

2016 – A Year of Bankruptcy and Restructuring for Chinese Shipping Companies

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Chinese shipping companies are going through a period of painful transformation. At the end of 2015, Shanghai International Shipping Institute (SISI) conducted a shipping prosperity survey among more than 200 shipping companies, which revealed that the China Shipping Prosperity Index (CSPI) was 83.37 points in Q4 2015, remaining in the stagnant interval for four quarters in a row, and China Shipping Confidence Index (CSFI) was 51.44 points, remaining in the stagnant interval for 4.5 consecutive years. Chinese shipping companies generally suffered from operation decline and the industry came to a period of profound adjustment.

I. Shipping companies are being on the verge of bankruptcy

In Q4 2015, the prosperity index of shipping companies was 82.04 points, in the relatively stagnant interval, and their confidence index was 34.42 points, in the moderately stagnant interval. Shipping companies found themselves in the stagnant interval because of a number of factors including shipping capacity release, shipping space utilization rate, freight income, profit, corporate financing and loan, with business performance declining.

Dry bulk shipping companies have been losing money for many years in a row. In Q4 2015, their prosperity index was 68.67 points, in the stagnant interval for two years in a row, and their confidence index was 40.56 points, still in the stagnant interval since this index was first released in Q2 2011. In particular, their profit prosperity index stood at 36.67 points, staying in the stagnant interval for almost two years, and their current fund prosperity index was only 62.78 points, falling for the fourth consecutive year and indicating an extremely tight capital chain. A large number of dry bulk shipping companies can hardly stay in business and are threatened of bankruptcy.

The prosperity index of container shipping companies fell to a four-year low. In Q4 2015, their prosperity index was 79.25 points, falling to the stagnant interval and creating a new low in four years, and their confidence index was 33.75 points, in the moderately stagnant interval. Although container shipping companies have kept improving the dispatching of their shipping capacity, their utilization rate of shipping space has dropped considerably. The prosperity index of shipping space

utilization rate was 50 points this quarter, a sharp fall of 26.43 points from last quarter into the moderately stagnant interval. As a result, more container shipping companies registered reduced profits and increased losses, and their profit prosperity index quickly fell to 51.25 points in the moderately stagnant interval.

II. Shipping companies face a wave of bankruptcy and restructuring in 2016

First, more than 60% of surveyed companies believe BDI will be lower than 800 points in 2016. As the bulk cargo market remains in recession and shipping overcapacity is serious, dry bulk freight has constantly seen historic new lows. In 2016, the downstream demand for bulk cargo will continue to shrink, shipping demand may grow at a slower pace, and shipping capacity cannot be effectively absorbed in the short term, thus the international dry bulk shipping market will continue its negative trend. 61.29% of dry bulk shipping companies hold that BDI will be in the 498-800 range in 2016, 29.03% believe it will be in the 800-1,000 range, 6.45% believe it will be lower than 498 points, and only 3.23% think it will be in the 1,000-1,500 range. No dry bulk shipping company thinks BDI will rise to be above 1,500 points, while generally speaking, the companies' breakeven point (BEP) corresponds to the BDI range of 1,500-2,000 points.

Second, Chinese shipping companies experienced larger operation pressure in Q1. Chinese shipping companies' operations continued to decline in Q1 2016, and their prosperity index was forecasted to be 87 points, still in the relatively stagnant interval and the situation is likely to deteriorate. Among that, dry bulk shipping companies expect to have a prosperity index of 67.97 points, in the stagnant interval, and container shipping companies expect to have a prosperity index of 94.5 points, also in the stagnant interval. In Q1 2016, shipping companies' confidence index is expected to reach 39.09 points, in the moderately stagnant interval, indicating entrepreneurs' lack of confidence in the industry. Among that, the confidence index of dry bulk shipping companies is expected to be 13.33 points, falling to the extremely stagnant interval, and that of container shipping companies is expected to be 55 points, in the stagnant interval.

Third, dry bulk shipping companies may trigger bankruptcy wave. Surveys show that more than 60% of the dry bulk shipping companies experience long-term losses, and about 40% of them have limited current fund for a prolonged period of time, but corporate financing is extremely difficult and costly, thus quite a number of dry bulk shipping companies may face bankruptcy in near future. As the dry bulk shipping market will

remain relatively sluggish in 2016, more dry bulk shipping companies will lose money, which will further threaten the existing tight capital chain and may trigger a bankruptcy wave in dry bulk shipping industry.

III. Government should take measures to ensure stable development of the industry

Chinese shipping companies face a serious challenge. Shanghai is the hub of global shipping elements, and competent authorities of this city should take effective measures aimed to ensure the stable development of shipping industry.

First, lighten the burden on companies by reducing tax. Shanghai should apply for support from national fiscal and tax administrations, expand the scope of deduction of VAT withholdings for modern shipping service industry to keep the integrity of VAT withholding chain, and actively strive for policies in Shanghai on pilot income tax reduction and exemption for sailors.

Second, support the development of medium and small shipping companies with financial and fiscal measures. Shanghai should set up a development fund for medium and small shipping companies in order to guarantee their current fund; encourage banks to lower the interest rate on ship mortgage and extend the maturity of ship owners' loans to mitigate their financing pressure; and establish a financing guarantee mechanism for medium and small shipping companies to mitigate their capital pressure.

Third, urge industrial associations to carry out stricter discipline and management of the industry. Shanghai should urge industrial associations to carry out stricter discipline, regulate and manage improper competition in the industry, and avoid freight that is far below the rational level. It should put in place an internal coordination mechanism for medium and small shipping companies in order to enhance their bargaining power. It should also work with bank guarantee agents and intermediaries to establish a credit rating system for medium and small companies in order to reduce information asymmetry in the financial market.

Fourth, accelerate the reform of state-owned shipping companies. Shanghai should implement the State Council's guidelines on expanding the reform of state-owned enterprises (SOEs) more quickly. It should push the reform of Shanghai-based state-owned shipping companies comprehensively, actively introduce other state-owned capital or various non-state-owned capitals to diversify the equity structure, and improve modern corporate management system and remuneration system, so as to fully motivate the vitality of state-owned shipping companies.

Fifth, improve the environment for corporate restructuring and encourage enterprises to grow faster. On the premise of letting the market play a decisive role, relevant government departments should adhere to the concept of "saving industry rather than companies" in the critical period for the transformation and upgrade of shipping industry. They should sort out regulations that restrict cross-regional merger and restructuring, straighten out interest distribution among different regions, give private investors wider market access, remove barriers to merger and restructuring of shipping companies, and properly address such matters as settlement of redundant personnel, re-allocation of corporate assets, debt consolidation and disposal, and distribution of fiscal revenue, tax and interests. Meanwhile, Shanghai should improve fiscal and tax policies that support merger and restructuring of companies, and actively guide medium and small shipping companies in that direction by means of capital injection and credit financing, in an attempt to stimulate them to grow at a faster pace.