However, the first rule of strategy is to not leave outcomes to chance – to take control and create the desired outcomes.

- Vivek Sood

Mr. Vivek Sood is a director of Business Intelligence Group Based in Sydney, Australia, which he helped co-found in 2000. He combines 10 years of sea-going experience with nearly 12 years of strategic consulting experience at top-tier consulting firms. Mr. Sood specializes in advising boards and senior executives of large corporations on supply chain strategies.