ECONOMIC IMPACTS OF ACQUISITION & MERGER OF SHIP BUILDINGS & SHIP YARD COMPANIES

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ABSTRACT

Mergers and Acquisitions (M & A) are common business strategies that major corporations adopt to expand and grow their businesses globally (Hellenic Shipping News, 2016). Motivated by the growth of shareholder value such actions not only target formation of new entities but also new economic and social strategies that enable the respective companies to grow rapidly beyond their competitors in the industry ensuring that the weak companies are edged out of business or are acquired (Roberts, Wallace, and Moles, 2016). The shipping industry has faced tough economic challenges since the 2008/9 global economic crises that saw most of the maritime global industries suffer heavy financial losses. Ship building companies and other maritime activities are already burdened by the negative effects of the 2008/9 recession including unsustainable demand for shipping vessels. The oversupply conditions that developed mainly due to the recession global recession have compelled the industry to turn its attention to mergers and acquisitions to remain afloat (Gordon, 2018). Some of the notable M&A include AP Moller-Maersk and Hapag-Lloyd (Wagner, 2015). The adverse effects of fuel prices before 2010, low freight rates and the high number of small ship sizes in the industry propelled most companies in the industry to pool resources together to compete with big liners in the industry. The demand for upgraded ports is also increasing as shipping alliances seek to maximize their returns (Wagner, 2015). In 2001, top ten shipping liners held only 37.3 percent of the shipping industry internationally **(Figure 1)** but currently due to M & A activities, the top ten shipping companies now own 63% **(Figure 2)** of the global shipping market (Wagner, 2015). This paper offered a descriptive overview of M & A and indicated some related economic aspects in relation to the shipping companies and related ship yard entities.

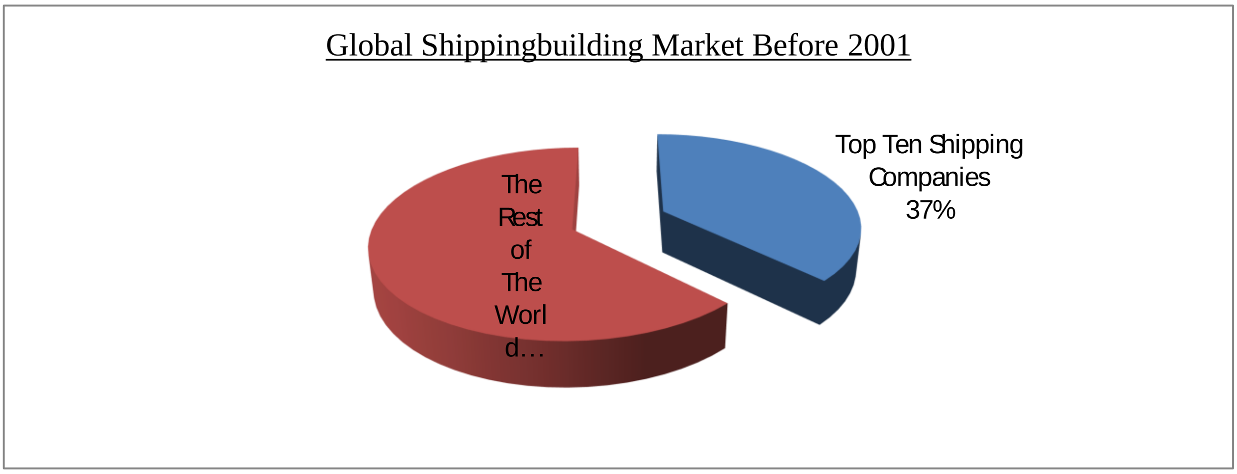


Figure 1: Sources: (Wagner, 2015)

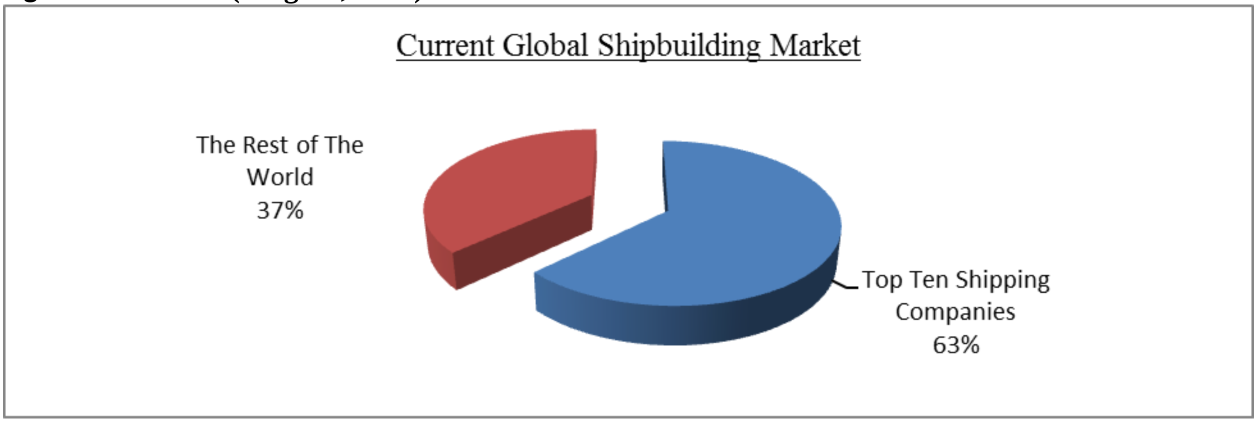


Figure 2: Sources: (Wagner, 2015).

INTRODUCTION

A merger or acquisition refers to the process of combining two or several companies to make one new entity or corporation. Mergers are formed through a negotiated process while acquisition does not involve any negotiation. It can either be friendly acquisition or hostile takeover. According to icontainers (2018) the unprecedented high number of consolidation among shipping companies that has been witnessed in the last decade is most likely to continue at a reduced rate as the companies strategize on how to secure the waning shipping market. The collapse of the American financial corporation Lehman Brothers 2008 and the financial crisis that followed marked the worst moment in the shipping industry. The transitioning to recession resulted in rapid trade reduction especially on new ship building order books (Gordon, 2018). The period saw the high revenue rates that averaged over US$300,000 per day prior to the crisis in June 2008 plummet to a low of US$2000 per day in November 2008. The hard economic conditions led to fewer orders on shipping building industries while small and medium shipping liners opted to consolidate their efforts in order to fight for survival in the global market.

ECONOMIC FACTORS THAT FACILITATE MERGERS & ACQUISITIONS

Globalization

The globalization wave commenced in mid-1990's and spread quickly among the developed and developing nations. The global market growth was initially slow but it facilitated mergers and acquisitions that allowed companies to expand to other international market much faster (Wagner, 2015).

Internet and electronic communication

Globalization was further aided by the discovery and expansion of the digital era that also included the internet and the electronic communication. The internet facilitated faster and efficient communication.

Privatization of state owned entities

Privatization of government entities have also contributed to the expansion of mergers and acquisitions. Government bodies that have been sold off to the public and other interested companies have provided lucrative opportunities for companies that are specialized on provision of certain services to expand internationally.

Trading blocks

The formation of regional and global trading blocs made it easier for companies to merge and acquire weak companies. International mergers link companies from different countries. Trading blocs like the EU have common currencies that make it even easier for companies to merge easily. The trading blocs have also deregulated most of the financial institutions and also liberalized trading activities.

Economic hardship

High operation costs and competitive market rates have compelled some shipping firms to merge (Hellenic Shipping News, 2016). Shipping companies are merging in order to survive in the market. For example, smaller shipping companies are merging together to pool resources to acquire larger ships that are more economical to maintain and operate their businesses more efficiently.

ECONOMIC IMPACT OF MERGERS & ACQUISITIONS

Economies of scale

Mergers and acquisitions make it possible for companies to benefit from the effects of economies of scale. The average long run costs that companies incur after merging are relatively lower due to the high volume of services or products manufactured. The high volume of products manufactured reduces the cost per unit of product produced. Economies of scale lead to reduction of costs and product prices due to increased efficiency.

Expanded distribution

Mergers and acquisition expands the market base for the new company as the new entity now controls both the markets that the former two companies controlled separately. The acquired new market boosts the company's ability to reach more clients. Mergers and acquisition increases the sales volumes and eventually the revenues of the new entity increases.

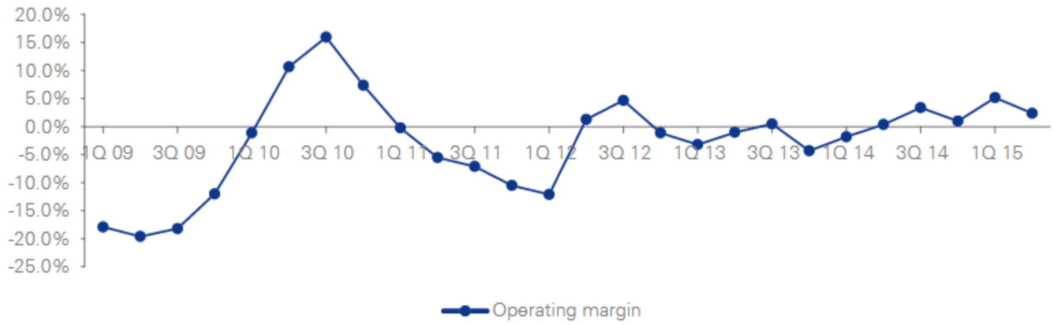
Diversification

Mergers and acquisition have contributed to diversification of trade in an effort to minimize market risks. They are applied as tools for corporate diversification strategy to penetrate new markets and expansion of business. The current trend on mergers and acquisition operations in the shipping industry indicate that shipping liners are keen on creating more alliances and the sharing of resources to maintain their profitability. **(Figure 3)** below shows the negative performance of shipping companies for the period preceding the crisis and other years.

Mergers and acquisitions have been gradually affected by the rapid decline in global oil prices. In 2015, oil prices reduced by 33% providing a life line to shipping companies that were on the verge of takeover compared to 2014. Large ships that are fuel efficient have been able to triple there operating profit margins. Major shipping companies formed alliances to capitalize on large ships that were economical to operate. Before the year 2001, the shipping industry was heavily fragmented.

The high rate of mergers and acquisitions is highly associated with the changes that were realized during this period. The global market for shipbuilding activities was dominated with small and medium enterprises before the year 2001 but due to economic challenges and reduced demand in the industry most companies had to merge in order to remain profitable in the market (Hellenic Shipping News, 2016). For example, some shipping companies were acquired after they went into receivership due to low demand and increased operational costs.

Figure 3: The quarterly operating profit margin for shipping companies, Q1 2009 – Q2 2015



Source: Alphaliner

NOTABLE MERGERS & ACQUISITIONS IN SHIPBUILDING INDUSTRY

In December 2014, the merger between Chile-based Cia Sud Americana deVapores (CSAV) merged its container shipping segment with Germany's Hapag-Lloyd AG. The merger brought in one of the largest container line globally. The merger is expected to result in over US$300 million in cost savings.

China's COSCO and China Merchant's group teamed up to purchase US$950 million worth shares in Turkey's private port in 2015. COSCO is also among the top companies that are planning to acquire majority stake in Greece's Piraeus Port.

Chinese COSCO (Chinese Ocean and Shipping Company) and China Shipping Container line are still negotiating merger deal. Temasek Holdings from Singapore is also planning to sell its liner operations while CMA CGM from France acquired Singapore's Neptune Orient Liners in 2016.

The high activities by Chinese firms have been encouraged by China's influence on the Silk Road economic initiative that links Yangtze River, Pearl River and Bohai sea region. The economic zone promotes M & A activities both in China and overseas markets.

The European shipbuilding industry dominated the market for most parts of the current and last century however the high growth of the Japanese economy and the government supportive programs assisted the industry to takeover global leadership. The earthquake of the year 2011 and the preceding Tsunami that hit the Japanese coast resulted in serious damages to the country's economy especially the shipping industry. Japanese government is reconsidering its funding of the industry and it may not support the industry in future. European ship builders have experienced lower completion rates and reduced order book that was occasioned by the expansion of emerging new markets in Vietnam, Brazil, India, Russia, Philippines and Turkey. The emerging markets took over 6% of all the new orders in 2008.

SHIP BUILDING INDUSTRY

Japan and Europe dominated the market for some time controlling over 90% of the shipbuilding market before 1970. China together with S. Korea surpassed Japan and Europe to take over the global shipping industry in 2006. Other entrants from India, Turkey, Vietnam, Brazil, Philippines and Russia also entered the shipbuilding market. However, China and South Korea have maintained their leadership position in the ship building market but Europe is gradually being overtaken other countries from emerging markets as shown on the pie chart below **(Figure 4)**.

Global Shipbuilding Market in 2017

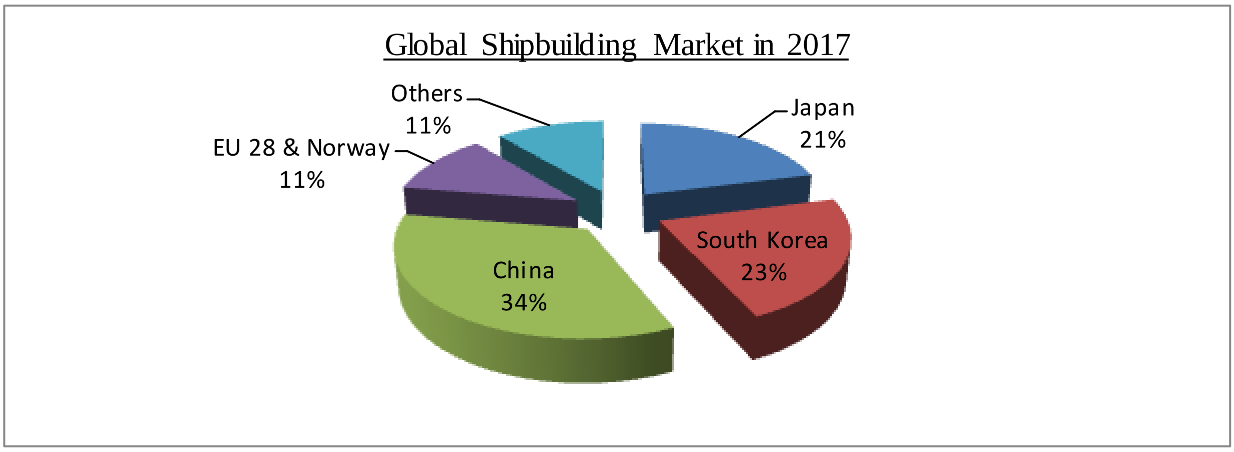


Figure 4: Source: (Statista (2019)

The building boom however ended suddenly in 2008. The financial crisis that started in 2008 ended around 2010 as companies recovered from its adverse effects however the order book continued to decrease for new shipping vessels. The orders for new shipping vessels in 2010 were 26% lower than the ones for the same period in 2008 (Mickeviciene, n, d).

In 2009, China won 44% of all the new orders compared to South Koreas 40.1%. The table below **(Table 1)** shows the completion rates, order book and the market share for all the global shares (Mickeviciene, n, d).

Table 1. World ship building results in CGT between 2000 2010

Million CGT/Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Order Book	45.9	48.3	48.9	70.8	92.8	107.2	138	184	194	156	135
New Orders	29.4	23.3	20.5	41.7	45.1	39.6	57.3	85.3	43	16.6	26.3
Completion	20.3	20.2	21.4	22.8	25.5	29.4	34.1	34.6	41.9	44.4	40.5

Source: (Mickeviciene, n, d)

However, the demand for shipbuilding has changed in the last decade as new shipbuilding orders for tankers and cargo carriers plummeted while the demand for cruise ships attracted about 70% of the total global investment during the first half of the year 2016. European shipyards won about US$11.6

billion worth of contracts amounting to about 61% of the global market shares while South Korea, China and Japan controls $US 1.8 billion, $US 4.1 and $US 1.1 billion respectively for cruise ship construction (Sea Europe, 2016). The total number of shipping vessels orders currently stands at 5642 amounting to 101m CGT as illustrated below **(Table 2) & (Figure 5);**

Table 2. Global Commercial Shipbuilding Production of Vessels in 2016

Number of vessels	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Order Book	2412	2227	3162	3477	3706	3605	3655	3061	2950	2950	1223
New Orders	3329	4404	2928	1599	2523	1940	1977	3375	2744	2744	420
Completions	7518	10703	11,729	9632	8308	7345	5892	5994	6148	6159	5642

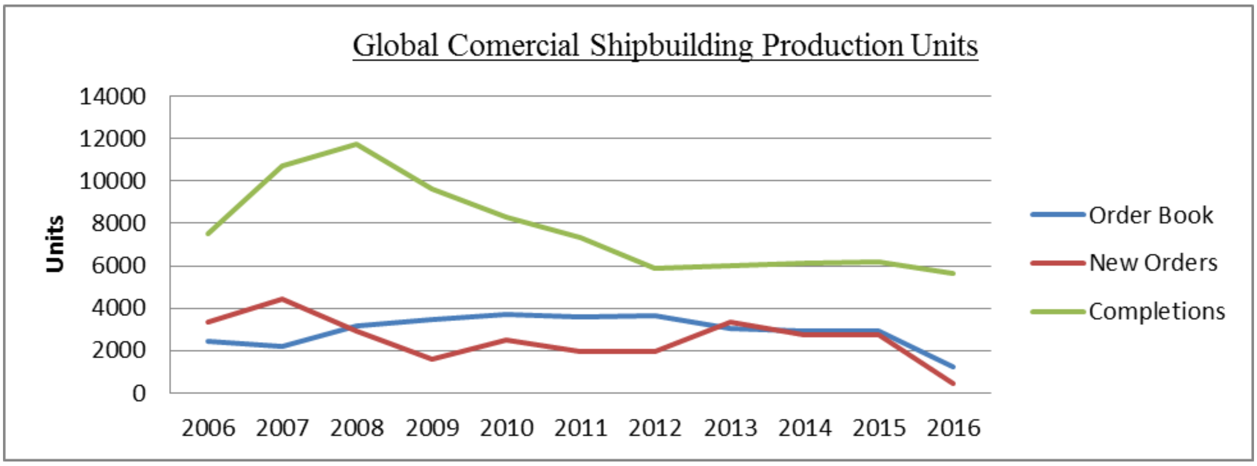


Figure 5: Source: (Sea Europe, 2016)

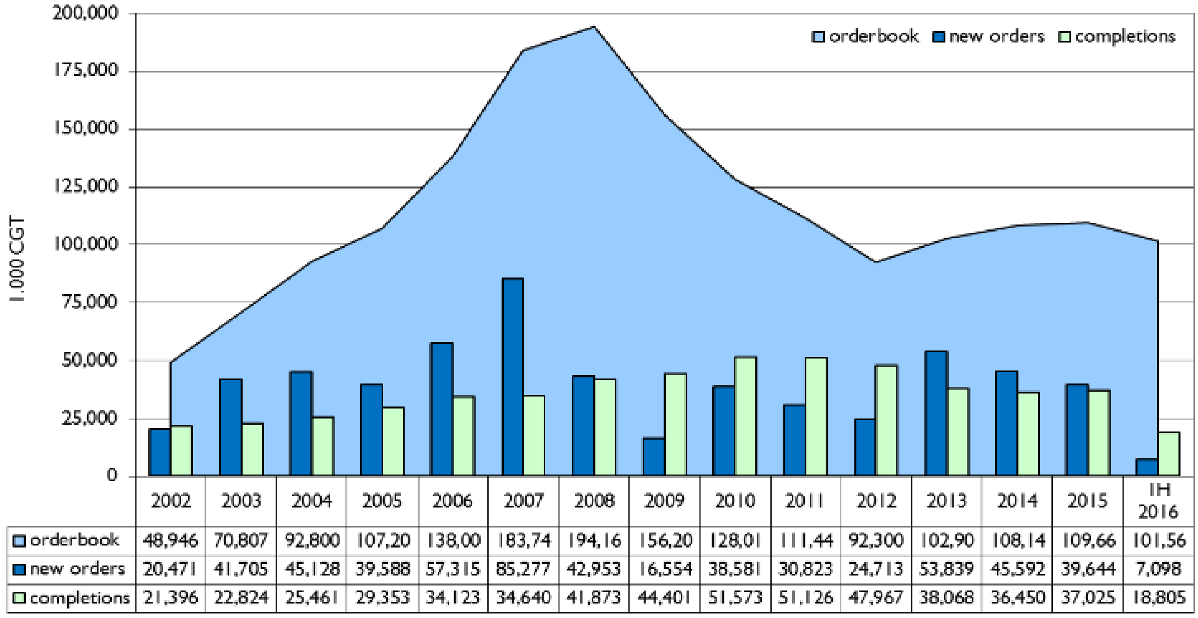
The number of new orders and order book fell to their lowest in 2016 while the highest levels were realized in the middle of 2007 for new orders. The highest rate of completion was realized in the middle of the year 2008 while the lowest were witnessed in 2016 as shown on the figure above. New orders currently stand at 420 ships with China leading with the highest number of orders at 114 while Europe, Japan and South Korea orders are 57, 101 and 37 respectively. A total of 1223 ships were completed and delivered in the first half of 2016 totaling to about 18.8 million CGT and about US$42.2 billion. The new build orders were the lowest in twenty years as most shipyards struggled to win very cheap orders. Asian nations have moved to secure their shipping industries from collapse by introducing new policies that would support the industry. China has already announced that they have secured deals to commence building the first Cruise Ships. The table and figure below **(Table 3) & (Figure 6)** illustrates the findings above in CGT (Millions);

Table 3: CGT (Millions)

Million CGT/Year	2010	2011	2012	2013	2014	2015	2016 (1 H)
Order Book	128.01	111.44	92.3	102.9	108.14	109.66	101.56
New Orders	38.823	30.823	24.713	53.839	45.592	39.644	7.098
Completions	51.573	51.126	47.967	38.068	36.45	37.025	18.805

Source: (Sea Europe, 2016)

Global Commercial Shipbuilding Activity in CGT



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	IH 2016
orderbook	48,946	70,807	92,800	107,20	138,00	183,74	194,16	156,20	128,01	111,44	92,300	102,90	108,14	109,66	101,56
new orders	20,471	41,705	45,128	39,588	57,315	85,277	42,953	16,554	38,581	30,823	24,713	53,839	45,592	39,644	7,098
completions	21,396	22,824	25,461	29,353	34,123	34,640	41,873	44,401	51,573	51,126	47,967	38,068	36,450	37,025	18,805

Figure 6: Source: (Sea Europe, 2016)

Despite the improving economy the demand for new shipping vessels continues to drop even as the completion and order book rate increases. Several cancellations were witnessed in 2008/9: orders for 209 ships were cancelled in 2008 about 2 million CGT, 506 or about 7.8 million CGT and 180 ships or about 3.5million in 2009 and 2010 respectively. The orders for Japanese made ships reduced by 50% as there shipyards witnessed a reduction of about 10% in ship production. **(Table 4)** below evaluates the order book for several shipping companies in 2018.

Table 4. Global market of major shipping companies & new Orders

Rank	Operator	Teu	Share	Existing fleet / Orderbook
1	APM-Maersk	4,068,920	17.9%	
2	Mediterranean Shg Co	3,321,530	14.6%	
3	COSCO Group	2,765,618	12.2%	
4	CMA CGM Group	2,679,218	11.8%	
5	Hapag-Lloyd	1,647,938	7.2%	
6	ONE (Ocean Network Express)	1,517,577	6.7%	
7	Evergreen Line	1,191,248	5.2%	
8	Yang Ming Marine Transport Corp.	636,228	2.8%	
9	PIL (Pacific Int. Line)	423,986	1.9%	
10	Hyundai M.M.	412,971	1.8%	
11	Zim	337,338	1.5%	
12	Wan Hai Lines	250,249	1.1%	
13	IRISL Group	154,415	0.7%	
14	Antong Holdings (QASC)	140,325	0.6%	
15	KMTC	138,721	0.6%	
16	Zhonggu Logistics Corp.	138,480	0.6%	
17	X-Press Feeders Group	123,035	0.5%	
18	SITC	112,867	0.5%	
19	Arkas Line / EMES	74,886	0.3%	
20	SM Line Corp.	74,810	0.3%	
21	TS Lines	72,791	0.3%	
22	Sinotrans	61,990	0.3%	
23	RCL (Regional Container L.)	60,266	0.3%	
24	Sinokor	58,712	0.3%	
25	Salam Pacific Indonesia Lines	53,208	0.2%	
26	Emirates Shipping Line	49,230	0.2%	
27	Matson	43,897	0.2%	

Source: (Alphaliner, 2018).

In 2016, three Japanese shipping companies, Nippon Yusen KK, Mitsui O.S.K. Liners, and Kawasaki Kisen Kaisha announced their intention to merge. The three companies would consolidate about 7% of the global shipping market under one company. The company would control about US$19 billion worth of sales that would be comparable only to Chinese COSCO shipping Corporation that controls about US$40 billion (MFAME, 2016b).

ECONOMIC IMPLICATIONS OF M&A ACTIVITIES

The major economic implication of mergers and acquisitions has been noted in in the significant growth in the number of large shipping vessels and congestion of ports. The transport sector has witnessed increased growth as countries across the world make effort to create expand and integrate infrastructure especially in the marine sector. Port efficiency is critical when dealing with a huge number of vessels. Over 90% of all international trade deliveries is done via shipping vessels (Wagner, 2015). Port congestion as a result of larger shipping vessels and the increased shipping alliances has affected port terminal businesses in many countries especially the US (Wagner, 2015). Limited bank financing mainly in Europe has encouraged equity financing and M & A activities. Terminal operators have extended their financing options to sovereign funds and other governments to fund terminal expansion.

Ship building industries have also witnessed improved sales since the 2008/9 financial crisis that saw the industry's production reduce by 75% (Mickeviciene, n, d). However, the rapid M & A activities have adverse effects on ship building industry. Shipbuilding industry is under recession as orders for new shipping vessels reduce significantly (Marine Fuels and Marine Engine Users

(MFAME), 2016). The industry is wrestling with oversupply in the market as shipping liners merge to optimize shipping vessels. Global shipping companies are more engrossed on how to cut down costs through mergers instead of placing orders for acquisition of new vessels. The most recent mergers being AP Moller-Maersk, CMA CGM and Hapag-Lloyd. The orders for new vessels have fallen from ninety-one (1.614 million TEU) ships in the year 2015 to five (70,000 TEU) in 2016 (MFAME, 2016). The demand of international shipping for containers and equivalent supply reduced from an index of 89 to 80.7 in 2015.

CONCLUSION

Majority of listed shipping entities have experienced a decline in average profits and EBITDA making them easy targets for acquisition and mergers. Alliances have proved to be more preferable compared to M & A among the relatively small players in the shipping business. Reluctance to share or lose control of business operations due to cost implications for family owned companies have favored the formation of alliances. They are also ideal in cost-saving strategies especially temporary alliances that are formed for specific ventures. Major ocean carriers and liners are selling off terminal assets to concentrate on core business. However, creation of alliances have little effect on solving overcapacity issues or high freight charges besides alliances are still affected by inefficiencies hence M & A activities are still expected to increase as the shipping sector realigns its operations while embracing technology in various fields. Low fuel prices have relatively cushioned shipping lines from excessive losses even as revenues continue to decline. Fuel costs decline relatively compared to revenues. Ship building companies and other maritime activities are still burdened by the negative effects of the 2008/9 recession including unsustainable demand for shipping vessels. The oversupply conditions that developed mainly due to the global recession have compelled the industry to turn its attention to mergers and acquisitions to remain afloat. The hard economic conditions also led to fewer orders on shipping building industries while small and medium shipping liners opted to consolidate their efforts in order to fight for survival in the global market. Limited bank financing mainly in Europe has encouraged equity financing and M & A activities while shipyard and terminal operators have extended their financing options to sovereign funds and other governments to fund terminal expansion. China engineered the merging of its two major shipping companies, Chinese COSCO (Chinese Ocean and Shipping Company) and China Shipping Container line in order to achieve maximum economies of scale. The dominance of the Asian economies in the ship building industry has been underscored by their respective government's recognition of the importance of the shipping industry as a strategic factor in economic development and growth. The strategy that most of the leading corporations in the shipbuilding and shipping industry are using to expand their market share and profitability is to merge and acquire other companies in the market.

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