Fall of Hanjin Shipping: What Implications for International Trade?

From raw materials to finished goods, the global shipping industry carries the lifeblood of international goods trade. But after years of weakening demand, overcapacity, and falling freight rates, the shipping industry is struggling on several fronts. Now, with recent news on the fall of Hanjin Shipping – the world's seventh largest container line – it is evident that the industry has hit a crisis point, and a massive transition will be needed in order to turn industry profitability around.

Hanjin Files for Bankruptcy

After losing support from its main creditor Korea Development Bank, Hanjin Shipping Co. Ltd filed for court receivership, which went down as one of the largest bankruptcies the shipping industry has ever witnessed. The company's financial woes can be attributed back to the financial crisis in 2008, which severely hampered global growth and trade. It ultimately had a knock-on effect on the shipping industry, which lost an estimated US$15 Billion. According to IHS Global Insight, Hanjin suffered losses estimating US$ 1.1 Billion during 2009. Amidst this bleak background, Hanjin, along with other major carriers, invested heavily in the creation and use of megaships, which led to a large glut in capacity, driving down rates to unprofitable levels. As overall demand continued to weaken, Hanjin faced a serious mismatch between ambitions and reality. The company continued to sustain losses for four consecutive years since 2011, whilst receiving several lifelines from the government to keep it afloat. By the end of 2015, the company was carrying debt worth over US$ 5.5 Bn, raising its debt-to-equity ratio to over 800%.

Trade Disruptions

At the time of the announcement, the organization had 97 of its container fleets in operation, carrying over US$14bn worth of manufactured goods in transit. The demise of Hanjin significantly disrupted trade across major trans-pacific routes, as well as routes from Asia to Europe. According to a study done by SeaIntel, there will be an instant capacity reduction of 6-8% on trans-pacific trade and a 5-6% reduction on the Asia-Europe trade. Hanjin also has major stakes in ports of Busan and Osaka, which will most likely see high capacity disruptions, and impaired profitability, as these ports will lose its ship calls from Hanjin. Ports have also denied access to Hanjin vessels, amid fears that the company would not be able to pay the fees to dock and store its containers, leaving most of Hanjins ships stranded at sea. Several creditors and authorities have also seized ships, along with the cargo in it. This has caused major disruptions across supply chains, largely due to the scale at which Hanjin was operating.

Cargo owners, including companies such LG & Samsung, are now scrambling to find ways to transport their cargo, as retailers prepare to stock goods for the busiest shipping period of the year.

Freight rates have also seen a temporary surge, as a result of the sudden supply "shock" across routes that were using Hanjin ships. Container spot freight rates on routes from Asia to Northern Europe have risen by 36.6%. Rates across the U.S West & East Coast have increased by 51% and 45% respectively. Competitors, however, welcome the increase in rates and capacity demand, which will provide much needed respite. Most disruptions are expected to last for a short time period, however. The company received US$90 Million as emergency funding to help unload cargo stranded on its vessels. Competitors will also be eager to fill up the supply chain voids left by Hanjin. Maersk Line, the world's largest container shipping group, has already benefited by picking up customers on major trade routes.

Shipping Industry: Mired in Crisis

The crisis surrounding Hanjin highlights the severity of the container shipping industry's slump, which is experiencing its deepest and longest downturn in over six decades. This year itself, major container shipping lines have seen operating profits plunge, with earnings being exceptionally volatile. According to a study done by Moody's, 'consistent fall in profits and poor economic climate drive expectations of a negative outlook for the shipping industry over the next 12-18 months'.

Part of the industry's woes is due to overall sluggish growth in international trade, ever since the 2008-09 financial crisis. The recovery in global trade has been bleak, as trade expansion rates have failed to reach the historical rates of 6% -7%. Much of this has been due to the economic rebalancing in China, and its immediate knock-on effect on other emerging markets especially in Asia. Additionally, the Eurozone crisis and the rising rates of protectionist measures amongst the USA and Europe has also halted global trade growth.

The industry is further imperiled by record low freight rates. The Shanghai Containerized Freight Index – a measure that reflects the movement of freight rates across the export market – dropped to a record-low since it was first introduced in 1998. The drop in rates has been largely due to a series of investments made in large, cost-efficient vessels which has led to an overcapacity in the market. According to Moody's, fleet capacity has continuously exceeded demand, with expectations that supply growth will outpace demand growth by more than 2% in 2016.

There is also very little evidence to show that shipping lines are willing to scrap their vessels to allow freight rates to grow back to profitable levels, and with few signs of strong global economic recovery, shipping lines will continue to face an uphill battle in restoring profitability.

Outlook

The collapse of Hanjin may provide the shipping industry short-term relief in the form of higher freight rates, but it does not solve the industry's problem of chronic overcapacity. Through liquidation, most of Hanjin's assets are likely to be bought by major players and possibly even new entrants, which could place downward pressure on rates once more. Industry consolidation could possibly provide a stable foundation, which could enable the industry to return to profitability. Either way, the industry must undergo significant changes to address its underlying problems, otherwise the scale of Hanjin's bankruptcy may be the first of many more to come in the industry.

This column is part of the 'TIPS' initiative of the Ceylon Chamber of Commerce, aimed at enhancing awareness on trade policy issues among the Sri Lankan private sector.

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