Shipping Reform and National Ports Strategy Seminar, Melbourne, Australia

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Port reform, privatisation and private equity investment

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Abstract

- Drivers for port reform
- Definitions, extent and methods of port privatisation
- Recent trend for private equity funds to acquire terminals and entire seaports
- Why are private equity funds investing in ports and what are the implications?

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How important are ports?

"In the beginning the harbour made the trade"

(Sargent, 'Seaports and Hinterlands', 1938)

"Seaports are the mouths through which continents speak to each other"

(Stevens, 1998)

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Why are ports important?

- Our ocean is the best resource we have – it is the sea highway to markets and trade
- Ports are the doors through which trade flows
- Ports can facilitate OR constrain trade
- Ports' (and maritime logistics) aim should be to lower transaction costs
- State should prevent exploitation of seaport economic rent (Goss, 1990)
- State role is to give ports the capacity to do better – the state economy will depend on it!

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Drivers for port reform

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Drivers for port reform

- Improving efficiency
- Reducing government involvement
- Reducing financial burden on government
- Providing access to alternative sources of investment for new infrastucture/superstructure
- Introducing commercially focused management
- Expanding trade

(Frankel, 1992; Sherman, 1995; UNCTAD, 1995)

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Factors driving institutional reform

- Dynamism of the operational environment:
  - globalisation of production/growth of global trade
  - developments in the shipping industry
  - inter-port and intra-port competition
- The port problems which may result:
  - low levels of efficiency and productivity
  - high port prices and poor services

(Nagorski, 1972; Eyre, 1992).

- Changing government strategies which aspire to achieve new objectives

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Definitions, extent and methods of port privatisation

What part(s) of a port can be 'sold'?

Port devolution matrix, Baltazar and Brooks (2001), adapted from Baird (2000)

Governance	Port Functions		
	Regulatory	**Landlord**	**Operator**
Public **Mixed** **Private**	• Licensing, permitting • Vessel traffic safety • Customs & immigration • Port monitoring • Emergency services • Protection of public interest • Determining port policy • Ensure competitive environment	• Water side maintenance (e.g. dredging) • Marketing of location • Development strategies, planning • Maintenance of port land access • Port security • Land acquisition & disposal	Cargo and passenger handling Pilotage and towage Line handling Facilities security, maintenance, and repair Marketing of operations Waste disposal Land side and berth capital investment, equipment etc

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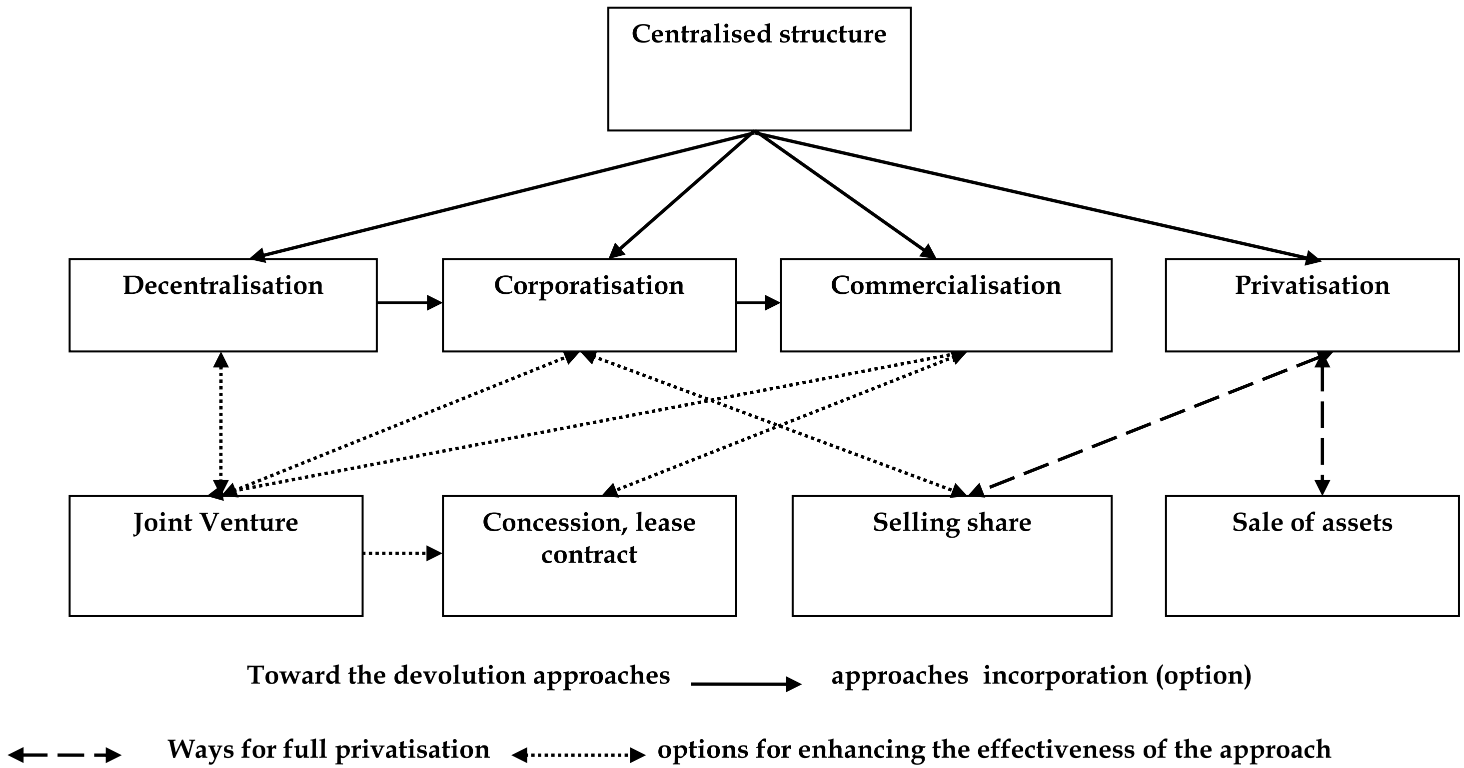
What to sell? What to keep?

PORT PRIVATISATION MATRIX			
PORT MODELS	Port Functions		
	Regulator	Landlord	Utility
Public	*Public*	*Public*	*Public*
Public/Private	*Public*	*Public*	*Private*
Private/Public	*Public*	*Private*	*Private*
Private	*Private*	*Private*	*Private*
Source: Baird (1995; 2000)			

Devolution approaches, and options adopted for operating and managing the port



Source: Ghashat, 2011

‘Standard’ port devolution

- Most common (general cargo) port approach:
  - Public port authority coupled with
  - Private terminal concession/lease arrangement
- Public sector, in vast majority of cases, regulates and owns port
- Exceptions:
  - UK (“Anglo Saxon” model)
  - Brisbane?

Recent trend for private equity funds to acquire terminals and entire seaports

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Why are PEF’s buying into ports?

- Barriers to entry in many ports/terminals
- Terminals are established/mature businesses
- Seemingly ever increasing trade flows (volumes rising faster than GDP, year-on-year)
- The essential infrastructure nature of terminals (trade being vital for national economies)
- Steady cash flows
- High regional market share / ‘local’ monopoly

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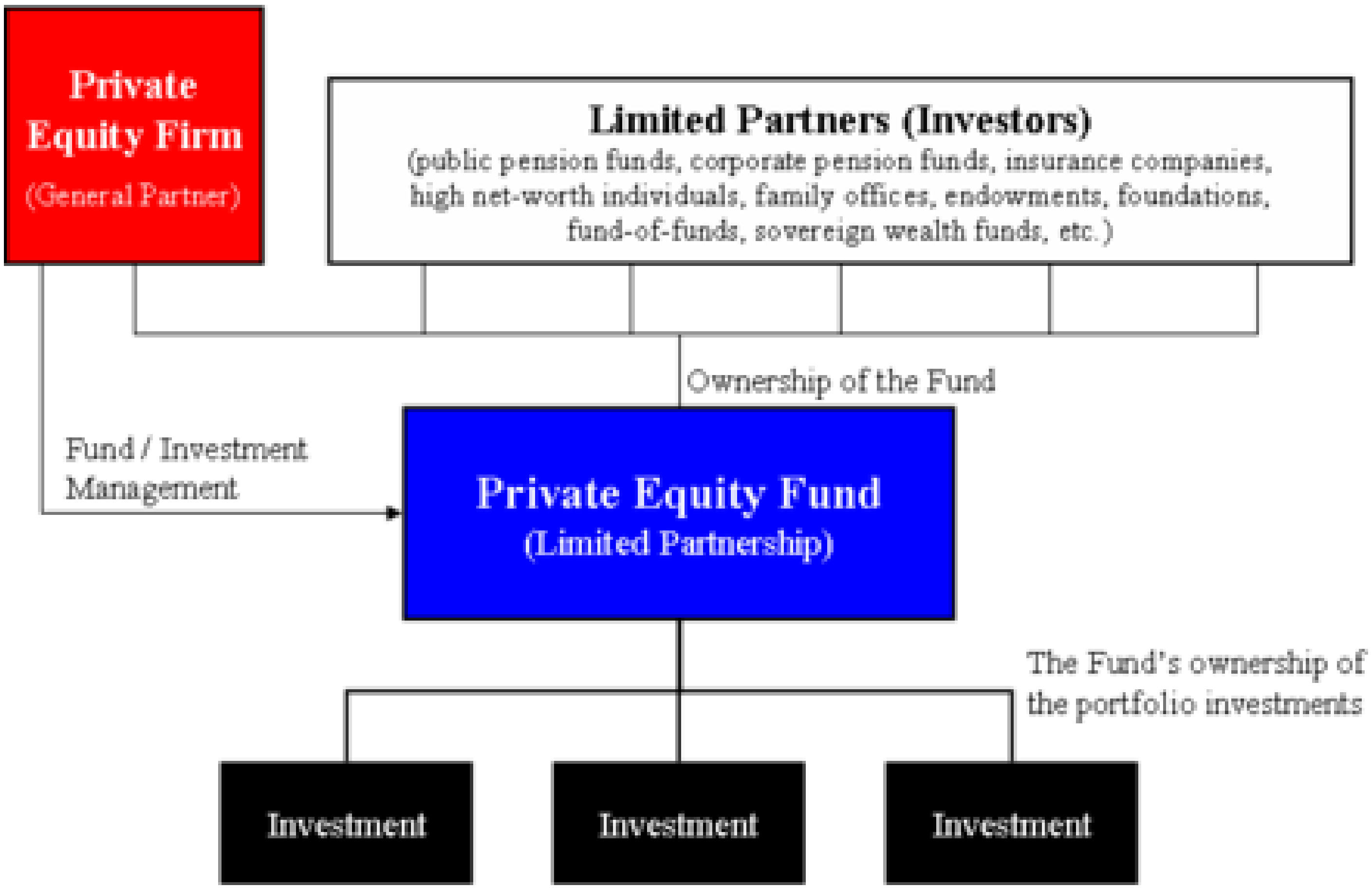
The private equity process



Source: BVCA

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‘Waves’ of development in international container terminal operations			
First wave	***Second wave***	***Third wave***	***Fourth wave***
Pure stevedores	**International terminal operators**	**Integrated global carriers**	**Private equity funds**
HPH	PSA	Maersk-Sealand	Babcock & Brown – Teesport/UK
P&O Ports	CSX	Evergreen	Borealis, GIC, Goldman Sachs, Infracapital – ABP/UK
SSA	BLG	Hanjin	AIG New York – Acquired Marine Terminals Corp and P&O’s USA terminals, plus stakes in Hanjin and Evergreen’s US terminals
ICTSI	HHLA	K-Line	Macquarie Bank – investments in terminals in USA, Canada, Poland and China
Eurokai	DP World	NYK	Goldman Sachs, NY – bought 49% of Carrix/SSA
	Dragados	MSC	Morgan Stanley – bought 80% of Montreal Gateway Terminal
	TCB	OOCL	Ontario Teacher’s Pension Fund – bought OOCL’s Canada and New York terminals
		CMA-CGM	RREEF Infrastructure (Deutsche Bank) acquired Maher Terminals and 49% share of Peel Ports (UK)
			Arcus acquired Forth Ports for $1.2 billion
			GIC et al. bought Port of Brisbane

[US/Canada deals are for terminal leases/operations only]

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Perspectives on PEF’s

- PEF’s have provided high returns (pre-crash)
- Performance varies between different types of funds/difficult to track
- Funds select ‘safe’ places to make investments (utilities, infrastructure)
- Don’t need to disclose inner workings, like public companies (Kuttner)
- “Standard modus operandi of the funds is” (Sarkozy):
  - to buy in, beef up the chosen investment, and
  - sell out fast at a substantial profit
  - sell off firms in pieces, sack staff
  - collect profit, create zero wealth
- Leads to windfall returns for ‘financial engineers’
- PEF’s make big (leveraged) investments but have little experience in shipping (Brogren, 2008)

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Where do PEF's get their money?

- "Over the last 30 years there has been a huge concentration of wealth in the hands of the very rich"

  (Krugman, 2002)

- Much of this wealth is effectively "sterilised" because it goes, not into productive investment, but into speculation and financial engineering
- Private equity managers are financial engineers
- Debt finance via multiple sources

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What are the implications of PEF ‘investment’?

Implications of PEF ‘investment’

- PEF targets are:
  - Established/essential infrastructure
  - Protected or semi-protected markets/barriers to entry
  - Significant or dominant market share
- PEF’s pay (too) high price to acquire ports
- Immediate/intense focus on $ returns
- PEF’s leave managers to operate
- Limited focus on creating new assets

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Implication of PEF ‘investment’ in UK ports

- Sweat assets – leads to congestion & high rates
- Tends to be limited capital investment
- Exploit local monopolies via:
  - High prices
  - Aggressive lease renewals
- Diminishing quality/capacity port infrastructure
- Loss of shipping to continental ports
- Loss of national competitiveness
- Seriously worsening trade deficit
- Weak urban waterfront redevelopment strategies

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Implications of PEF ‘investment’

- Transparency (how much does PEF ‘take’ each year?)
- PEF ‘management fees’?
- Push for profits to pay interest and repay debt = high prices
- Rise in trade means more infrastructure needed in future:
  - What future investment guarantees?
  - How much? When? In what?
- Someone will have to pay for high/inflated sale price:
  - importers/ exporters
  - trade & consumers
- Higher port charges are a tax on trade
- PEF model could lead to loss of state competitiveness
- What happens if PEF defaults?

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We have been warned before!

“Port privatisation may simply be seen by government as an opportunity of obtaining a substantial one-time cash contribution to depleted State Treasury coffers”

(Setchell, 1994)

Note of caution:

“Selling an entire port to a PEF may come at a high cost to future generations”

(Baird, 2011)

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Thank You

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(Sargent, 'Seaports and Hinterlands', 1938)

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