Shipowning: Mounting obstacles and how to overcome them

Greek shipping has developed as a result of the effort and commitment of individuals who pursued their quest by overcoming adversity. Shipowning has been and still is a risk-full occupation with a discouraging survival rate. Nevertheless, the successful ones have grown to form in many instances shipping empires and have collectively formed the 'Greek shipping miracle'.

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This article is devoted to all readers who have a burning ambition to enter shipowning and are intimidated by the numerous obstacles erected before them.

In my opinion, a healthy rate of newcomers is synonymous with the continuous evolution of Greek shipping as it brings with it new ideas, dynamism and fresh entrepreneurship. Assisting such new entrants to succeed is, I believe, part of our duty towards our industry and this duty should be shared between shipping bankers, advisors, the shipping ministry, the industry's bodies such as the Greek Shipowners' Unions and the wider shipping community consisting of suppliers, repairers, agents, insurers, etc. Over the past decade in particular, the barriers to new entrants have grown enormously thus rendering their task much more difficult. Briefly, the increased obstacles can be categorized as follows:

1. Financial

Banks have increasingly come to the conclusion that new entrants represent a higher and, in most, cases unacceptable credit risk. Banks would rather lend large amounts to top names (often with poorer terms/returns) than to spend time assessing the survival chances of a new entrant. In addition, the "herd" instinct is very strong among bankers and few dare risk their careers by supporting a new entrant even when the risk/reward appears acceptable. The new Basel II criteria have re-enforced the above tendency and so has the newbuildings rush by Greek owners, which offers banks the ability to lend against new assets, often with the benefit of secure charters.

Banks have set minimum credit criteria which involve clients with a minimum number of vessels, a young fleet and a long and successful operating and credit track record. Clearly, new entrants have none of the above attributes. They do, however, have other qualities, which may in part at least compensate for their above shortcomings as I will explain later.

2. Regulatory

The rush of new regulations and procedures has become a stampede. In addition, to the ISM Code and the new ISPS, owners have faced increasingly stricter Port State Control inspections, Class and Flag scrutiny, charterers' selection procedures, insurers' scrutiny, etc., all of which weigh disproportionately heavily on small owners, let alone a new entrant.

As such, a new entrant will have to convince banks, insurers, charterers, flag and class and the market as a whole that they have the organisation, attitude, ability, experience and resolve to overcome the above obstacles.

3. Economies of scale

Larger companies can spread overhead costs among a larger fleet and achieve fixed cost economies of scale. There are also commercial benefits, such as lower or more efficient operating, technical, procurement, insurance and crewing costs. Lastly, size also counts in obtaining better charters, spreading charter risk, admissibility into employment pools, etc. The above economies of scale are significant and impact on small fleets of up to 3-4 vessels. Thereafter, they are still significant for fleets up to 8-10 vessels and decline relatively thereafter. It should be said that once shipping companies exceed 10-15 vessels, there are also diseconomies of scale that emerge to counteract the declining economies of scale. Clearly a new entrant has the odds stacked up against him.

organisations actively cares to support new entrants. They are regarded either with apathy or often with open hostility. To a new entrant this is seen as a conspiracy by the "haves" towards the "have nots". The relative absence of pure "shipping banks" and the elimination of small banks from the banking scene have added to the lack of interest.

Lastly, as the industry is increasingly being concentrated in the hands of relatively few owners as part of the wider consolidation trend in both shipping and other industries worldwide and as most bodies and organisations are increasingly dominated by the powerful few, the interest to support new entrants is now a very low priority indeed. If there are many aspiring shipowner readers that are still with me and have not "slashed their wrists" by now, there are better news ahead. Please read on. The way to overcome the above obstacles is not to deny their existence

4. Insurance

Lately it has become virtually impossible to obtain any terms for a "single ton" Hull and Machinery and P&I cover. In the few occasions where this can be obtained it is done at disproportionately high costs often double or even triple the corresponding cost for a large owner.

5. Lack of support

It is true to say that none of the shipping industry's

but to recognise them and put forward counter arguments or reasons to support a new entrant. It is fair to say that to stand a better chance at a new entrant's project coming off the ground, the minimum start must be 2 vessels. Such a start considerably increases the odds of obtaining both finance and reduced cost insurance. Selection of the right shipping sector is also paramount. Entering the tanker or container sectors, dominated by major players and being extensively vetted by charterers is an uphill start. Choosing a smaller niche within such sectors, i.e. container feeders or smaller product or specialist tankers may assist but still the capital commitment tends to be rather large.

The safest bet by far is to choose a sector showing higher owner dispersion, such as the dry bulk sector. Here, according to the latest Petrofin Research®, surprisingly the average number of dry bulk vessels owned by the 332 separate dry-bulk management Greek shipping companies is approximately 4. This sector gives the new entrant a relatively low size barrier. Within the dry bulk sector, since a new entrant's capital is low it is safer to choose smaller vessels. However, they should not be so small as not to allow an owner to finance such vessels or obtain period charters if he so selects. As such, 15-25,000 DWT does appear to be a reasonable size and bearing in mind that few are being built, such vessels do not face as high a risk of obsolescence or competition with newbuildings. Latest Clarkson's statistics show that in the 15-25,000 DWT sector, over 72% of the existing fleet is over 15 years old.

Vessels of attractive specification should always be sought so that they represent desirable assets at all times, attractive to owners, banks and charterers. As such, vessels with questionable engines or poor gear or of poor specification and in bad structural shape should be avoided. The ultimate test is whether the proposed choice is acceptable to charterers, the banks and insurers and if they can be operated efficiently and economically.

Age of vessel is a criterion especially for banks. Banks are used nowadays to financing newbuildings and vessels under 10 years old and are unlikely to get excited with financing vessels over 20 years old, regardless of their condition. As the proposed vessels' age rises the interest of banks falls and ultimately financeability collapses. To conclude, from a banking point of view vessels of between 12-15 years old should be sought with special surveys and dry-docking not due for at least 12 months or so.

The timing of the purchase is a key contributor to the success of the venture. New entrants may be induced to buy during buoyant shipping conditions on account of higher earnings but it is the capital price for a ship that is the key determinant of success. For example, a 25-30,000 DWT 10-year old vessel's price has ranged between \$6m to \$10.8m over the last 6 years alone and clearly a purchase close to \$6m would have resulted in a useful springboard for the subsequent expansion of the fleet. Here the proposed start with 2 vessels is seen to work best as one vessel can be sold and its profits can be used for new purchases, whilst the other vessel continues trading. Alternatively, the 2 vessels whose value to loan would continue trading could be used together with new equity and/or trading profits to add a further 1-2 vessels. Although the right type, size, age and timing of vessels is important, the organisational structure and new entrants' approach to entering the market is even more fundamental to the success of the new venture. The new entrant must establish a clear strategy and put it across clearly with banks, insurers, etc. Capital represents the key building block and enough capital should be secured. It is believed that a minimum of \$3-5m is required for a 2-vessel fleet bought at a relatively low period of the shipping cycle.

As such the finance being sought at the start of the venture should not exceed approximately 60% with sufficient working capital in reserve. Such a relatively low percentage of finance should give banks more comfort especially if one-year time charters are also secured providing some initial income consistency. Smaller banks and/or niche financial institutions may be interested in such deals provided they are not deemed to be aggressive and speculative.

with frequent financial and qualitative information. Shareholders and/or member interrelations are of vital importance in a new venture and should be based on integrity and full information flow. Banks as well as all other shipping organisations will respect a new venture if it consists of experienced shipping professionals, if it has a clear vision, strategy and organisation and sufficient capital and commitment to succeed. In addition to the above approach, there

I should mention here that independent shipping consultants with long finance experience and an established name in the sector of shipfinance can and do play an invaluable role in guiding new entrants through the critically important steps into shipowning. The new entrant's strategy and background must be presented clearly as well as offer full transparency. But how does a new entrant get $3-5m in equity? This is perhaps the most difficult problem to tackle and I will provide readers with some of my thoughts. There are many ways to seek capital and the matter is largely subjective. From my point of view, in order to access sufficient start up capital it is recommended that a number of shipping professionals sharing the same burning ambition and having professional respect for each other and their respective capabilities should join forces. The ideal mix would be for each to cover a key area of management, i.e. technical, operations, crewing, chartering, regulatory, procurement, financial/accounting, etc. The above founding members should commit as much as possible over the $3-5m capital required as well as the commitment for each to handle their respective duties in the new organisation. Management may consider also entering into private agreement with passive investors from their respective circle of friends and associates stressing at all times that such investors should trust the new management and be of a trouble free nature. The nature of such relationships are once again quite subjective.

Such passive investors should also be consulted on all major decisions, i.e. purchase, sale, long t/c, etc. but otherwise the management to remain free to run the vessels to the best of its ability in line with a predetermined budget and

may be successful new entrants who might exploit opportunistic deals or reduce the size and value of vessels to so little as not to require bank finance at the beginning of their endeavours. Trying to make it with one or two highly overage and of doubtful quality vessels in today's market is asking for trouble. Professional ship managers do offer a combined management and often finance offer but this is more for passive investors with sufficient capital wishing to enter shipping slowly and without needing to set up a whole management organisation. Other new entrants may decide to enter shipowning through the chartering side by developing a name as charterers and developing joint ventures with other owners. This is, however, a long process as it takes time to build up a reputation as a quality charterer and the risks involved in reading the market wrongly cannot be underestimated.

I should also mention as another way to enter shipowning the decision to bare-boat charter one or two vessels. If sellers can be found to sell their vessel on bare boat hire purchase, often at a higher sale price, this method is attractive to the extent that it allows a bareboat charterer to manage the vessel(s) and build up an operating record without raising finance other than to put up the upfront bareboat deposit and finance the vessel's working capital requirements. I hope that in this article I have presented some ways that the new entrant may enhance his chances of success. The successful formula would need to be fine tuned to the particular strengths and weaknesses of each aspiring new entrant. Wishing all aspiring owners good luck, good timing and lots of success.