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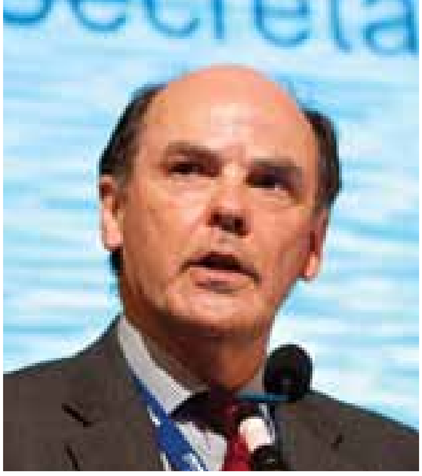




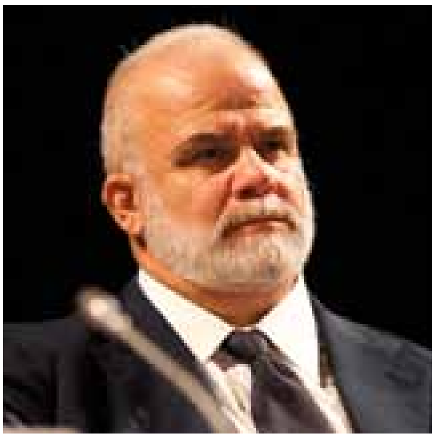





While passenger numbers continue to reach record numbers in Europe, operational and financial pressures surface at the European Cruise Council's 2011 Conference.

by John McLaughlin

> The industry's ships can have a big impact on the struggling economies of southern Europe.
>
> Lefebvre



It has been a difficult six months for the European cruise industry, though in some ways it might be said that this is not through any fault of its own.

Political turmoil in North Africa and the Middle East has sent a chill wind whistling through the Mediterranean, with bookings slowing markedly from January on, according to a number of senior cruise line executives. At the same time, consumer confidence, and consumer willingness to spend, continues to suffer intermittent batterings from the European economy, and specifically from the debt problems of Greece and Ireland, Portugal and Spain.

As if this were not enough, costs are on the rise again. Fuel prices have surged over recent months as one autocratic oil producing country after another has been forced to confront popular demands for greater democracy. And all this at a time when the Mediterranean is crowded with cruise ships, the European contingent supplemented by vessels despatched from a still-sluggish US market.

Just how significant this combination of circumstances may prove for the industry's fortunes was a subject of considerable debate at the annual conference of the European Cruise Council (ECC), which was held in Brussels in mid-June.

As per usual there were plenty of optimists in attendance: convinced that the industry 'value proposition' remains a winning card in the struggle for growth in the European tourism market, and ready to argue forcefully that, with cruise penetration still relatively low in Europe by comparison with the US, the future is rosy.

Unusually, however, this latest ECC Conference was also marked by significant concern – even alarm – among some attendees about the severity of the challenges ahead and the industry's ability or otherwise to respond to the operational and financial pressures now weighing in on it.

There was plenty to reassure in the latest analysis of the industry by GP Wild, which was unveiled on the first day of the conference. The figures on market growth were particularly impressive.

This year, according to Wild, "there were 45 cruise lines domiciled in Europe, operating 132 cruise ships with a capacity of around 137,100 lower berths. Another 66 vessels with a capacity of nearly 81,000 lower berths were deployed in Europe by non-European lines."

By comparison, the previous year saw the same number of lines operating 124 ships with 127,00 lower berths – more than 10,000 fewer than in 2010 . Non-European lines added 64 vessels with a capacity of 76,600 lower berths, taking the shortfall to more than 15,000 berths.

Other indicators of growth were equally impressive. In excess of 5.5 million European residents booked cruises last year, more than 10% up on the 4.9 million of 2009. The increase boosted Europe's share of the global market by one percentage point to 30%.

Similarly, more than 5.2 million passengers embarked on cruises from a European port, 7.6% up on the 4.8 million registered the previous year. Some 1.2 million of those came from outside Europe, delivering a much-needed boost at a time of real difficulty for the wider European economy.

In terms of economic impact, the industry's performance was again largely positive, with only shipbuilding's tale of woe to darken the mood. The industry generated a total economic impact estimated at €35.2 billion, and generated in excess of 307,000 jobs – more than 10,000 more than the previous year. Direct spending by the industry rose once again, from €14.1 billion to €14.5 billion.

The cruise lines spent €6 billion on goods and services – everything from provisions to travel agent commissions, insurance to advertising – an increase of 9.5% on 2009. Passenger and crew spending added €3.1 billion to the mix, up from €2.9 billion in 2009, with passengers spending an average of €61 per person at each port visit and crew spending €16. Wages and salaries came in at €1.24 billion, a rise of 5.2% on 2009.

The one area of regression was spending on the construction, maintenance and refurbishment of vessels. With demand picking up only slowly from the depths of 2008, the shipbuilding industry remains in the doldrums; and that was reflected in last year's drop in spending in this area from €4.6 billion to €4.2 billion.

Indeed, such is the slump in activity at Europe's yards that it had a major impact on the cruise expenditure rankings of individual countries where shipbuilding is a traditional strength.

Finland, for instance, dropped out of the top six in terms of total economic impact of the cruise sector, ceding its place to Greece, this after a 49% plunge in shipbuilding and related expenditures last year resulted in a 41% decline in total direct expenditures. Similarly, France saw total expenditures slip 16.1% after a 33% fall in shipbuilding and related spending.

And as Corrado Antonini, President of Italian state-owned shipbuilder Fincantieri, described it, the future looks no more encouraging than the very gloomy present. "The cruise market is healthy," he said, "but the builders are delaying investment programmes due to a search for margin improvement, fuel price increases and financial constraints.

"The order intake is not enough to feed the European cruise shipbuilding industry," he stated. "There is a severe lack of work." And this not merely a cyclical downswing or a temporary anomaly. Rather, he believed, it marks the beginning of a new phase in the evolution of cruise shipbuilding after the giddy order spree of the five years leading up to the financial crash in November 2008.

Antonini noted that between 2004 and 2007 the industry averaged orders of 12 ships per year. In 2008 that number tumbled to just three, and in 2009 there was just one cruise ship order placed. Last year the total came in at seven. Antonini sees this as "the new normal", arguing that it is reasonable to anticipate six to eight orders each year from now on.

That is, at least, an improvement on the previous two years, though it is clearly not enough to keep Europe's cruise shipbuilding capacity occupied. Indeed the demand squeeze is already beginning to bite, with STX closing

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Antonini

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Bayley

yards and laying off workers at its facilities around Europe.

For its part, Fincantieri is lagging on this score after the recent withdrawal of a plan floated by CEO Giuseppe Bono that would have seen two of its eight Italian yards closed and another significantly downgraded, with the loss of 2,551 jobs or almost a third of the workforce.

That plan ran into fierce political and union opposition, stemming from the importance of these yards to their communities at a time of economic difficulty. As protests spread across Italy, a panic-stricken Berlusconi government intervened and Fincantieri hastily backed away from the proposal.

The predicament that prompted it remains, however. As Antonini noted: "There is no viable industry where capacity is twice the available demand. All of us, to a greater or lesser degree, are going to have problems."

He advocated several measures that could alleviate the difficulties now facing European shipbuilding. He highlighted "innovative designs and configurations" that would cut emissions and save energy. He also spoke of "safety-focused design" on the basis that "The ship is its own best lifeboat."

Antonini declined to be drawn on Fincantieri's future prospects. Industry observers in Italy, however, noted that the promised combination of lobbying in Brussels for ship-scrapping incentives to spur new construction, public works contracts and new high-technology 'green shipping' initiatives were unlikely to make up for the shortfall in work.

Sooner or later, they reasoned, yard closures and job losses are likely to reappear on the Italian government's agenda. From that point of view the release of the Bono plan, however short-lived, may come to be seen as the first step in conditioning Fincantieri's workers to an inevitable rationalisation.

If the shipbuilders see daunting times ahead, their customers among the cruise lines are better placed. Conference host and ECC Chairman Manfredi Lefebvre d'Ovidio highlighted the industry's contribution to employment in Europe, which had risen to 307,000 from just 187,000 five years ago.

He added that the industry's ships, which call at some 250 ports every year, "can also have a big impact on the struggling economies of southern Europe".

For his part, Michael Bayley, Executive Vice President International at Royal Caribbean Cruise Lines, called Europe "a wonderful success story. It has driven the growth of the industry over the past five or six years."

He noted that, from 15 million cruisers in 2006, the industry was set to handle 19.3 million cruisers this year, with the European market expanding by 78% over that period to become its primary growth engine. Relative penetration levels

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Dingle

suggested that there was more of the same to come, he said.

North America's 10 million annual cruisers represent 3% of the region's population, he said, but penetration in Europe is just 1%. Meanwhile, the Asia and Latin America markets, where the industry has barely scratched the surface, also appear ripe for growth, with the rise of China likely to be the main driver in the hugely promising Asian market.

David Dingle of Carnival UK was similarly ebullient, for all the pressures homing in on the industry, citing the industry's 12% average annual growth over the past five years. He also said that, despite a somewhat rocky start to 2011, my guess is that, in the round, the result will be pretty much as it was last year," meaning solid growth once again. Dingle added that success was all about getting passengers on board. "You've got to fill your ships," he said, and Europe is certainly doing well on that score. Indeed, "Europe is still growing as a market and a cruise region faster than in other parts of the world." Not only that: "If you look at the results of the major US cruise companies, they are doing rather well – and they are bringing customers to Europe."

Not everyone was quite so buoyant, however. AIDA President Michael Thamm talked hopefully of the market's "huge potential", adding: "My personal expectation is that the European cruise market will hit the 10 million passenger mark by the end of this decade."

But he also expressed concern at the gravity of the challenges ahead, and wondered aloud whether the industry would be capable of meeting them. "If the industry is to hit that 10 million target," he said, "we will have to fight for it. We have to attract 4.5 million more passengers, and with prices rising it will be more and more difficult to attract them from other forms of tourism."

He added: "I don't believe our industry is the shining light of European tourism. We're not the golden goose." As he said, it may be true that every new ship released into Europe's waters creates its own market. "But it is true that a lot of ships ordered over the past ten years and delivered over the past three or four did not earn the return on investment needed.

"It is also true that many of the brands in the market trade below their cost of capital. I'm not sure that we can really paint the situation of the industry in such a positive manner. Many of us are not able to maintain the prices we were able to generate up to 2008. On the other side, costs are rising. The cost of capital is going up in the near future. There has also been a significant increase in fuel costs, and I am worried that we may have still worse ahead of us."

Costa Crociere President Gianni Onorato also believed that the industry was, to some extent at least, sabotaging its own prospects. "Sometimes we limit ourselves to talking about passenger numbers in order to talk about the success of the industry. And it is successful," he said, "but what is the right price for a cruise today, and are we getting the right price?"

Onorato said that despite consumers' increasing preference for buying direct, distributors such as travel agents would always be important. But he also believed that, in some countries, "We are in the hands of the distributors." He cited Spain, in particular, where he said travel agents were selling brands on price alone and without any attempt to discriminate by brand, or build brand awareness.

"We need to recognise that the scenario has changed since the ECC and US-based CLIA were founded," argued MSC Cruises President Domenico Pellegrino. "We can no longer be represented through local organisations. This is now a global industry." He called for greater

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Thamm

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Onorato

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> Pellegrino

integration, suggesting that the industry needed its own version of IATA. “It is the only way I can see us becoming a larger, more successful industry.”

Consolidation has certainly been the name of the game over recent years. As V.Ships President Roberto Giorgi pointed out, the big four cruise groups now account for 85% of available capacity. The remainder, some 30 independent operators, face challenges of their own, from shore organisation to career planning, from procurement to sales and marketing.

Giorgi saw consolidation ahead in this segment of the market too, particularly in the expedition ship area, where eight small operators are grappling with high overheads and older vessels. He anticipated new owners emerging, and the Chinese market taking off for the smaller operator as well as the large. “I don’t know when, but it will happen.”

Operations aside, Europe’s cruise lines face a number of significant challenges if their next decade is to be as successful as their last. The threat of piracy is one such challenge, though many in the industry seem to view it as a minor threat, whether because few cruise ships travel through pirate-infested waters or because those ships are too fast to be caught or too toweringly awkward to board if they are.

It is not quite that easy, however. As Royal Marines Lt. Col. Andy Price, Executive Officer of the European Union Naval Force, told a spellbound audience in Brussels, cruise vessels may be less vulnerable to capture than other ship types, but the danger to perceptions of cruise shipping from even an unsuccessful pirate attack are real and menacing.

Somali pirates operating in the Red Sea and the Indian Ocean have been increasingly successful over recent years in targeting commercial shipping, he said. Last year the 23,000 vessels transiting the Red Sea suffered 127 attacks with 47 ships captured. The total ransom haul for the year was put at $79.8 million. But already this year it is higher, at $82.9 million for the first five months.

Price estimated the cost of mounting a piracy operation at $50,000. The value of ransoms, on the other hand, have climbed steadily to almost $5 million per ship, and with profits that high the earnings of the average pirate compare very favourably with the $200 per year average wage in Somalia. The forces ranged against them are limited, some 20 ships in 2.6 million square miles of ocean – roughly equivalent to 20 police cars covering continental Europe.

With success the pirates have become more ambitious, using captured cargo vessels as mother ships to range north as far as Iran and south almost as far as South Africa. They have also become more ruthless, torturing and sometimes executing captured mariners. And they are likely to become more heavily armed as shipping companies resort to deploying armed guards as a deterrent to attack.

Cruise ships may be a difficult target, Price said; they may also be an undesirable one, given the problems any pirate band will have handling that many hostages and the outcry that would ensue if a cruise ship was attacked, let alone taken. But, he noted, pirates operating at the limit of their range, almost out of food and fuel, may not be the most rational of antagonists.

Price also said that a rocket-propelled grenade fired into an area where cruise passengers had gathered could be devastating, not just in loss of life and the financial impact on the target cruise line, but to the industry’s reputation.

The port session provided a welcome return to prosaic reality, though the challenges the cruise lines face in their sometimes strained relations with the ports are certainly pressing. Issues of berth access and port dues, shore excursions and ship reception facilities were the subject of a heavily attended meeting between lines and ports before the conference proper began.

It was a valuable exercise, according to MedCruise President Giovanni Spadoni – less because of any concrete responses to those vexed issues but because of the opportunity it provided to launch what is sure to be a long-running debate on how to ease the challenges in each of these areas. Each is now well aware of the other's point of view, which received a further airing during the conference.

RCCL Vice President Commercial Development John Tercek pointed out that, as demand surges in the Mediterranean, six or seven ports can be described as facing "challenging" times. Barcelona, Livorno, Civitavecchia, Venice, Dubrovnik, Tunis and Cyprus "have problems today and are going to have serious problems in the future". He said all but Cyprus had registered compound annual growth in excess of 15% over the past ten years.

Spadoni added that congestion is one of the most challenging issues faced in the Mediterranean. "Growth doesn't allow time for infrastructure construction," he said, "and there is congestion not just in the ports but in the tourist venues." But tackling congestion is not just a matter for the ports, he said. Noting that both RCCL and NCL had put two post-panamaxes into Barcelona, he argued that "Congestion goes hand in hand with itinerary planning."

The environment, and specifically the wave of environmental regulation now bearing down on the industry, is another area of concern for ports and lines alike. Last year the conference had little joy out of its encounter with European Commission (EC) officials, with Elena Visnar-Malinovska, a cabinet member at the EC's DG Environment, assuring them that there would be no watering down of regulations mandating 0.1% sulphur content in fuel in certain emissions control areas by 2015, and no delay either.

There was a touch more encouragement this time. Soledad Blanco, a director for sustainable resource management, industry and air at DG Environment, said a proposed revision of the EU's sulphur directive would contain a derogation in cases where there was insufficient low-sulphur fuel available, though she "could not commit to the precise wording".

Cruise lines are concerned that it is already too late for refineries to invest in sufficient capacity for such fuel to feed the global shipping industry. Blanco added that a study on the availability of low-sulphur fuel would be completed by 2018, ahead of the introduction of widespread restrictions in 2020. The EC has called for that study to be brought forward.

Carnival UK Chief Executive David Dingle, meanwhile, said the industry was prepared for the environmental challenges to come. Asked about the prospect of a carbon tax, he said: "Our eyes are open. We have to assume that carbon charging will be applied to the cruise industry as a member of the wider shipping industry.

"We are a consumer industry," he added, "and we cannot be blind to the needs of our customers." He cited a string of initiatives and practices introduced of late to cut emissions and save energy, from slow steaming to improved hull coatings to new engine designs and innovative hull forms.

The issue of a carbon tax is not going to go away, he said. "Fortunately we have a time period to absorb the costs, so they don't impinge too much on the bottom line."

" Growth doesn't allow time for infrastructure construction. "

Spadoni

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>
> Vago

It was a view echoed by MSC Chief Executive and ECC Vice-Chairman Pierfrancesco Vago, who said the industry understood the need for environmental sustainability – but also needed to remain competitive.

“For this to be possible,” he said, “we need Europe to continue to be a good place to do business, with an appropriate and understandable regulatory framework that meets the legislative ambitions of the EU institutions without compromising the sector’s competitiveness.

“The White Paper (on transport), released at the end of March, is an excellent starting point for developing this framework,” he stated, “and it is going to set the transport agenda in Europe for the next decade.” The cruise industry, he said, is highly interested in being part of the debate, “as most of the topical issues this paper addresses are at the heart of the cruising business”.

He cited environmental issues, welcoming the suggestion that transport should improve its environmental performance. At the same time, though the cruise industry was constantly pushing the frontiers of environmental technology, he claimed that the limits of that technology were now being reached.

“Future compliance will therefore depend more on adequate port reception facilities being in place and at competitive prices. A zero-discharge ship can only be achieved if operational waste can be discharged ashore.”

He urged the EC to ensure that the review of the port waste reception facilities directive “results in truly world-class European port infrastructures”, argued for “the mandatory application of an energy efficient design index in July” as part of a push to develop a global regime for maritime emissions, and advocated the full alignment of the sulphur directive with the IMO’s Marpol Annex VI.

As for “people” issues, Vago also encouraged the European Commission to adopt the third maritime safety package, to “intensify its anti-piracy activities in close cooperation with the international community”, and to support the goals of the maritime labour convention.

And on passengers’ rights, he said that, while the EC backs the idea of a passenger rights charter covering all modes of transport, it was concerned at the possible repercussions of a “one-size-fits-all approach” that “could risk overlooking the special requirements of the cruise sector in this area”.

Vago’s message on sustainability and competitiveness is one the European Commission seems to be listening to – witness the keynote speech delivered to the conference by Siim Kallas, Vice President of the EC with responsibility for mobility and transport.

Kallas said the industry must not rest on its laurels, and stressed the need to cut greenhouse gas emissions and the sulphur content of fuels. He also underlined the importance of vigilance on ship safety (promising a thorough review of current legislation) and of ensuring that Europe’s seafarers were properly trained, rewarded, and encouraged to remain in the industry.

But he also described the industry’s commitment to quality and sustainability as a critical contributor to its economic success over recent years, and said dialogue and cooperation would be the key to progress going forward. “We want the cruise sector to continue to grow sustainably, and provide quality jobs and of course an unforgettable experience for cruise passengers,” he concluded. ●

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