# PIRAEUS MARINE CLUB

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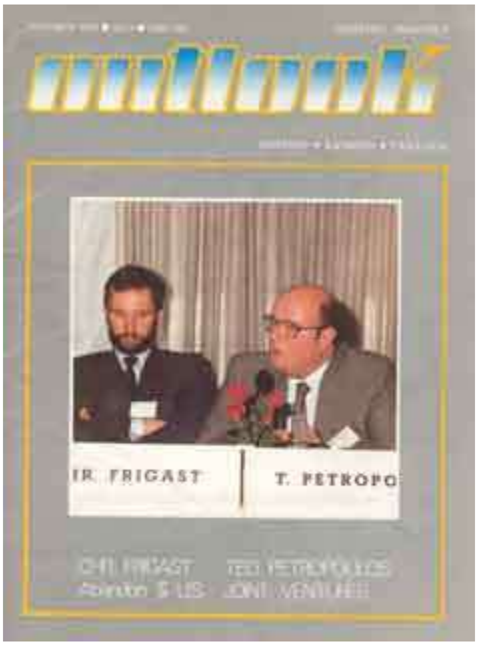


## Maritime Joint Ventures

I will tackle the subject of Maritime Joint Ventures (MJVs) between participants of Less Developed Countries (LDCs) primarily offering cargoes and shipowners of Developed Countries (DCs) offering capital, management and operational expertise.

I will concentrate on 2 main areas:-

1. **What are the advantages of and obstacles to MJVs and;**
2. **How does a large international bank assess MJVs from the point of view of providing secured finance and on , the likely positive and negative aspects of MJVs as they affect financial risk.**

**1.** The factors supporting the formation of MJVs are numerous and significant, with benefits to both participants.

The main advantages to DC participants (i.e. shipowners) are as follows:-

1. Securing the availability of cargoes over a period of time. This ensures the utilisation of vessels brought into the MJV at rates which should be consistent and adequate to provide satisfactory returns to both parties. The rates required to achieve this are likely to be low, given the currently depressed second-hand vessel values.

2. Sharing of the equity capital required. Both parties are expected to contribute towards the equity capital required by the venture unless an unequal MJV is envisaged.

3. Sharing of the risks of the trade. However, given that the purpose of the JV is the transportation of existing cargo import / export requirements by the LDC at mutually acceptable rate levels, the risks are reduced.

4. Lower costs of operation. Should competent local crews exist or can be developed, then some savings can be had by using inexpensive local crews. Depending on the structure and location of the MJV, some overhead savings may also be realised by operating out of a relatively inexpensive country.

5. Some justifiable fees can be charged by the DC partner for work performed over and above the MJV envisaged duties of each party i.e. technical support. These costs may be borne by the MJV and paid directly to the DC partner. Such a scheme will utilise the DC partner's already existing administrative and technical staff.

6. The incentives to DC participants to enter into Joint Ventures are strongest at a time of recession.

The main advantages of Joint Ventures to LDC participants are as follows:-

***Economic / Financial***

- *Locking in low, stable and long term transportation costs. This is particularly true in to-day's depressed market conditions.*
- *Opportunities to share in the vessels' capital appreciation potential from current depressed second-hand vessel values.*
- *Reduced equity capital requirements as well as sharing in the risks of the trade.*
- *Enhanced access to finance as an MJV because of involvement of a quality known DC partner.*
- *As MJVs are expected to stand on their own feet and raise project finance. A state guarantee may not be required and, as such, there may by reduced overall LDC foreign debt obligations.*
- *Development of finance / financial control experience.*
- *Minimisation of foreign currency out- flows as well as allowing some currency inflows i.e. crew remittances, cross-trading income etc.,*
- *Unless LDC partner is a state/state owned concern, previously untapped local equity capital may be attracted.*

***Management / Operational / Technical***

- *The MJV through the DC partner will have access to greater management, operational and technical know-how with corresponding benefits in knowledge and experience to the LDC partner. In this process, the establishment of a stable shipping line / concern run on efficient profit maximisation lines will be of assistance.*

- *Once an MJV is seen to work, the development of a success record will be invaluable for the LDCs shipping development plans.*

***Other advantages***

Joint Ventures require and encourage:

- *The development of a legal (maritime) infrastructure by LDCs, i.e. maritime code, established legal procedures, speed of legal procedures, priorities, etc.,*
- *The development of an LDC infra- structure, i.e. shippers, cargo and sale and purchase brokers, insurance brokers, etc.,*
- *The development of LDCs' port infrastructure, i.e. cargo handling, trans-shipment, local repairs and maintenance, further inland distribution, etc.,*

In analysing the obstacles to MJVs, we must begin by looking at the likely participants.

On the LDC side, participants are likely to be governments or state owned/run corporations rather than private shipping companies. This is essentially due to the lack of capital, management and operating expertise and lack of tradition in shipping.

DC participants are likely to be private or publicly quoted companies with an established position in the industry, run on entrepreneurial and profit maximising lines but at the same time developing an alertness to structural changes in sea transportation which calls for MJVs. The first and major obstacle to MJVs is the lack of communication between DC and LDC interested parties. Even if interest in developing the concert further may exist, there are no established routes for expressing that interest or of beginning a dialogue with potential identified partners. At the same time, interested parties do not have access to any international organisation that would provide an advice/orientation service in an unbiased way.

This is about to change with the formation by the International Chamber of Commerce in Paris of the Maritime Joint Ventures Bureau whose functions would be to a) provide information, research and advice into MJVs, b) to act as a bureau de marriage between DC and LDC participants and c) provide independent advice on the structuring of an MJV and assist in the first stages in bringing the participants closer together.

The second major obstacles to JVs is the distrust between DC and LDC potential parties. Whether this is linked \ to political and economic ideology, misconceptions, prejudice or merely due to the distance created by the differences (real or imaginary) between the parties, distrust undoubtedly exists. In the eyes of LDCs, DC partners are likely to exploit them, over value their contribution, take advantage of their areas of weakness and, in general, work on a maximum immediate profit over the smallest time and capital commitment basis. To DC potential partners, LDCs may be viewed as backward, politically sensitive and unstable, unreliable in keeping to agreements and difficult to communicate with. In fact, communication is, once the preliminary obstacles are overcome, the biggest hurdle to a successful MJV. The different nature of the participants themselves, their different emphasis in the objectives of the JV and varying levels of knowledge and speed of decision-making, contribute to a major communication problem.

The third obstacle is the lack of legal and maritime infrastructure attributable to many LDCs.

Difficulties also arise with the manning of the MJVs vessels. Often competent LDC crews are not immediately available and until they can be developed by local marine training schools, non LDC crewing will be required. The transition to LDC crewing, may also present the JV with labour / operational problems from the point of view of efficiently as well as due to pressures on the DC partner, not to dismiss experienced, long-serving crew that may continue to be employed on the vessel from the time prior to the MJV set up.

A Joint Venture will involve elements of real compromise and bending by both partners to each other’s way of doing things as well as to market, political, economic and social constraints.

In general, the problems of a Joint Venture are the same as with any partnership between two radically different parties who must work harmoniously together for the joint good. However, bearing in mind the considerable potential benefits to both sides the difficulties are not insurmountable. The seriousness of the obstacles to be overcome naturally differs greatly from country to country and owner to owner.

**2.** I would like now to move to the second part of the presentation on the assessment of MJV risk as seen by banks.

The first consideration to a lender is to whom are we lending? Banks believe that they are primarily financing ship owners rather than vessels and look into owner's management, operating experience, track record, reputation, fleet diversification, employment position policy and, last and currently most important, liquidity, prior to examining the terms of a specific proposal. liquidity, prior to examining the terms of a specific proposal.

With an MJV client a bank has to critically assess not only the two or more parties involved separately using the above mentioned criteria, but also to critically examine the MJV itself, i.e.

- *The MJV's track record (if any)*
- *Clarity of objectives and scope of the MJV*
- *Nature of the JV i.e. north / south, north / north, south / south etc.,*
- *Ownership split of the MJV.*
- *The relative strength and weaknesses of each partner and what they each bring into the MJV.*
- *Examine whether there is clear demarcation of responsibilities, what constitutes major collective decisions, the complimentarity and working rapport of the partners and the establishment of mechanisms for the settlement of disputes.*
- *The relative commitment of each partner to the MJV i.e. management, operational and financial support.*
- *The legal and managements structure of the MJV. Also the physical location of the MJV's management as well as that of its partners. Is there a separate MJV management responsible for the MJV? Are its members drawn from the partners or hired from outside? The strength of the financial base of the MJV and access to additional equity funds. Adequate financial auditing and controls.*
- *The effect, if any, political/ govern- mental policy changes may have on the ability / willingness of either party to fulfil its obligations i.e. the potential instability factor.*
- *The probability of survival of the MJV at least as long as the term of the finance involved.*
- *The partners' knowledge of the home country market (the market in which the MJV will operate).*
- *The cost benefit/enhanced revenue effect of cargo preference allocation, low bunker prices, berth preferences, subsidies etc.*

Banks are aware that often MJV fail and their loans are adversely affected, not because of market and security considerations, bur more due to the imperfect set-up of the MJV itself. Specifically, an MJV often lacks its own relatively independent management. Often the temptation is to allocate one person from each MJV partner to represent the interests of the partners and to coordinate work performed by each partner's established organisation. It is important to have an MJV management, committed to the MJV and controlling such work performed by each partner outside the MJV management itself. Often, the partners themselves have not established the working rapport and mutual respect required to succeed. Grey areas of responsibility and potential conflict exist and an insufficient effort is made to fully understand each other's decision-making and working modes.

A strong financial base is required to enhance the MJVs survival, especially when there is insufficient additional commitment to the MJV by the partners who may consider that the MJV should stand or fall on its own.

An overall bank assessment of the quality, financial strength and survivability of the MJV is required prior to considering the financial merits and drawbacks of the finance itself. This requires considerable time, effort and keen judgement. In many areas of importance, the bank is likely to be unstable to make a judgement until a MJV is seen in operation. Many banks feel hesitant to fully commit themselves until the MJV can be seen to be working smoothly for an initial period.

Firstly, we look into the MJV's prepared cash flow and checkout the reasonableness of the assumptions used, i.e. projected earnings in line with forecasted demand / supply for the sector, operating and interest expenses, working days per annum etc. The ability of the project to withstand major changes in the above variables is tested via a sensitivity analysis. Even where vessel employment has been assured and at fixed rates, the lender will do a market analysis to determine the degree of reliance of the project on such fixed employment, in case the MJV were to fail and the vessel had to be redeployed elsewhere.

It is to be expected that MJV finance proposals will display favourable cash flow characteristics since the employment factor is often the underlying reason behind the formation of an MJV. Bankers, however, become uncomfortable where MJV obtained rates are significantly higher than market rates and a high percentage finance is requested in line with such high rates. Secondly, the vessel or vessels are considered from the collateral point of view. Collateral desirability and value depend on the following factors:

### *1. Type of vessel*

The more specialised and sophisticated a vessel is, the smaller its relative market will be, from the purchase and sale, employment and number of participants aspects. As such, for specialised vessels, in good markets, substantial premiums may be paid to secure such vessels, especially if needed for a specific project. In depressed times, however, sale prices have to drop to extremely low levels to attract one of a few potential buyers / users of such vessels. The latter is very important to banks since it would be under such depressed conditions that asset disposals often take place. In addition, market valuations for such vessels vary considerably between valuers, with banks always having to take the lower valuations to be on the safe side.

Banks also assess the potential factor of the probability that a particular type of vessel may fall out of market favour.

### *2. Age*

Young vessels provide banks and owners more flexibility in tackling problems as they arise. This has become acutely apparent during the current shipping recession and hence, most financial institutions limit the age of the vessels they finance to current age plus the term of the loan not exceeding 15 years. However, certain vessels e.g. passenger, with adequate maintenance do enjoy a considerably longer .useful lifespan than the 20 years assumed on average.

### *3. Country of Registration and Crewing*

The third factor affecting collateral desirability / value is that of the country of registration and crewing.

Country of registration is often the biggest obstacle to be overcome by commercial banks in financing MJVs. Most developing countries lack a well established maritime tradition, policy or legal framework and experience. A bank's security position is thus affected from the point of view of ranking and rapidity within which a bank's decisions can be legally implemented. Dual registration of vessels and permission to allow local ownership of foreign flag vessels, (where allowed), may provide some assistance in minimising this problem. Banks are also concerned with the competency of crew~ employed on the vessels and wish to be assured that the crew on board irrespective of nationality is up to standard. An insistence of one partner to utilise doubtful quality crew would be of concern.

Lastly, in this section, we must consider the problem of sovereign / country risk also known as transfer risk or cross border risk. This is the risk to a loan, made in a freely convertible currency e.g. $, £, Dm etc., normally at a major financial centre, to a borrower who is wholly or partly reliant on a local economy and / or generates local currency or foreign currency which must be repatriated to the local country and may require central bank permission to repay the loan. As such, local market, political or foreign exchange problems may endanger an MJV so that an otherwise healthy borrower cannot meet his obligations.

Another element of risk may be in the difficulty encountered by a bank in successfully foreclosing in a country where one of the MJV partners is of particular r importance, e.g. state or state controlled company etc., or in obtaining permission to remit/apply the foreclosure proceeds against the loan.

Banks look into the strategic and commercial importance of the MJV to the sovereign risk country, to obtain an element of comfort where all or a large proportion of the loan is a sovereign risk. All international commercial banks have country exposure limits and otherwise acceptable MJVs may not be financed should they possess significant country risk exposure and that respective country risk limit is full. The Third World debt crisis has increased this likelihood. The less poor country risk involved in an MJV the easier it will be for a bank to provide finance. Innovation and flexibility in structuring the JV and its finance requirements is necessary. It is clear that MJV finance analysis is considerably more involved than the majority of shipping proposals a bank considers. The analysis requires additional time and cost to a bank which has to be reflected in the terms of the loan, since considerable travel and numerous meetings with often geographically dispersed partner are involved. Following the granting of the loan, monitoring too, is more time consuming and costly and should the MJV be located where the bank has an inadequate presence, the bank will feel uneasy that the loan can be effectively monitored.

JVs involving at least one internationally experienced shipping group which may already be a customer of the bank will enhance the MJVs attractiveness and will positively affect all the bank lending criteria outlined earlier.

Often, the internationally established shipping group undertakes to prepare a feasibility study on an MJV which is extremely useful information to a banker and in having more experience in banking relationships such a group will be able to anticipate and cover a bank's likely questions and difficulties.

In some instances, especially in MJVs involving a high element of poor country risk, the partner will provide corporate guarantees of additional securities to the bank, on a reducing basis, to get the JV off the ground. Increasingly, though, often as a result of mixed experiences with MJVs, MJV partners attempt to obtain finance based entirely on the financial and commercial strength of the MJV rather than on partner support. Maybe in this part of the presentation, having concentrated on the potential pitfalls and difficulties associated with MJVs from a bank's point of view, I have left an impression that international commercial banks are sceptical and not supportive of the MJV concept. This is not true but that simply MJVs present banks with additional problems to be overcome as outlined earlier and a. great deal of thought has to be given to the MJVs structure at the outset.

All financial institutions can playa positive and rewarding part in the successful set up and operation of MJV s and opportunities exist for institutions to develop a lead in the field to their considerable benefit.

JVs based on the principle of co- operation for mutual! benefit could also apply to financial institutions which can mutually provide finance and overall assistance to MJVs from their respective positions of strength. As such, international development banks could provide assistance in reducing the country risk element and merchant banks could provide considerable assistance in the identification of potential MJV partners, advice on the MJV set- up, assistance in the preparation of financial feasibility studies and presentation of MJV financings to international commercial. banks as well as provide continuous financial advice.

International commercial banks could combine, in accordance with their set- up and abilities, the role of the merchant banks as well as the provider of finance. All the above institutions, together with specialised ship finance institutions could develop a co-operative approach to overcoming the problems potentially associated with JVs, so as to allow for the considerable synergistic benefits of MJVs to come through.