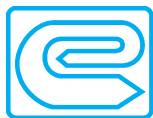


# EXIM BANK: RESEARCH BRIEF

## INDIAN SHIPPING INDUSTRY: A Catalyst For Growth



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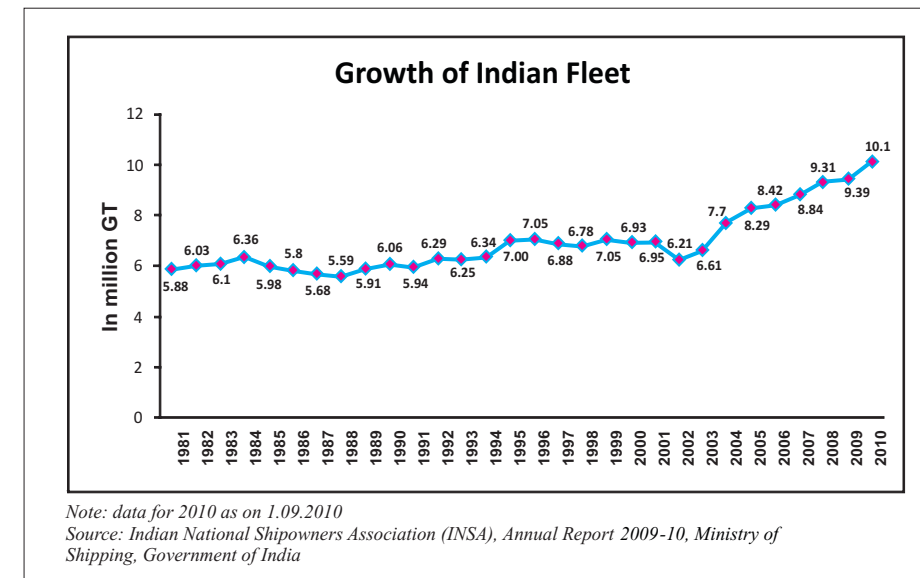
The growth in international trade, removal of trade barriers being the principal reason, has made the developing countries to concentrate more on the improvement of their infrastructure, like roads, airports, seaports, which play a vital role in the development of the economy. Product storage, along with the capacity to move large shipments, have placed the shipping industry in a very advantageous position. Containerization, multi-modal transport services, advancement of marine engineering technology, specialized systems, and computerization have contributed towards making sea transport as the prime mode for movement of internationally traded goods. However, the development of shipping industry in a country also depends on its population density, economic advancement and many other inter-related conditions like port and refueling capacities.

### INDIAN SCENARIO

According to the Ministry of Shipping, Government of India, approximately 95% of the India's trade by volume, and 70% by value, is moved through maritime transport. India is among the top 20 leading countries having large number of merchant fleets in the world. The Gross Tonnage (GT) under the Indian flag was 10.1 million GT as of 1.09.2010, with as much as 1029 ships in operation.

Ports act as an interface between ocean transport and land transport. India has 12 major ports viz. Kolkata (including Dock complex at Haldia), Paradip, Vishakhapatnam, Chennai, Ennore, Tuticorin, Cochin, New Mangalore, Mormugao, Jawaharlal Nehru at Nhava, Mumbai, and Kandla, and 187 minor ports.

Despite recessionary conditions, traffic handled at major ports has grown on an average by 5.7% in the year 2009-10, over the



year 2008-09. However, ports like Haldia (-20.4%), Ennore (-6.9%) and New Mangalore (-3.2%) are few of the main ports that witnessed negative growth in 2009-10. Nevertheless, most of the ports have not achieved their growth target for the year 2009-10. It has been the endeavour of Government of India to consistently enhance the cargo handling capacity of the major ports keeping in view the projected traffic for the country. The aggregate capacity in major ports as on 31.3.2009 was 574.77 MTPA. Major cargoes handled at Indian ports include: petroleum products, iron ore, fertilizers & raw materials, coal and containerized cargo. In case of POL, fertilizer and other cargo, Kandla handled the highest traffic.

### INDIAN SHIPBUILDING INDUSTRY

World order book position for ship building in the year 2009 was 9226 ships, which was around (-) 18.6% less compared to the position in the previous year. In fact, after 2007, new orders for shipbuilding had

reduced by almost half in 2008 and in 2009. However, completions of the shipbuilding orders have shown improvement over the years. India currently has around 32 shipyards, owned by: Central Government (6), State Governments (2), public listed private shipyards (3), and privately held shipyards (22).

According to the world order book position, during 2009, Indian shipyards had an order book of close to 260 ships constituting 1% share in terms of Gross Tonnage (GT) and 2.8% share in terms of number of bookings. China was top in the list with the largest number of bookings of 3523 ships, followed by South Korea (1675), Japan (1286) and Europe (447). India stood at the sixth position in the world order book, after Vietnam (287). Although India occupies a small percentage of the global shipbuilding market, the Indian shipbuilding industry is well positioned for growth. According to a study by the Indian Shipbuilders Association, the industry can grow at a rate of more than 30%, and this rate of growth could be achieved through

supportive measures by the Government, including incentives for shipyards.

## CHALLENGES AND STRATEGIES

### Challenges

#### Onerous Tax Regime

According to a Research Paper by the Ministry of Finance, Government of India, the shipping industry is facing significant tax burden, though the tonnage tax has been introduced. The paper lists out taxes such as minimum alternate tax, dividend distribution tax, withholding tax liability on interest paid to foreign lenders, withholding tax liability on charter hire charges paid to foreign ship owners, seafarers taxation cost to employers, wealth tax, sales tax, VAT on ships and spares, lease tax on charter hire charges, customs duty on import of certain categories of ships, stores, spares and bunkers, and services tax. The Paper is of the view that such tax regime makes Indian ship owners to prefer to own vessels outside India.

#### Multiplicity of Regulations

Shipping industry, catering to the demand across continents, is regulated by both domestic and international regulations. Internationally, the International Maritime Organisation has a set of rules to ensure safe, secure and efficient shipping, besides the labour standards required for seafarers worldwide. There are also international regulations on operations of ships, such as International Convention for the Safety of Life at Sea, International Convention for the Prevention of Pollution from Ships, Convention on the International Regulations for Preventing Collisions at Sea, International Convention on Loadlines, International Ship and Port Facility Security Code, and International Safety Management Code. There are also international regulations for seafarers, such as International Convention on Standards of Training, Certification and Watch-keeping for Seafarers, and ILO Merchant Shipping Convention.

UN Convention on the Carriage of Goods by Sea (called the Hamburg Rules), The UN Convention on International Multimodal Transport of Goods (1980), and the UN Convention on Conditions of Registration of Ships (1986) are some of the other regulations initiated by UNCTAD.

Domestically, there are several acts that regulate the Indian shipping industry, such as: The Merchant Shipping Act (1958), The

Inland Vessels Act (1917), The Coasting Vessels Act (1838), and The Multimodal Transportation of Goods Act (1993). Besides, there are also other statutes that govern the shipping industry indirectly. These include: The Indian Ports Act (1908), The Dock Workers (Regulation of Employment) Act (1948), The Seamen's Provident Fund Act (1966), and The Inland Waterways Authority of India Act (1985).

The wider regulatory framework makes stricter entry barriers into the industry, and adds cost to the compliance of such regulations.

#### Declining Share of Indian Shipping Tonnage in India's Overseas Trade

Over the years, the share of Indian shipping in overseas trade has declined. From 85% in 1981, the share has declined to 32% in 2009. As on September 2010, India had 693 vessels under coastal trade and 336 vessels under overseas trade with a total of 1029 ships. High transportation costs, port delays, poor turnaround time of coastal ships on account of over-aged vessels, and inadequate mechanical handling facilities are some of the other reasons for the declining share of Indian shipping tonnage in India's overseas trade. Continued slippages in the share of Indian shipping in the carriage of India's overseas trade is in turn causing a drain on precious foreign exchange, in terms of payment of freight charges, which could otherwise be used for other high priority imports or for building up indigenous infrastructure. One of the major reasons for the declining share in overseas trade has been the age profile of the shipping vessels in India. Majority of the Indian shipping fleet contains ships which are over 20 years of age. This reduces the competitiveness of Indian vessels as compared to the foreign vessels. The increasing size and sophistication of ships and port facilities require heavy capital investment, which is one of the major problems faced by Indian shipping industry.

#### Declining Cargo Support

As per the existing Government policy, all import contracts are to be finalized on FOB (Free On Board) basis in respect of Government owned / controlled cargoes on behalf of Central Government Department/State Government Department and Public Sector Undertaking under them, with a view to retain control over shipping arrangements within the country, and for

providing cargo support to Indian flag vessels by providing first right of refusal. For meeting the above objective, the policy provides for centralized shipping arrangements through the Chartering Wing (TRANSHART) in the Ministry of Shipping, Government of India. As regards chartering of vessels for movement of cargoes on private accounts, the same are regulated through the Director General of Shipping by granting permission to private charters after taking into consideration the availability of Indian flag vessels by granting first right of refusal.

Data collated by Ministry of Shipping, Government of India, on Government owned / controlled cargoes handled by the chartering wing of Ministry of Shipping, shows that the share of Indian vessels in moving cargo under TRANSHART has been declining over the years. Cargo support in favour of national shipping is very important, since reservation of national cargoes for national fleet provides the national fleet with a certain degree of stability in an otherwise violently cyclical market.

#### Manpower Shortage

One of the major problems faced by the shipping industry is the shortage of manpower. India is not able to provide adequate number of seafarers to man Indian flag vessels. This is mainly because not enough young people seem to find seafaring an attractive and appealing career with many of the officers preferring to sail on-board foreign flag vessels owing to favourable taxation policies. Industry experts opine that over-regulation of the industry, owing to which seafarers have to undertake lots of job responsibility in a very short time, is another reason for declining interest to undertake seafaring as a profession. The only way the shortage of seafarers can be managed is by creating a workplace environment that is attractive to applicants, and corporate values that are aligned to wider social interests. Though, the International Labour Organization (ILO), the IMO (the IMO has designated 2010 as the "Year of the Seafarer"), and shipping industry organizations began helping to stimulate initiatives for recruitment into the industry a couple of years ago, it is considered that the ultimate solution lies with the industry itself.

#### High Port Calling Costs

High port charges, like port dues, berth hire, pilotage and cargo-handling charges, in India are also affecting the Indian shipping

industry. India is known to be having high ship calling cost as compared to other competitor countries in the region. According to industry sources, port calling costs for a ship that can carry 1,200 standard cargo containers is US \$ 19,000 ( ₹ 8.4 lakh) at Kochi. The rate is US \$ 3,300 in Colombo, Sri Lanka, and US \$ 5,700 in Jebel Ali, United Arab Emirates. This makes the Indian ports non competitive compared to other foreign ports. High prices would normally deprive a port a part of its patronage (vessels and cargo owners) and thus reduce demand for port services.

### **Congestion in Port and Connectivity with Hinterland**

Indian ports are the gateways to India's international trade, and are handling over 90% of foreign trade. Though the bulk of Indian trade is carried by sea routes, the existing port infrastructure is insufficient to handle trade flows effectively. The current capacity at major ports is overstretched. The major ports together have a capacity of 574.77 million tonnes per annum (MTPA), handling traffic of 560.96 million tonnes during 2008-09, and the capacity utilization during this period was 96.7%. The capacity utilisation at major ports has been increasing over the years owing to growing trade. During 2001-02 the capacity utilization was 83.6%, which has peaked to 99.7% during 2007-08, signifying increasing congestion in all the major ports. Another major challenge faced by Indian shipping industry is the relatively low hinterland connectivity with the ports. Indian ports are finding it difficult to handle additional traffic because of slow evacuation from ports. Therefore, it is important that connectivity of major ports with the hinterland is augmented, not only to ensure smooth flow of traffic at the present level, but also to meet the requirements of projected increase in traffic.

### **Strategies**

#### **Increasing Investment in Shipping Industry**

Shipping analysts feel that there is a pressing need for the Government to take on the role of a facilitator and create opportunities for a healthy business climate to attract fresh investments in the shipping sector. The old ships are being used by the ship owners primarily due to low investment capacity to buy new ships, and the growing demand for

shipping transport. Usage of old ship is highly risky apart from being operationally more expensive. Further, several countries around the world have banned certain class of ships, as per their build and age, to be operated from their ports. A large part of the current order book of the shipyards would go towards replacing these old vessels and the incremental growth in capacities would be additionally catered by orders placed outside India.

Developed countries have evolved various innovative structured models for financing shipping industry. Norway has evolved the Kommandittelskap Structure (KS Model), which is a tax-deferral method employed to finance ship acquisitions. The German adopted the 'Kommanditgesellschaft' (KG) model for financing of various projects including that of shipping industry. Both KS and KG models operate more or less on similar principles. Such models would be best suited for Indian shipping industry too. The German KG Model would help the Indian shipping industry in mobilizing necessary funds for the shipping companies, as also would serve as an effective investment tool for high net-worth individuals, who would benefit from tax exemption and also earnings. The Indian shipping industry can also use this model for the purpose of purchasing LNG vessels as they are perceived to be relatively safe investments backed by long term charters.

#### **Strengthening Shipbuilding Industry**

Shipbuilding acts as a catalyst for overall industrial growth due to spin offs to other industries, including steel, engineering equipment, port infrastructure, trade and shipping. The dynamics of India's economic growth has created and will continue to create a demand for new ships, most of which will have to be built abroad due to inadequate indigenous capacity. On the other hand, the benefits to Indian industry and potential for employment generation from shipbuilding, and the associated ancillary industry would grow manifold, if India builds ships for meeting its entire tonnage requirements. Also single window clearance system needs to be brought into place for according clearances to new shipyard projects covering land acquisition, environmental clearance, power and water etc., so that project implementation is not delayed. The present requirement to obtain multiple clearances from various

departments acts as a deterrent to attracting investment into this sector.

#### **Developing Adequate Container Freight Stations**

To increase the competitiveness of the country's exports in the global market, by reducing the transaction cost (both absolute and implicit cost) in exports, the Government of India is laying stress on developing a number of container freight stations (CFSs) in the country. Modern and technologically advanced CFSs play a significant role in effective custom clearance activities in the port, and thereby shorten the turnaround time of ships. More CFSs need to be developed in the vicinity of export clusters across the country. Mapping of existing network of CFSs with the Towns of Export Excellence shows that the CFS network needs to be strengthened further.

#### **Integration of Shipping and Logistics**

It is important to note that the economy today is experiencing more and more trade related activities. Hence, overall logistics development has become very essential, especially in the transportation sector. In order to be competent with the global majors, India needs to offer exemplary transportation services along with logistics services by integrating the two segments. It may be mentioned that traditional transport companies, courier companies and freight forwarders have emerged as integrated logistics service providers by leveraging on their existing infrastructure and experience. They not only provide the prime functions like transportation, warehousing, packaging, clearing and forwarding, but also provide value added services, such as order processing, documentation of sales tax and excise duty, invoicing, collection of bills, inventory management, and others. This kind of development is very important and useful for the shipping industry in particular.

#### **Creation of Adequate Warehousing Facilities**

Warehousing and storage is also an integral part of the logistics industry and plays a very important role in the shipping industry. Since ports act as an interface for seaborne trade movement, most of the major ports in India provide warehousing facilities to its users through its own warehouses, as also with those privately-owned warehouses located within or outside the port arena. With an



increasing number of ships calling at Indian ports, storage and warehousing facilities need to be upgraded manifold. Domestic ports suffer from inadequate storage facilities, which result in delay in consignment delivery. In the coming days, the number of ships calling at Indian ports is likely to increase manifold. This will result in huge unloading of cargoes, which needs to be stored properly before being sent to the final destination. Therefore, a major investment opportunity lies in setting up warehouses that not only provide storage facilities, but also offer services in packaging of goods, so that they do not get damaged during transit.

### Creation of Multimodal Logistics Parks

Another trend has been the establishment of multi-modal logistics parks. These multi-modal logistics hubs have been planned to provide total transport solution and other value-added services to industry in and around the dedicated freight corridors. Establishing logistics parks would open up new avenues and opportunities for manufacturers, retailers, suppliers, and logistic players to improve their supply chain. Service, cost and time advantage are direct benefits of such parks, and outsourcing of value-added services, which are traditionally performed in-house, would further increase the competitiveness. Logistic parks across the globe provide ample reference points and are excellent showcases against which India's logistics parks could be modeled. It may be mentioned that Indian railways have identified 11 sites in the Delhi-Mumbai corridor for developing multi-modal logistics parks.

### Tapping LNG Business

In order to harness India's power and fertilizer projects, LNG (Liquefied Natural Gas) is being imported by India. If transportation of LNG is taken up by the shipping industry, it would provide significant volume of business for the shipping industry. However, many shipping companies may not have adequate resources to buy LNG vessels to engage in this business. According to industry sources, a LNG vessel costs around US \$ 200 million; therefore, it is important for the Indian shipping companies to build strategic tie-ups with foreign counterparts so that they do not miss out this business opportunity.

It may be mentioned that the state-owned Shipping Corporation of India (SCI) has already started building strategic tie-ups through collaborative approach with Japanese consortium. Although the Indian shipping companies are interested in LNG transportation, low level of experience and the volume of investment act as major hindrances.

### Bilateral Shipping / Cargo Reservation Schemes

Bilateral shipping arrangements are considered to be an effective tool to ensure cargo support to the Indian shipping companies. In this context, it may be mentioned that cargo support in favour of national shipping is prevalent in many countries, since reservation of national cargoes for ships carrying national flags provides a certain degree of stability in an otherwise violently cyclical market. Such support enhances the competitive strengths of national shipping companies, and thereby contributes to the growth of national fleet. According to Office of Maritime Administration of US Department of Transportation, USA is providing cargo preference to US national flags, of Government-impelled cargo, with 100% preference for military cargo, and export cargo supported by US-Exim Bank; 75% preference for agricultural cargo (governed by the Food Security Act of 1985); and 50% Civilian Agencies Cargo (governed by Cargo Preference Act of 1954).

India too is providing cargo support to Indian ships, through TRANSCART, for movement of Government owned / controlled cargo. However, there has been decline in support provided through TRANSCART, as, pursuant to trade liberalization, there has been decanalisation of imports of various items, which reduced the quantum of such support to Indian ships. According to a study by UN-ESCAP, the lower share of Indian shipping in the carriage of country's overseas trade is due to the terms of trade being used by India's trading partners, who by and large have been entering into shipping contracts favourable to them. In the above context, Government may consider including cargo reservation schemes in the

negotiations under the bilateral / regional trade agreements.

### Conclusion

The Indian shipping industry has been growing in the last two decades; however, the competitive position of the Indian shipping industry needs to be strengthened. Government of India has been supporting the growth of the industry through various measures. Government has a role to develop Indian port sector which would contribute to the growth of the Indian shipping. The players in the shipping and associated sectors have also a role to play for the development of the industry, for it to carve a niche in the world shipping map. Indian shipping industry needs to team up with foreign consortium of fleet owners to tap the growing LNG transportation business. Indian shipbuilders must focus on benchmarking their own processes to international standards to improve the efficiency, delivery time, price and quality. Innovative financing measures such as German KG Model may be adopted to encourage fund flows into this sector. It is therefore essential for India to put together all such strategies, that would lead to optimal and effective contribution towards developing the shipping industry.

*The contents of the publication are based on information available with Export-Import Bank of India and on primary and desk research through published information of various agencies. Due care has been taken to ensure that the information provided in the publication is correct. However, Export-Import Bank of India accepts no responsibility for the authenticity, accuracy or completeness of such information.*

Note: Indian Rupee are referred in crore and lakhs:

1 crore : 10 million

1 lakh : 100 thousand

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