

Decarbonizing the shipping industry: the one opportunity no company can afford to miss

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2021 has offered plenty of evidence that can be viewed as early warning signs of the onset of a 'decarbonization tsunami' which will change the competitive landscape and disrupt business models of maritime transport as we know them today. The future of shipping companies and cargo clients alike will be shaped by how they respond to these signs today.

Ships are not always safest in the harbour

Concluding a recent panel on navigating change in shipping markets, I played a clip of a poem by Drew Dellinger, "What did you do once you knew." The poem, an imaginary conversation with future generations, exploring the moral dimension of inaction in the face of climate change, offers an opportunity to reflect on the consequences of failing to embrace the impending change in the business context too. Paraphrasing Gandhi's motto, *the future of your business depends on what you do TODAY*, I submit a business case for acting in the interest of decarbonization and point to *the urgency of the one investment no shipping company or cargo client alike can afford to miss!*

Connecting to my early sailing experience and my entrepreneurial journey in the years which followed, as I coached and encouraged young entrepreneurs to leave the safety of their harbours to fulfill their potential, I found J. Ked's metaphor highly effective. "Ships are safest in the harbour, but this is not what the ships are built for." However, I realize that the notion of safety in the harbour in the case of the decarbonization of the shipping industry could be misleading. This is an outside-in, not an inside-out change, affecting the entire industry. As such, placed in this context, the concept of safety, or lack thereof, must be viewed differently.

As opposed to an individual who risks missing out on fulfilling his/her potential, remaining in the proverbial harbour as shipping embarks on a journey of decarbonization may bring about far more profound consequences. Indeed, the risk companies face is similar to that faced by ships stuck in the harbour, as a tsunami unfolds. When born in the ocean with an amplitude of a meter, a tsunami poses little danger to ships. However, as it approaches the coast and builds in height, its devastating force tosses the ships in the harbour around like toys.

The lens of future compliance

As new technologies and the regulatory framework are still "works in progress," filled with uncertainty, it is difficult to see a clear path to mitigate risks and measure the economic outcomes of the investments necessary to decarbonize. And, in the year which has seen the most volatile shipping market in more than a decade and the supply chain under unprecedented pressure on the back of post-COVID recovery, it is not difficult to appreciate that, for some companies, decarbonization has taken a back seat. In the end, we tend to attach a greater sense of urgency to problems that seem closer. But, in the past 12 months, decarbonization has taken anything but a back seat on the world stage.

The political, social and business momentums to address climate change have only gained in strength, and 2022 could be considered the most significant year for decarbonizing shipping thus

far. The IMO adopted new mandatory measures to cut the carbon intensity of international shipping. The European Union proposed to add shipping to the EU's Emissions Trading System. 230 industry leaders and organizations representing the maritime value chain signed a call for action to deliver the policies and investments needed to reach critical tipping points in decarbonizing the maritime industry. But, the IMO's regulations, in their current form, are not aligned with the goal of the Paris Agreement, and the EU's initiative demonstrates that regional governments are growing impatient. More regional initiatives, most significantly from the US, are likely to follow.

These policy initiatives and the calls to close the price gap between fossil and green fuels leave can be viewed as early warning signs of the onset of a US\$ 1.8 to US\$2.4 trillion tsunami, on the course to change the competitive landscape and disrupt business models of maritime transport as we know them today. Against this background, waiting to see how the industry standard evolves and viewing decarbonization through the lens of future compliance, may not be commensurate with the scale of the challenge. Indeed, it may amount to remaining in the proverbial harbour as a tsunami unfolds.

The lens of future opportunity

Imagine, as a charterer back in 2019, you had a crystal ball with an insight into how the shipping market unfolded in 2021. Presumably, notwithstanding the daily business challenges then, you would have likely gone "long freight," to build a cost advantage and compete more effectively this year. If you were a ship operator with a similar insight, you would have likely chartered ships for long-term time-charters, to carry you through the post-Covid recovery period with inexpensive ships on hand, giving you an edge over your competitors

In both cases, your advantage would have been based on building an edge around the cost of time charter rates which, next to the ports' and fuel costs, is one of three pillars of variable voyage costs, driving freight rates. On long-haul routes and in certain market environments, fuel may represent more than 50% of the freight cost. For example, this would be the case for a voyage on a Panamax loaded with soybeans bound for China from Brazil a few years ago. And, even today, in an entirely different charter market, it is still about a third of the cost. Considering the marginal impact of freight volatility on what is otherwise a low-margin commodity business, an insight into the future direction of fuel costs could prove immensely helpful indeed.

While we do not have a crystal ball that offers us a perfect view into the future, given the certainty and increased pace of the energy transition and its estimated costs in the years to come, we can foresee, with reasonable certainty, that the cost of fuels will be affected in a major way. And, that CO₂, in ways yet to be decided, will be factored in as the fourth pillar of voyage economics, significantly impacting freight rates.

Of course, this is a rather simplistic view, drawn to drive the point that those who have been able to factor decarbonization into their business models are likely to fare well, compared to those who have not done so. And, that the basis to compete will be affected in a variety of other material ways; access to capital, retention and attraction of talent, brand recognition and the capacity to retain and grow the customer base. What is certain is that this transition, and the new technologies and innovative business models whose development it will catalyze, will offer some companies an unassailable competitive edge, while placing others at a significant competitive disadvantage.

The one investment opportunity no shipping company or a charterer can afford to miss

What assets should you be investing in most? When asked that question, Warren Buffet had a simple answer: “By far the best investment you can make is in yourself. Address whatever you feel your weaknesses are, and do it now. Whatever you want to learn more, start doing it today.’

Because of the inherent uncertainties, positioning vis-a-vis decarbonization is anything but easy. But, it does not mean companies that have yet to start their journey or those that did but got stuck due to the complexity and the scale of the challenge, do not have a choice. The choice is, as I see it, between embracing change and embarking on a journey towards “a tsunami” or holding on to the illusive safety of the harbour and facing far greater consequences later.

But, what does embracing change, in the above context, actually entail? It means creating a culture of sustainability and placing it at the core of your business; building up the necessary knowledge capital, reimagining your business in a decarbonized world and crafting a strategy and a roadmap to take you there. It also means forming alliances and roundtables with your customers and other stakeholders in the industry and beyond, to learn and identify collaborative growth opportunities. Finally, it means *appreciating that all of the above does take time, which is quickly running OUT.*

This transition will be messy. But, failure to lead during these defining moments will cost far more than not getting everything perfectly right. And, it will define the level of confidence your employees and stakeholders have in you. They will have an inevitable right to ask you at one point: *What did you do for our company, once you knew that shipping would decarbonize?*

