



# SHIPPING: COMPETING IN A GLOBAL MARKET

Analyzing the industry's value chain

By Professor Peter Lorange (March , 2008)

**IMD**

Chemin de Bellerive 23  
PO Box 915,  
CH-1001 Lausanne  
Switzerland

Tel: +41 21 618 01 11  
Fax: +41 21 618 07 07  
info@imd.ch  
<http://www.imd.ch>

The shipping industry is a perfect example of how globalization will force many companies to restructure fundamentally, calling for new strategies and business models. In his forthcoming book, **Owning ships or operating steel: New strategic thinking in shipping**, Dr. Peter Lorange talks about the resulting turbulence which, he believes, will create opportunities especially for the first-movers.

Traditionally, a successful shipping business was linked to the amount of tonnage it owned. It also undertook various associated functions such as buying and selling ships, financial operations, promoting innovation in ship design and in-house crewing. However, with growing external investment, publicly traded companies and professional managers are replacing the privately-held shipping companies and shipowners of the past, bringing with them a focus on integrity, timeliness and accuracy of financial reporting.

### Consolidation

Shipping companies reacted to the resulting pressure for improved performance by consolidating, and they needed to be large to compete in the global economy. Size not only gave them the flexibility to move their ships around to take maximum advantage of the fluctuations in supply and demand, but it also deterred would-be competitors from entering the market. More importantly, alternative financing based on large-scale fleets, was one way of producing the financial results expected by the shareholders.

### Specialization

But companies that aspire to become global winners may find that specialization is the answer. By specializing, shipping firms define their core activities and thus the commodity-based activities that can be outsourced. This means a company can find one sliver of the business it excels at and then broaden out through outsourcing across other sectors, thus delivering a specialized product that can compete on a global market.

The resulting specialization is breaking down integrated shipping companies into four archetypes – owning steel, using steel, operating steel and innovating around steel. Those firms that own steel will focus on size, scale and low costs. Those that use steel will focus on developing strong bonds with their customers via scope, brand name, operations, service, etc. The third archetype will concentrate on innovating around steel, while the fourth specializes in operating steel with a focus on low cost crewing and maintenance.

## Why change?

For those struggling to overcome the sentimentality of actually owning ships, there are five key reasons why the classical integrated shipping company approach should be revised. Firstly, because owning steel usually requires a long-term focus, which needs a lot of liquidity, with a resulting high risk factor. When using steel, however, stop-loss management is paramount!

Secondly, steel owning implies the efficient running of ships as well as asset-play timing, with the ship being the unit of transaction. However, using steel implies financial engineering, chartering, marketing and trading with freight derivatives etc – not necessarily based on the ship as the unit of transaction.

Thirdly, whereas in the past, the different shipping activities were integrated into one package, customers are now able to access the specialists with little transaction cost. There is less likely to be any long-term benefit in exclusively controlling all parts of the business as has previously been the case with large integrated shipping firms. In fact, it could have a negative effect. For instance, if an innovation-specialist firm, such as Marsoft, were involved in shipowning, trading and operating, its advice would no longer be seen to be truly unbiased.

Fourthly, financing takes on different forms with specialization. For shipowning, for instance, the emphasis will be on securing the lowest cost of capital. For a trading or chartering firm, however, the focus will be on securing reasonable financing based on a relatively steady, ideally growing cash flow. This would also make it easier to secure public funds – in contrast to the less predictable cash flow patterns of classical shipowning firms.

Finally, different aspects of the value chain require different competencies and managing too many unrelated activities at world-class standards can be difficult. By focusing on fewer activities, the chances of excellence increase along with the chances of success for the firm.

## Paper or steel?

In reality both “owning steel” and “using steel” can be found within the same firm, but it is important to separate the focus for each archetype of business. Awilco, a Norwegian company, has two shipping platforms: tankers and offshore supply platforms, but it also specializes in investing in stock within the shipping and offshore segments, using its specialist knowledge to decide where it can get the best return before the majority of the institutional investors discover how the underlying market is performing.

This emerging tendency towards more paper market trade is accentuated by the emergence of derivatives and futures trading as well as that of the International Maritime Exchange (IMAREX). Specific funds with asset play in mind can likewise be established. In order to achieve the asset play objective successfully, timing decisions for both entering and leaving the market are critical. Clearly, it is easier to enter and exit the stock market and/or the future trading market than to purchase and sell actual ships.

Shipping firms that focus on innovation represent the third archetype of specialization. In the past, the integrated shipping companies tended to deal with their own in-house innovation – often with rather homemade results. Specialization often delivers better quality results. Operations, the fourth archetype, provide crews as well as the day-to-day maintenance for ships.

### **What to do**

Faced with the need to adapt, the first step for a shipping firm is to determine where the most promising opportunities might be now and in the future. This should be followed by a specialist focus on one of the archetypes along with a clear understanding of the critical success factors. It is important that management understand what is imperative for their specific business, based on the particular specialist archetype chosen. It is likewise critically important to understand who the customers are for each archetype along with the kind of service they want.

For all of these emerging specialist shipping firms, however, it is vital that planning, leading, staffing and managerial focus be tailored to the given archetype. There is no one best way to run a shipping firm. Focusing on what really matters is key – and these critical success factors will differ for each of the four shipping business archetypes.

Dr. Peter Lorange is the President of IMD. He teaches on the High Performance Boards (HPB) and the Orchestrating Winning Performance (OWP) programs.

## RELATED PROGRAMS



### **ORCHESTRATING WINNING PERFORMANCE - <http://www.imd.ch/owp>**

#### **The 6-day global business program**

Program Director Bettina Buechel

- A unique energizer: boost your performance, broaden your perspectives and expand your global network
- Design the program that suits you



### **INVESTMENT AND RISK MANAGEMENT IN SHIPPING - <http://www.imd.ch/irms>**

#### **Anticipation, Strategy, Action**

Program Directors Jean-Pierre Lehmann and Arlie Sterling

- Explore macroeconomic trends, demographic shifts, market changes, political and strategic context, effective trading guidelines and risk management
- Network with industry leaders from around the world and from all segments of the market