Shipping

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Shipping Risk Survey 2016

"Among the biggest risks in shipping today are distressed bank loans and the exit of private equity. It remains to be seen whether this will lead to an extended market depression."

"Economic uncertainty is becoming more and more of an issue these days."

"A general sense of uncertainty pervades all shipping sectors, unlike previous downturns."

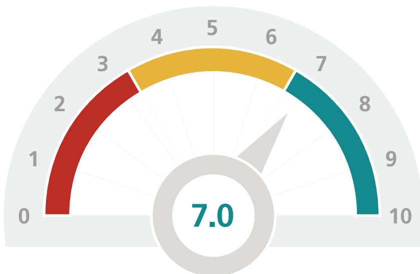
"There are problems with defaults on loan repayments as a result of reduced charter income, or no income at all in the case of idled vessels."

Our second annual Shipping Risk Survey revealed a lower overall level of satisfaction compared to last year, that sound risk management was contributing to the success of their organisations. The percentage of senior management exercising a high degree of involvement in providing support in respect of enterprise and business risk management was also slightly down compared to last time. More than 40% of respondents confirmed that the management of such risk was being formally documented.

Respondents to the survey rated the extent to which enterprise and business risk management is contributing to the success of their organisation at an average 6.6, on a scale of 1 (low) to 10 (high), compared to 6.9 last time. Under a quarter of respondents (23%) returned a rating of 8.0, compared to 26% last time, while 70% put the figure at more than 5.0 out of 10.00, as opposed to 74% in 2015. Charterers recorded the highest rating (6.8), and brokers the lowest (5.8). Geographically, Europe (7.1) was ahead of Asia (6.6).

Overall, respondents rated the extent to which enterprise and business risk was being managed effectively by their organisations at 7.0 out of 10.0 (unchanged from last time). Brokers (7.4) expressed the highest level of confidence in this regard, and charterers and professional advisers (at 6.5 and 6.3 respectively) the lowest.

One respondent noted, "Financially well-managed shipping companies need only fear another collapse in rates and values," but another said, "We misjudge the market and don't take the right course of action to protect profits."



Enterprise and business risk management confidence

Risk factors

18%

Demand

1

17%

Competition

2

13%

Cost and availability of finance

3

The three factors likely to pose the highest risk to their organisation over the next 12 months.

Which factors pose the highest risk?

Demand trends were deemed by the greatest number of respondents to pose the highest level of risk to their organisation, closely followed by competition, with the cost and availability of finance in third place. One respondent said, "Market reports are uncertain. Company-specific risk matrices need to be drawn up on the basis of experience, fundamentals and hindsight following evaluation of available market analysis reports which are, however, uncertain." Another noted, "The development of markets in the Middle East is very much dependent on the complete removal of Iranian sanctions, whereupon a new and attractive market would be available to the industry." Yet another respondent bemoaned the "lack of financing" in the industry.

Changes to the level of risk over the next 12 months

Respondents to the survey felt that the level of risk posed by most of the factors which impacted their business would remain largely unchanged over the next 12 months, with the exception of tonnage supply and competition, which were perceived to have the potential for increased risk. It is to be noted that no-one overall expected less risk in any of the categories.

Increased risk

- Competition
- Supply of tonnage

Steady risk

- Ballast water management
- Breaches in health and safety
- Bunker and fuel costs
- Changes in tax legislation
- Changes to accounting standards
- Cost and availability of finance
- Demand trends
- Emerging information technology and cyber security in shipping
- Fuel emissions
- Insufficient controls over financial reporting
- Operating costs
- Other changes to laws and regulations
- Piracy
- Port congestion
- Supply of competent crew
- Supply of shore based personnel

Less risk

How is enterprise/business risk management supported by senior management?

Overall, 69% of respondents felt that the senior managers in their organisations had a high degree of involvement in enterprise and business risk management, as opposed to 72% in the previous survey. Meanwhile, 20% said senior management's involvement was limited to "periodic interest if risks materialise" (up from 18% last time), while almost 10% of respondents (up from 8%) said that senior management "acknowledged but had a limited involvement in" enterprise/risk management. Just over 1% said that senior management had no involvement whatsoever.

One respondent said, "The problems are internal rather than external. We are not versatile enough. Emerging IT is not a risk in itself, but we are too slow to adapt to changing needs and competition." Elsewhere it was noted, "Embedded derivatives are not being disclosed. For example, bunker escalation clauses in contracts of affreightment are de facto derivatives, but I have never seen them disclosed separately."

How are enterprise and business risks managed?

Overall, 35% of respondents (compared to 37% in the previous survey) confirmed that such risk was managed by means of discussion without formal documentation, while 41% noted that risk was documented by the use of spreadsheets or written reports, compared to 42% previously. Internally developed software was employed by 17% of respondents (13% last time) to manage and document risk, as opposed to the 5% who used third-party software."

What is the likelihood of material mis-statement?

On a scale of 1.0 to 10.0, estimates of claims and provisions, and changes to legislation (both 4.2) were deemed the most likely factors to result in a material mis-statement in companies' period-end financial statements. Impairment involving vessels in use (4.0) featured in third place in this regard.

> "We are too slow in adapting to changing needs and competition."

"The effective management of risk is fundamental to profitability and efficiency – and ultimately survival – in any industry, and nowhere more so than in shipping."

Michael Simms,
Moore Stephens partner,
Shipping & Transport

Conclusion

The survey revealed that risk is being managed effectively within a high percentage of those organisations which participated in the survey. It is nonetheless disappointing to find that, at a time when shipping's exposure to risk is arguably greater and more varied than ever before, confidence on the part of respondents in the level to which enterprise and business risk management contributes to the success of their organisations has fallen slightly in the past 12 months. So, too, has the involvement of senior managers in risk management at the highest level.

If ever there was a time when shipping should be increasing its risk awareness and improving its risk management procedures, it is now. Shipping is a risky business, one in which an unwillingness to take any risk whatsoever sometimes represents the biggest risk of all. But that does not mean that the industry can afford to ignore or underestimate risk. It must achieve the right balance between risk and reward, and especially so when reward levels are low, as they are at present. The rewards may vary, but the risk will not go away.

Shipping faces exposure on a number of different levels, including financial, operational, legal and environmental risk. The industry's level of vulnerability is reflected in the diverse nature of the threats identified by respondents to the survey. Few other industries, for example, could claim to be exposed to risks arising from economic uncertainty, mis-diagnosed analyses, renegotiation of existing contracts, lack of financing, uncertainty over asset valuations, defaults on loan repayments, political sanctions, monopolistic policies, regulatory changes, falling crude oil prices, customer insolvency, fears over the Chinese economy, uncertainty in Europe (and not just as a result of Brexit), and plain old supply and demand.

It is hardly surprising that estimates of claims and provisions, together with legislative changes and vessel impairment, featured as the top three likely causes of material mis-statement cited by survey respondents. It makes no sense to be paying less attention to risk management at such a volatile period for the industry.

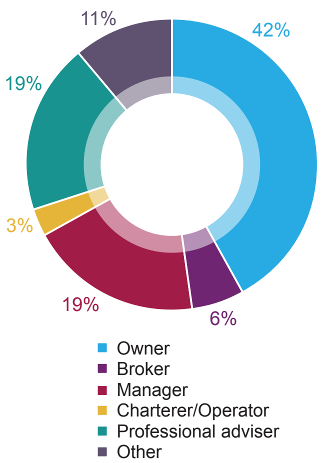
Since the start of the worldwide economic downturn in 2008, shipping has coped, to varying degrees of success, with what might be regarded as the 'traditional' risks associated with operating in the industry. But there is also a growing threat from extraneous factors such as cyber-security and the increasing level of IT-related risk. The industry's risk profile is changing, and with that the industry itself must change its approach to identifying risk. For some, outsourcing is a solution. However, managing the risk of doing this must not be overlooked. If the risk is not recognised, it cannot be controlled.

The key to identifying and mitigating any type of risk lies in the application of sound, firm-wide governance control systems. Companies in today's shipping industry need to fully understand and comply with the corporate governance responsibilities placed upon them. Failure to do so will endanger the company's security, profitability and reputation. Simply paying lip-service to the requirements will not do. The tone needs to be set by senior management, who must lead from the front and be seen to be doing what is required of them.

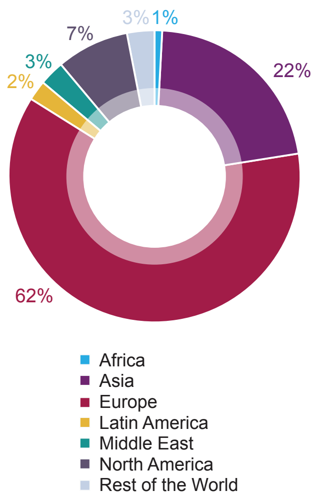
The effective management of risk is fundamental to profitability and efficiency – and ultimately survival – in any industry, and nowhere more so than in shipping. The shipping market is experiencing pressure on operating costs, the tighter grip of regulation, and intensified competition on the back of a continuing imbalance between supply and demand. Accelerated ship recycling and cutbacks in newbuilding plans have not as yet been able to redress the balance effectively.

It could be argued that a rating of 7.0 out of 10.0 in respect of the level of effective management of risk at companies which participated in the survey is not too discouraging. But it needs to be higher, as does the figure of just over 40% of companies which formally document the management of risk. Not enough companies are pursuing joined-up risk management procedures. Ultimately, the price to pay for inefficient management procedures, and the failure to monitor risk in a systematic and documented fashion, could be corporate failure.

Respondents by type (%)



Respondents by location (%)



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