MANAGING DIRECTOR'S SOAP BOX

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Mergers……..

Following the failed attempt to merge UK and Britannia Clubs, the industry appears now to have settled back down, but there is still an uneasy calm and it is difficult to evaluate the full effect that this initiative has had on the International Group. There are a number of the larger Club Managers who are now more focused on the size of the Clubs they manage and their perceived vulnerability following the threat of two very large clubs joining together to become a mega Club and thus controlling the IG.

There are of course also significant financial reward creating opportunities for independent Club Managers following a successful merger, takeover or sudden surge in the size of their business! It is therefore unlikely that the issue of mergers or takeovers will go away for the foreseeable future.

The UK / Britannia Failed Merger - The Fallout

Whereas previous International Group Club takeovers have come about as a result of Clubs in financial distress, we have not experienced in the recent past two strong Clubs, both in terms of size and financial strength, merging to achieve premier status within the group, as in the case with Britannia and UK Club. Of course Standard Club also tried to merge with the Britannia some 20 years ago with similar consequences to those of UK and Britannia this year. Clearly lessons from the past were not learnt!

It may be desirable for the industry to see the weaker Clubs in the International Group being absorbed by their stronger and perhaps more dynamic and efficient brethren.

However let's be honest, the real reason to grow any Club that already has critical mass is not for some altruistic desire to benefit the Shipowners, but for Club managers to enhance their profits and reward.

The Club system, over many decades, has successfully leveraged "economies of scale" not least by bringing together approximately 95% of the World's Shipowners to buy a unique, impressive and secure reinsurance programme at a very competitive cost. Additionally the Group created the pooling agreement that provides quota share reinsurance for all I.G. Clubs without profit to 3rd party underwriters.

Economies of Scale - The Fallacy

There has been comment by brokers and others that significant "economies of scale" will result from Clubs merging. However we believe this is unlikely or of minimal benefit to the Shipowners for the following reasons :

- Most Club costs are not very susceptible to economies of scale. This is because a high proportion of their costs are unlikely to increase or reduce based on size.
- The largest annual cost component for all Clubs is the Members' net claims, which are not reduced by consolidation whether a single Club or all 13 Clubs of the International Group.
- The cost of Group Reinsurance is not influenced by Club consolidation. The Group purchases this cover for and on behalf of all IG Clubs and shares the cost equally across its members - the largest Clubs charge their members exactly the same rates per gt as the smallest Clubs.
- Costs potentially susceptible to change through consolidation may be "other non group reinsurance costs", but the vast majority of Group Clubs already buy independently similar retention reinsurance.

"The club system over many decades has successfully leveraged economies of scale ...."

- Approximately 80% of the total premium a member pays is unlikely to change merely on account of Club size. Therefore, any potential saving will emanate from the management fee of the remaining 20% element of the members premium – let's speculate 15% efficiency saving on the remaining 20% i.e. 3% overall.
- It is interesting to note that some of the largest Clubs have the highest proportionate management expenses. There is no guarantee that size brings reduced costs or greater efficiency!

It was apparent at the time of the UK and Britannia Clubs proposed merger that the Managers never really promoted (at least publicly) the potential for savings! The likely reason for this is that the Managers themselves - who are of course profit making organisations unlike the Mutuals they manage, would want to keep any reasonable efficiencies / cost savings for themselves. It is therefore not surprising that thus far only the independent Club Managers have sought mergers.

North of England, a Club that owns its management is the only Club that has successfully taken over other Clubs and on the basis of "benefit" to the Club itself. It has been a recognised ambition of the NOE management and their Board of Directors to grow the Club since the late 80s. They have successfully taken over Liverpool and London, Newcastle Club and more recently Sunderland Marine, a fish boat Club previously operating outside the International Group …. all of whom were struggling to survive. Certainly in the cases of L&L and Newcastle they were distressed. Note, because of the dilemma of those Clubs the takeovers were successful - North of England was strong and well capitalised and the counterparts were not!

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The Conclusion

It remains to be seen if Shipowner members are convinced that Club consolidation within the International Group is in their best long-term interests and those of the P&I industry. It also remains to be seen if the anti-competition department within Brussels has any interest in the potential loss of competition, particularly now that the United Kingdom (from where many clubs operate) has voted to leave the European Union. It is however clear that in all cases of mergers, Capital is the no.1 consideration and unless both / all parties are convinced that there has been an equalisation of Capital, any proposed merger will surely fail or leave one side disadvantaged with obvious long term consequences.

It is also certain that reduced competition will result in higher premiums for Shipowners!

Julian South
Managing Director
Wilson Europe Limited