Financing shipping companies

There are several advantages for a shipping company to outsource a particular service or department. The main advantages with outsourcing are better cost control, lower risk and the outside supplier’s expertise.

Better cost control is achieved because outsourcing leads to less fixed costs and more variable costs. This means that the company in the short term is more flexible, and able to adjust costs faster and in some cases with less hassle. Outsourcing a service or department also lowers the need for an initial investment by removing the capital injection necessary for establishing a department/service. Less fixed costs and less long term fixed assets means lower risk for the company.

In economical theory there also is an general opinion that outsourcing in many cases leads to cost reductions, due to a small internal department within the company not having the same degree of expertise as a bigger outside supplier and therefore not being able to deliver the services at a competitive cost. This lack of expertise compared to the outside supplier that specialises in the segment might also lead to a lower quality of service if the work is kept in house.

With regards to expertise there also is a big advantage in that the company can keep focus on their core business where they have the necessary know-how and stay clear of outside disturbance.

There are however also disadvantages with outsourcing. The main problem is loss of control due to the company not having the same supervision over the work being done. Another problem is that the outside supplier might not be able to adjust the service as well as an inside department after the company's needs at any given time.

The degree of the advantages/disadvantages with outsourcing varies greatly with the complexity of the work that has to be done, the potential savings and the importance of in-house supervision. A certain degree of outsourcing of services will always exist i. e. transportation for a company's employees, postal services, big IT reforms etc.

Solstad has decided to keep outsourcing at a minimum and integrated shipping operations are a part of the company's philosophy[1]. The company manages the total operation of the vessels[2], and have a large onshore support mechanism which includes freight, crewing, accounting, chartering, technical, and other administrative functions. The company is nevertheless open to outsourcing services and will evaluate whether it is possible to achieve more cost effective operations and an optimal return on capital employed in cooperation with new suppliers with a view to long-term strategic co-operations[3]. Such collaboration is also evaluated with regard to risk and capital injection.

How has your company financed its vessels? Explain advantages and disadvantages by such financing.

It isn't possible to find public information on how most of the specific vessels have been financed. However according to a news article in Skipsrevyen[4] about the acquisition of the M/S Normand Seven, the long term financing for that vessel is provided by Eksportfinans in cooperation with Nordea Bank, Fokus Bank and Danmarks Skibskredit AS.

The company's balance sheet doesn't show in detail to whom the long term liabilities is owed, so to answer the question we will have to assume that the financing of the M/S Normand Seven is representative of how Solstad normally finances its fleet.

As of the end of 2008 the company have long term fixed assets in vessels and new buildings of 7. 289. 858. 000 NOK[5]. This equals just over 70% of the company's total assets of 10. 213. 357. 000. The assets are financed with a total equity of 3. 697. 624. 000 and total liabilities of 6. 515. 734. 000. Out of the total liabilities long term loans to credit institutions/leasing obligations amounts to 4. 831. 208. 000.

In economic theory an equity ratio of 30 % is generally considered healthy, and the company also states in the annual report that the aim is to be financed by the owners (equity) with a ratio higher than 30 %. The total equity in percentage of total assets in 2008 was 36%, well above the company's goal. The company's equities are important when you need to raise capital from outside sources, as it may provide security for the lenders.

Assuming that the financing of M/S Normand Seven is representative for the entire fleet the long term liabilities is provided by commercial banks like Nordea bank, Fokus bank, and Danmarks Skibskredit as well as government backed ship credit schemes like Eksportfinans. According to the annual report some of the fleet is also financed by leasing agreements.

The advantages in getting mortgage-backed loans from commercial banks are that capital can be raised quickly and flexibly, while the owner is still left with full ownership of the business.

The disadvantages by such financing is that commercial banks are uncomfortable with loans that are longer than 5-6 years[6] and often prefers to receive a balloon payment that might be difficult to handle for the shipping company. A leasing company is often more attractive if the borrower want longer finance than a commercial bank is willing or able to take onto their balance sheets. Eksportfinans also offers longer term finance than is usual for commercial banks, and offer repayment periods for up to 20 years[7].

Commercial banks normally take little risk and require a lot of security to protect their investment. According to the annual report[8] some vessels are placed as security for the mortgages. In addition, accounts receivables and bank deposits (2007) are tied. Solstad's loan agreements are also subject to the owner's working capital being positive at all times and that the market value of the vessels amounts to at least 110-125% of the outstanding loans. The company states that they satisfy all conditions of the loan agreements at 31. 12. 08[9].

Name three of the most important conventions your company must adhere to. Give reasons why those are among the most important ones.

Solstad have ships registered in the Norwegian International Ship Register (NIS), Isle of Man Ship Registry (IOM), and the Norwegian Ship Register (NOR). Some of the criteria for NIS/IOM/NOR registered vessels are that they adhere to international conventions such as " Safety of Life at Sea (SOLAS 74)", " Prevention of Pollution from Ships (MARPOL 73/78)" and " Standards of Training, Certification and Watch keeping (STCW 95)" as well as other international regulations ratified by the flag states.

" Safety of Life at Sea (SOLAS 74)" is the most important international treaty protecting the safety of merchant ships in the world. The first version of the treaty was passed as early as 1914 in response to the sinking of the Titanic. [10] It prescribed numbers of lifeboats and other emergency equipment along with safety procedures, including continuous radio watches.

The intention had been to keep the convention up to date by periodic amendments, but a completely new convention was adopted in 1974. The convention regulates among other things use of the global maritime distress safety system, set construction criteria (subdivision and stability, machinery and electrical installations), fire protection/detection/extinction, obligatory life-saving appliances and arrangements, radio communications, safety of navigation etc. and is the centrepiece of maritime safety.

Prevention of Pollution from Ships (MARPOL 73/78) is the main international convention covering prevention of pollution of the marine environment by ships from operational or accidental causes[11]. It was designed to minimize pollution of the seas, including dumping, oil and exhaust pollution. Its stated objective is to preserve the marine environment through the complete elimination of pollution by oil and other harmful substances and the minimization of accidental discharge of such substances.

MARPOL contains 6 annexes, concerned with preventing different forms of marine pollution and covers pollution by oil, chemicals, harmful substances in packaged form, sewage, garbage and air pollution.

The International Convention on Standards of Training, Certification and Watch keeping (STCW 95) sets qualification standards for masters, officers and watch personnel on seagoing merchant ships[12]. The aim of the convention was to introduce internationally acceptable minimum standards relating to training, certification and watchkeeping for officers and crew members.

Today there are amendments concerning quality standards systems, oversight of training, certification procedures and rest period requirements. The amendments require that seafarers are provided with familiarization training and basic safety training which includes basic fire fighting, elementary first aid, personal survival techniques, and personal safety and social responsibility. This training is very important in ensuring that seafarers are aware of the hazards of working on a vessel and can respond appropriately in an emergency.

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