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**WORLD MARITIME UNIVERSITY**  
**Malmö, Sweden**

**Mergers in Liner Shipping:  
Strategic Options Available to Indian Shipping**

By

**RAJNISH KHANDELWAL**  
**India**

A dissertation submitted to the World Maritime University in partial  
fulfilment of the requirements for the award of the degree of

**MASTER OF SCIENCE**

in

**SHIPPING MANAGEMENT**

2000

## **Declaration**

I certify that all the materials in this dissertation that is not my own work has been identified, and that no material is included for which a degree has previously been conferred on me.

The contents of this dissertation reflect my own personal views, and are not necessarily endorsed by the university.

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## **Abstract**

Title of Dissertation: Mergers in Liner Shipping – Strategic options available to Indian Shipping.

Degree: MSc.

This dissertation is a study of the spate of mergers taking place in the liner shipping industry and the options these leave for a small operator the size of 'The Shipping Corporation of India Limited.'

A brief look has been taken at the measures liner operators have been taking to overcome the poor earnings from this industry. The evolution of the conference system and the global alliances has been examined here.

The liner industry has witnessed a number of mergers recently, and the motive driving these mergers and the rationalisation that has come to the industry has been looked into. Additionally case studies of three major mergers have also been presented for benchmarking purposes. A mention of major trends that are currently affecting the industry has also been made.

The dissertation is to propose a business strategy for Indian liner companies, hence the Indian scenario has been studied. Current status of the sole Indian operator, SCI has also been analysed with emphasis on the capability of the company to continue in the turbulent times in which many companies have given up. Options available to SCI have thus been evaluated and a course of action is proposed.

KEYWORDS: Liner, Container shipping, Mergers, Strategy, India, SCI.

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## **List of Abbreviations**

ANZDL	Australia New Zealand Direct Line
B-2-B	Business to business
Cb	Block Co-efficient
Cif	Cost Insurance Freight
Cosco	China Oceanic Shipping Company.
CP Ships	Canadian Pacific Ships
CRM	Customer Relationship Management
DWT	Dead weight tonne
Fob	Free on board
GATT	General Agreement on Trade and Tariffs
INSA	Indian National Shipowners Association
IPBC	India Pakistan Bangladesh Ceylon
IT	Information Technology
Kn	Knots
Loa	Length overall
Lpp	Length between perpendiculars
Lwl	Length at water level
MCR	Maximum continuous rating
MISC	Malaysia International Shipping Corporation Berhad

MSC	Mediterranean Shipping Company
NYK	Nippon Yusen Kaisha
OOCL	Orient Overseas Container Lines
SCI	The Shipping Corporation of India Limited
TEU	Twenty Equivalent Unit
THC	Terminal handling charges
UASC	United Arab Shipping Company.
UN	United Nations
Vship	Velocity of ship
WTO	World Trade Organisation

## 1. Introduction

“Container shipping is like a poker game - you just have to keep putting more and more money on the table which you are about to lose.”

*Late Sir Y-K Pao, one time chairman of World Wide Shipping.<sup>1</sup>*

A key feature of liner business has been capacity management. From an economic view point, what makes this form of business different from bulk shipping is, in liner shipping there is an obligation to stick to a timetable, which makes capacity inflexible. While in tramp, owners can respond quickly to supply/demand imbalances by moving their least efficient ships to lay up, a liner company has to keep up with its schedules and has to run its vessels to stick to the schedule, no matter even if the vessels are moving empty. This inflexibility does not leave any leeway for the liner operator when there is a seasonal variation in cargo in some trade routes.

Another aspect of liner business has been the problem of pricing. Since the liner market has a huge fragmented customer base, it is not practicable for operators to negotiate rates for each consignment, which is not a problem in the tramp sector where the customers are big in size and shipowners move from trade to trade negotiating rates with each customer.

These two limitations, inflexible capacity and fixed prices have always dominated the liner industry. Revenues have been highly volatile, with cash flows frequently affected by trade cycles, seasonal cycles and trade imbalances. Industry operating profits never exceeded 6 percent in the last decade<sup>2</sup> and there are very few liner operators who have been able to produce consistent, acceptable levels of

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<sup>1</sup> Lim, S.M. 1998. p.361.

profitability. To quote Ray Miles, CEO of CP Ships, twelve of the top twenty container lines suffered losses in 1998, while seven made insufficient profits and just one (CP Ships) made a satisfactory return.<sup>2</sup> This phase of dismal returns has driven away a number of established players from this business.

In order to have a stream of positive revenues, operators have been trying to influence the market forces. There has been array of experiments with some focussing on the revenue side by fixing prices for the transportation, while others tackling capacity by fixing up trade shares so that companies do not compete for each other's cargo. One obvious strategy for this has been the formation of cartels and liner shipping has such co-operation schemes known as 'Conferences'. In addition to the conference system, liner operators have also learnt the art of making friends with enemies, and competitors have worked together in the form of consortia and alliances as discussed in chapter 2 of this dissertation.

When the alliances were not able to result in desired savings, the industry witnessed weaker players surrendering to the more ambitious ones and thus started the era of mergers and acquisitions. Chapter 3 discusses this form of consolidation that the industry has witnessed in the last few years.

Chapter 4 takes a look at the current trends that have affected liner shipping in the recent past, and what is in hold for the future.

Since the dissertation is to find out a future course of action for Indian liner companies, Chapter 5 is an introduction to Indian companies in this business and the role played by those in the international arena. This chapter takes a look at The Shipping Corporation of India (SCI), which is the only Indian company having a presence in the international liner business today.

With the industry witnessing a number of takeovers, and the liner business not giving adequate returns to SCI, it becomes imperative to assess the options

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<sup>2</sup>Drewry Shipping Consultants, October 1999.

available to the company to overcome the turbulence. An analysis of the options available before SCI is, therefore, discussed at chapter 6.

Chapter 7, presents the conclusion as to the option best suited for SCI, and this forms the recommendations for implementation.

## **2.**

### **Co-operation schemes in liner shipping**

#### **2.1 Conferences**

The advent of steam ships brought a new dimension in shipping as it enabled operators to offer fixed sailing schedules, which they were not able to do with sail boats earlier, as those depended upon weather conditions. Steam ships had greater cargo handling capacity, and at the same time required less sailing days. This coupled with the opening of the Suez-canal in 1869 meant a high increase in cargo carrying capacity of the world merchant fleet. Unfortunately, the trade could not keep pace with the growing capacity, and the result was surplus tonnage on most trade routes. Operators, in a bid to attract customers resorted to rate cutting and freight rates soon came down to the level of direct operating costs. This was murderous and the only way shipowners' could get over it was to join hands. The result was an association of shipping lines operating on the UK-Calcutta route formed in 1875, which was the first shipping conference.<sup>1</sup>

Before the conference system there was absolutely no regulation of prices, as the customer base was big and operators negotiated different rates with different shippers. The conference system was, therefore, a very helpful alternative in this industry as it established freight by limiting rate wars, and permitting a regular and steady service. These were basically associations of mutually competitive liner operators, maintained for the purpose of controlling competition among their members, and for strengthening those members through co-operative action in their competitive fight against non-member carriers.

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<sup>1</sup> Herman, A. 1983.

In order to achieve the objective of controlling competition, the conferences adopted a series of measures as follows:

- Price fixation.
- Restriction on membership.
- Pooling arrangements - cargo and revenue pools.
- Active enforcement of conference agreements.

These arrangements were not received co-ordially by both shipowners and shippers alike. Small operators who were not admitted to the conference system due to limited membership were the first to come out in opposition to this system. And as the conference system set uniform rates regardless of the size of shippers, the big ones started to complain as they had a long lasting relationship with their carriers, which offered them discounted freights. These shippers turned to non-member liners, which shipped their cargo at lower rates. Conference lines, in order not to lose big regular customers, had to offer rebates on the conference rates to these customers and thus started the trend of offering rebates on conference rates. In order to satisfy big customers, schemes like the deferred rebate system and the dual contract rate have been devised in the past. These ensured that the conferences were market responsive, i.e. meeting the changing needs of the shippers and at the same time remaining an effective tool of managing freight rates.<sup>2</sup>

Liner conferences with typically closed membership were explicitly designed to limit competition among shipowners thereby creating a structure with the characteristics of a cartel. These are, however, exempted from anti-trust legislation as there has been broad consensus that liner shipping is an important facilitator of international trade and conferences are necessary to ensure the regularity, reliability and frequency of services. On a global scale, conferences have been regulated by the 'UNCTAD Code of Liner Conferences', which came into force in 1983. The anti-trust exemption has been the bone of contention for the shippers council, which has been trying at all forums to abolish this privilege enjoyed by the conferences.

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<sup>2</sup> Juda, L. 1983.



Conferences, it should be mentioned here, operate within strict regulatory guidelines. An example of this, is the European Union framework which allows conferences to fix rates for the ocean leg of transportation of goods only. Operators in multimodal transport cannot have an agreement on tariffs for the inland leg of the transportation network, and any agreement on the same runs the risk of attracting huge penalties running into a high percentage of the operator's revenues.

In modern times, the role played by conferences is unfortunately reduced and these have degenerated into bodies meant to fix tariffs. Tariff setting was the major function of conferences in the past and member companies stuck to these rates thereby ensuring some credibility to this set-up. However, the advent of containerisation, among other things made shipping companies offer differential rates as per the needs of individual customers and shipping companies, in practice consider conference rates as indicative rates only. While conferences have been becoming inactive over the years the death knell has been sounded by the 'Ocean Shipping Reforms Act' implemented in the USA last year. Shipping conferences earlier had to disclose the terms of contract specifying rates its member companies charge shippers, and in similar fashion non-conference liner companies had to file the rates with the Federal Maritime Commission. OSRA 1998, however, allows shipping companies to enter into confidential contracts with shippers. This means, while everybody has access to know about the details of contract between the shipper and the shipowner earlier, it is no longer public information. Nobody can know how much a shipping company charges its shippers, and hence the tariff fixation holds no meaning.<sup>3</sup>

Thus, the question now is what does a conference do? While there still exist big conferences on the main trade routes, critics say the death knell has already been sounded. As commented by Gunter Casjens, Ceo Hapag Lloyd<sup>4</sup> *"Conferences have ceased to exist because basically their main purpose of agreeing collectively on rates is not being done anymore"*.

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<sup>3</sup> Bascombe, A. 1998, September.

<sup>4</sup> Boyes, J.R.C. 1999, April.

## 2.2 Consortia

While conferences were very effective tool of bringing discipline to the liner industry in the early days, the advent of containerisation necessitated further co-operation within companies. One of the important consequences of containerisation was the increased capital intensity of liner industry. Containerisation led to the development of the hub-and-spoke system, which required high capacity and high frequency on the main trade routes. A weekly service on any of the Far-East - Europe, Far East-USA, Europe - USA sector requires at least 8 to 12 vessels. A weekly service for Asia-Europe for example, would require at least eight post-panamax carriers and 3 sets of containers per vessel. This entails an investment of about US\$750 mn for just one string (estimated at US\$65 mn per vessel and US\$1,500 per container). And that is not the end, as given the strong growth pattern larger vessels would be required to meet the additional cargo volume in the future. Shipowners, therefore, would be faced with a task of replacing their fleet every 5-10 years, which means more money again. Unfortunately, the track record of profitability in liner shipping has been so low in the past that no shipowner dares to put in so much money into such a venture.

Shipowners, therefore, experimented with different degrees of co-operation within competing companies, depending upon the requirements of individual routes and an individual company's position therein. Some successful forms of co-operations have been

- Slot Purchase
- Slot Sharing
- Vessel Sharing Agreements
- Joint Services

Of the varying levels of co-operations popular in the liner industry, 'Consortia' which was basically an operational, technical and commercial co-operation of shipping companies on a particular trade route, has been a very successful arrangement. Under this arrangement two or more companies operating on a trade route shared capacity and technical capability among themselves, which lowered the costs for one individual owner. Operators pooled in their vessels and each line received an

allocation that was proportionate to its own input, on each vessel running in the pool. With several strings in operation, carriers were thus in a position to offer a wider range of services than before. Apart from benefiting due to economies of scale, carriers were also able to restrict competition by raising barriers to entry.

Consortia remained as the most successful form of agreement between liner companies until 1990-91, when one of the major consortia on the east-west route of Trio, Scandutch and Ace group broke up.<sup>5</sup> This left liner companies to operate individually, once again, after having tasted the benefits of offering services in collaboration with others. What followed was a period of experimentation, until the novel concept of 'alliances' was launched in the mid-nineties.

### **2.3 Alliances**

One of the major limitations of consortia was that it operated only on a specific trade route. The industry needed closer partnerships and it was difficult to find a stable relationship that could have led to substantial cost savings. To make substantial savings, the co-operation had to be extended beyond mere vessel sharing on one single route. This resulted in the birth of the alliances in May 1994, when four of the world's major liner operators viz. American President Lines (APL), Orient Overseas Container Liner (OOCL), Mitsui OSK Lines (MOL) and Royal Nedlloyd announced the formation of the Global Alliance. This was a pioneering co-operation on a much larger scale and other companies rightly accepted this concept which was there to stay in the industry. Close on the heels of the Global Alliance, three other major alliances were immediately formed involving 12 of the 20 major liner companies, and the industry had never seen agreements on this scale earlier<sup>6</sup>.

As against earlier forms of collaboration, which were trade specific, the alliances covered more than one trade lane extending to global coverage. The alliances came as a succour to the depleting fortune of liner companies as freight rates were hardly increasing in real terms (in the long term), which put pressure on companies to cut

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<sup>5</sup> Drewry Shipping Consultants. 2000, October.

<sup>6</sup> Fairplay Publications, 2000.

down on costs. Although the earlier forms of co-operation were formed with the objective of cutting down costs, those basically shared ship related costs only i.e. operating, voyage or capital. These shared costs constitute only 30 percent of the total cost to the shipowner. Thus the responsibility of putting a tab on the remaining 70 percent was still on the individual shipowner. This huge chunk of 70 percent cost could be shared by having a greater degree of co-operation, and the alliance concept was born to address this issue only<sup>7</sup>. Alliances have successfully managed to bring some of these cost heads into the ambit of co-operation.

The alliances were intended to be long-term ventures and companies seemed to work in tandem until 1996, when the troubled liner divisions of P&O and Royal Nedlloyd, members of the Grand and Global alliance respectively, decided to merge. While this sparked off a realignment of membership within the alliance, the matter got confounded later when Neptune Orient Lines, then a member of Grand alliance, took over APL, a member of the Global Alliance. A round of musical chairs ensued thereafter and there have been a number of changes since 1996. Major alliances in operation today are at Table 2.1.

---

<sup>7</sup> Drewry Shipping Consultants. 1999, October.

**Table 2.1**

**Alliances in Liner Shipping**

Grand alliance	Hapag-Lloyd NYK Line Orient Overseas Container Liner P&O Nedlloyd Malaysia International Shipping Corporation (Europe-Asia trades only)
New World Alliance	American President Lines Hyundai Merchant Marine Mitsui OSK Lines.
United Alliance	Cho Yang DSR-Senator Hanjin Shipping Co. United Arab Shipping Co. (US-Mediterranean-Middle east & Europe-Middle East only)
Unnamed	Cosco K-Line Yang Ming
Unnamed	CMA-CGM Norsia Line National Shipping Company of Saudi Arabia

Source: Fairplay Publications

The alliances are primarily concentrated on the east-west trade routes only and there is not much co-operation on the north-south trade at present. Moreover, apart from being a member of the alliance on one route, there has been cross-alliance co-operation like vessel sharing agreements of companies on routes not covered by the alliance. It is, therefore, wondered how long will these 'marriages of convenience' last as there still exists a huge disparity between members coming from different countries. Each has regional expertise, which gives them a competitive edge over others in marketing their services. The inequality of members is clearly visible with P&O Nedlloyd dominating the Grand alliance, APL dominating the New World Alliance and Hanjin dominating the United Alliance. In order to have the alliances last, the balance of power within members has to be very stable, and long-term stability is absolutely necessary if members want these co-operations to result in cost savings.

Liner companies have been trumpeting in public about the advantages of less investment in tonnage and even boxes and chassis accrued by being in an alliance. However, the alliances have their own set of disadvantages, the most prominent being the problem of setting up realistic sailing schedules acceptable to individual carriers. It is very difficult to arrive at a common schedule which would be acceptable and of benefit to members disparate in size and functioning, and coming from different countries which means each has a different set of priorities. Arriving at a consensus is more difficult on matters concerning tonnage to be deployed or ordered, port rotation, frequency, joint use of terminals, and freight policies. Lines have candidly complained of alliances entailing time-consuming meetings, slow decision making, bureaucracy and looking too much inward<sup>8</sup>. It may be highlighted here that it is not necessary to be in an alliance for achieving cost savings as three of the world's five largest companies, Maersk-Sealand (from end 1999), Evergreen and Mediterranean Shipping Company operate independently outside any alliance<sup>9</sup>.

The alliances have long-term agreements of ten years, but it was the same for the earlier alliances too, which did not last half that period even. It is feared that the ongoing phase of consolidation in liner shipping may see another cross alliance merger which will trigger off the round of musical chairs again.

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<sup>8</sup> Fairplay Publications, 2000.

<sup>9</sup> Fossey, J. 1998, February.

### **3.**

## **Mergers and Acquisitions**

**3.0** While the seventies and eighties marked the evolution of strong independent carriers, the mid-nineties saw the development of the multi-trade alliances on a global scale. Since the second half of the nineties the pattern has been shifting from mere co-operation to full scale mergers. The trend was triggered off by deregulation (e.g. opposition by the European Commission to door-to-door conference tariffs, OSRA 1998 etc.), and the resulting further erosion of the conference system. Liner shipping is thus being transformed to a deregulated market structure having few big players and a number of small fragmented ones. With so many players in the game, key success factors in this business today are cost leadership and the quality of logistics prices. Small players have found it difficult to survive through the rate war and opted to sell off as the prudent strategy. This is evident from the number of mergers which took place in the second half of the last decade, enumerated in Table 3.1.

**Table 3.1****Mergers and Acquisitions in Liner Shipping since 1996**

	Purchaser	Company Acquired	Price (US\$ Mil.)
1996	P&O Transportacion Maritima Mexicana Compagnie Maritime d'Affrètement	Royal Nedlloyd Flota Mercante Grancolombiana Compagnie Générale Maritime	3
1997	Hanjin Shipping CP Ships CP Ships Neptune Orient Lines	DSR-Senator Lines Lykes Lines Conship Container Lines American President Lines	35 110 825
1998	P&O Nedlloyd CP Ships Safmarine Hamburg Sud Evergreen D'Amico CP Ships Hamburg Sud CMA-CGM	Blue Star Line Ivaran Lines Safmarine Container Line (part purchase) South Seas Steamship Co. Lloyd Triestino Italia di Navigazione Australia New-Zealand Direct Line Alianca Transportes ANL Container Line	100~146 29 55 57 100~120 6
1999	Maersk Line P&O Nedlloyd Hamburg Sud Safmarine Container Line Compania Sud Americana Compania Sud Americana Hamburg Sud Hamburg Sud Maersk Line Hamburg Sud	Safmarine Container Lines Tasman Express Line Barbican Line (part) Barbican Line (part) Grupo Libra (Liner only) Montemar SA (Liner only) Transroll Navegacao SA South Pacific Container Line Sea-Land Crowley American Transport (part)	240 800

Source: Drewry Shipping Consultants & Fairplay Publications



### 3.1 Case studies

The largest of all mergers were between P&O and Nedlloyd, NOL and APL and Maersk and Sealand, highlights of which are as follows:

#### 3.1.1 P&O – Royal Nedlloyd

The merger of liner operations of the English company P&O with the Dutch operator Royal Nedlloyd, announced in September 1996, was one of the first major take-overs in the liner industry in the recent past. This merger sent tremors across the liner industry as both companies were members of competing alliances. The well thought out alliances planned for the long-term were just a year old, and this merger was to make the whole exercise start once again.

The merged entity P&O Nedlloyd controlled a total of 112 vessels with a standing slot capacity of 224,000 TEU, and some 540,000 containers. The two companies had a combined turnover of nearly US\$ 4 bn and net assets value of US\$ 1.5 bn<sup>1</sup>. It was a merger in the true sense as both companies were equal owners of the new entity and the new board equally represented both. Although there were some major service overlaps, the combined entity covered virtually all the main trade routes in the world. Both companies made quite a fanfare about the savings of US\$ 100 per teu that would result from the merger. The majority of these savings were to come from the elimination of 1,400 positions around the world, which were about 15 percent of the combined work force of both the companies. Details of the synergy expected from the merger are seen in Table 3.2.

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<sup>1</sup> Dickey, A. 1996, Sept 10, and Moloney, S. 1996, Sept.10.

**Table 3.2**  
**Estimated Cost Savings – P&O/Nedlloyd**

	US\$ Million p.a.	% of Savings
Administration	130	65
Container Fleet	20	10
Route Elimination	20	10
3 <sup>rd</sup> Party Contracts	30	15
Total	200	100

*Source: Drewry Shipping Consultants*

Synergies were achieved without any major hiccups and P&O Nedlloyd declared that the new entity made a saving of over US\$ 200 mn in the first year of operation. However, merging the two entities was not an easy task and the company incurred a one-off restructuring cost of US\$ 104 mn, which wiped off a substantial part of the savings incurred from the merger in the first year.<sup>2</sup> The company's 1997 annual report claimed that 'P&O Nedlloyd largely retained the customer base of its two constituent companies'. P&O has definitely benefited from the merger, as it is the third largest operator in the world today, a position it would have had difficulty in achieving had it continued on its own.

### 3.1.2 Neptune Orient Lines – American President Lines

The take-over of APL by the Singaporean national carrier, NOL in November 1997 was surprising as APL was ranked higher than NOL in the container operator rank list. Although everyone knew APL was up for sale and there had been rumours floating around about P&O Nedlloyd and then Hapag Lloyd showing interest in APL, nobody expected NOL to clinch a deal so soon<sup>3</sup>. Industry watchers were surprised at the stars and striped Goliath being taken over by an operator smaller in size.

The combined entity of APL-NOL was forecast to have an annual turnover of US\$ 4 billion, from lifting of over 2 mn teus in a year. Annual savings from the merger process were pegged at US\$ 130mn for the full year of operation, which was

<sup>2</sup> Drewry Shipping Consultants. 1999, October.

<sup>3</sup> Fossey, J. 1997, December.

roughly US\$60 per teu. Synergies expected from the take-over are shown in Table 3.3.

**Table 3.3**  
**Estimated Cost Savings – NOL/APL**

	US\$ Million p.a.	% of Savings
Administration	45	35
Vessel Operations	30	23
Logistics	30	23
IT	25	19
Total	130	100

*Source: Drewry Shipping Consultants*

NOL claims to have achieved a saving of S'pore\$ 180mn in 1998, (about US\$ 108m) and upped the target to S'pore\$ 270mn in 1999.<sup>4</sup> Its results have, however, taken a sharp downturn since the take-over. The deal had not come cheap for NOL as APL was a respectable name in the industry and NOL had to cough up a huge premium for the goodwill. It paid close to 50 percent premium over the ruling market price to APL's shareholders (24.6 million shares at the rate of US\$ 33.5 per share). NOL incurred a huge debt (S'pore\$ 5bn) for financing the take-over and interest charges on the same (S'pore\$ 349mn) had a heavy impact on its bottomline in 1998, the first complete year of joint operations. NOL reported a loss of US\$ 245mn in 1998 but the management reasoned the same as the impact of the Asian crisis, as the company's average freight rates across all trade lanes deteriorated by 8 percent that year over 1997 levels. NOL's management justified the premium paid as necessary in the face of strong competitive bids.<sup>5</sup>

NOL hugely benefited from the merger process as it got a strong North American brand name and a readymade US transport and logistical network built to serve the Pacific trades. It adopted the APL brand and NOL's liner business operation today operates under the name of APL. APL was the pioneer of the double-stack rail operations in the US, and at the time of sale it was second to none. In the words of

<sup>4</sup> Drewry Shipping Consultants. 1999, October.

<sup>5</sup> Neptune Orient Lines, 2000.

the chairman of the NOL group<sup>5</sup> *“The company (NOL) came to the realisation some years ago that it would be impossible to survive if the company continued to stagnate at a ranking of around 15<sup>th</sup> among the container lines in the world. To move up quickly in the ranking among the top ten, which position would be necessary for survival, merger with another major container shipping line of around the same rank was the only way”*. APL is today ranked as the sixth largest liner operator in the world.

### 3.1.3 Maersk Line - Sealand

Denmark’s AP-Moller group’s purchase of Sealand last year was one more landmark take-over, which led to the disappearance of the last American liner company from international scene. The news came as no surprise as AP-Moller’s Maersk Line and Sealand had been operating in a close alliance for the past few years, and when news of Sealand being prepared for sale was public, everyone knew that it had to be Maersk bailing out the ailing company. The US-based CNX Corp was growing increasingly disenchanted with the group’s liner division operating under the name of Sealand, as dismal operating margins from this were affecting CNX’s ability to deliver value to its shareholders. CNX had been increasingly noisy in public about its unhappiness with the unpredictability of the liner shipping industry. The split of Sealand into three operating divisions early in 1999, was a harbinger of things to come in the future and observers knew it was just a matter of time before one, or other parts of Sealand would be sold off.<sup>6</sup>

Sealand was a mega-operator commanding a strong brand name in major trade routes, hence it had many big names bidding for it. The announcement of major asset sales by P&O Nedlloyd during 1999 raised expectations of the industry and industry circles predicted P&O to make a bid. Had P&O acquired Sealand, the biggest loser would have been Maersk Line, as its carefully built-up global service network in association with Sealand would then have been endangered. This consideration might have played a major role in discussions at the Copenhagen headquarters of Maersk Line, when finally it agreed to take over Sealand at this

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<sup>6</sup> Boyes, J.R.C. 1999, September.

moment last year after years of speculations<sup>7</sup>. Maersk's management stated that the acquisition came naturally as both the companies had been operating in very close co-operation, and Maersk Line could not have afforded to let Sealand go into the hands of any of its competitors.

Maersk paid US\$ 800 million for Sealand's international liner business, which in fact was US\$300 mn less than Sealand's book value.<sup>6</sup> Unlike the APL take-over by NOL, Maersk did not have to pay out heavily for the brand name. The deal included vessels, containers, selected terminals and certain lease obligations on vessels. The Domestic shipping services of Sealand were not part of the deal as the US Jones Act protects those, and CNX was careful to not to attract the wrath of the authorities in the transaction.

The new entity Maersk-Sealand controls over 600,000 teu capacity, that is about 12 percent of the total world capacity. The company has a clear lead of 200,000 teu over its closest rival, Evergreen and is double the size of the world's largest operator, P&O Nedlloyd. The size of this company can be seen from some of the statistics. It operates a fleet of 250 vessels, which sailed more than 62.5 million nautical miles in 1999, equivalent to 2,500 times around the world. The company made more than 20,000 port calls in 1999, which is about 55 calls every day or two calls per hour continuously. It operates a container fleet of about 700,000 units which if put in a line would stretch more than 6,000 kms, the approximate distance between Paris and New York. Maersk-Sealand has a policy of operating its own terminals at major locations in the world and today operates 24 container terminals<sup>8</sup>. The take-over has been beneficial for Maersk-Sealand in consolidating its position as the market leader.

### **3.2 Forces acting behind the mergers**

The story of the first, third and sixth largest liner companies in the world shows that the merger is one sure path to supremacy. While this factor has been one of the

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<sup>7</sup> Drewry Shipping Consultants. 1999, October.

<sup>8</sup> Maersk-Sealand, 2000.

major forces behind this consolidation move, there are a number of other motives too. Some of the factors instigating the merger wave in liner shipping are:

- Intense competition and consistent low margins in liner shipping.
- Low cost being the success factor.
- The Pursuit for gaining economies of scale.
- Limited synergy realisation from alliances.
- Deregulation and privatisation of the industry.

Freight rates in container shipping have been ruling very low in recent times, and many operators have suffered heavily in the past 2-3 years. Apart from over-tonnaging, market conditions have been badly affected by the South-east Asia meltdown three years back. Shipowners in the liner industry, have very little influence over revenues as no company is in a position to command a premium pricing. Cutting down on costs is the only way to survive in the long run, and operators have promptly realised this fact. Achieving economies of scale is a simple way of bringing down costs, and container shipping is a perfect case of scale economies, where the rule of the game is 'big is beautiful'. On the technical side, scale economies has been the motive behind the move of shipowners to acquire large vessels. While on the organisational front, these economies of scale can be fully realised only by way of mergers, and hence the trend. Although alliances and joint ventures have tried to attain these economies, but the extent of gain in such cases is limited.<sup>9</sup>

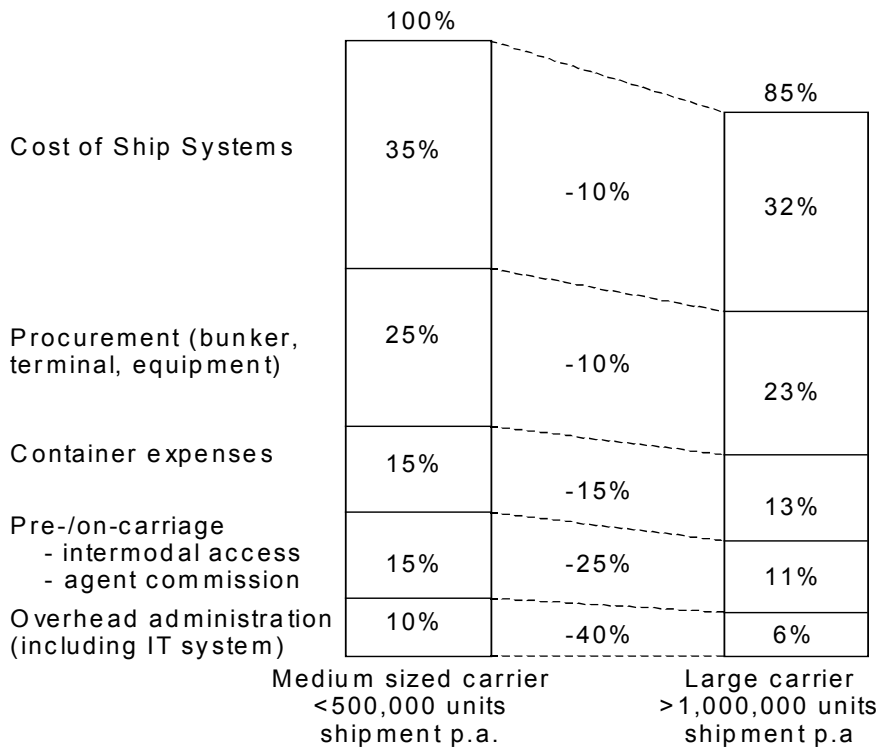
International consultants 'Roland Berger & Partners' state that economies of scale exist at two levels, namely, technical (ship sizes and systems) and organisational (scale and scope of companies). On the technical side, economies of scale are the motive behind companies' choice of acquiring even larger vessels. When filled (load factor of at least 80%) a post panamax ship is 6.3% more advantageous in terms of all-up systems costs, over a panamax vessel. On the organisational side, economies of scale can be realised in all business processes, with the most important being sales and documentation, information technology, and container

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<sup>9</sup> Ahlander K., Rehling C. 1999, January

logistics. A company with one million liftings a year has 15% scale advantage over a carrier one-third its size<sup>9</sup>. Areas where these synergies can be achieved are as illustrated in Figure 3.1.

**Economies of Scale in Container Shipping**



Source: Roland Berger & Partners

**Figure 3.1**

The conference and the alliances systems have not been able to achieve these synergies. Alliance members share only a significant part of the operating costs like running the vessel, container expenses, use of terminals, while the potential for savings on the administrative front remain untapped. Sales and documentation, IT systems and support, and logistics are some of the areas where alliances have found it difficult to have any co-operation so as to realise any synergy effect. Member companies are not forthcoming to share these operations within the alliance due to the sensitive nature of information these processes handle. This information is company specific and highly confidential, which mainly includes customer-related information and rates. A full-scale merger is the only solution if

companies experiencing increasing cost pressures, want to achieve synergy in these core processes. Financial benefits accruing from mergers are much higher than that, which can be achieved from other forms of carrier integration as shown in Figure 3.2.

**Scope of Financial Benefits Accruing from Carrier Integration**

Organisational form	Focus of common actions	Financial benefits
Merger or Acquisition	<ul style="list-style-type: none"> <li>• Common Pricing</li> <li>• Common Costs</li> <li>• Full realisation of scale effects in               <ul style="list-style-type: none"> <li>- sales</li> <li>- documentation</li> <li>- Information Technology</li> <li>- logistics operation</li> </ul> </li> </ul>	High
Alliance	<ul style="list-style-type: none"> <li>• Sharing of significant proportion of operating costs (abt 70%)</li> <li>• Sharing vessel scheduling thereby quality of service.</li> </ul>	Medium
Conference	<ul style="list-style-type: none"> <li>• Setting rates in certain trades.</li> </ul>	Low

Source: Roland Berger & Partners

**Figure 3.2**

Mergers also come naturally for the liner industry as it is highly fragmented with the largest company controlling just a little over 10 percent of the world capacity. There are a number of small players playing a dominant role in some niches. These small players do not have pockets deep enough to survive the financial strains from continuous low freight rates currently witnessed in the industry, and may easily fall prey to predators. Even for the big players, the changing face of technology and rising trade volumes in the recent past forced companies to invest heavily in large new building programmes. With freight rates running low, these companies are unable to generate sufficient cash flows to service debts, and in order to remain afloat need partners who can bail them out. These troubled companies are available cheaply and give the perfect opportunity to financially strong companies to increase their assets and augment services without a significant drain on their resources. Another factor forcing strong companies to buy out financially troubled companies is



to prevent outsiders from buying these and destroy freight rates further by running these companies at a low cost. Take-overs, in such instances, are defensive in the sense that the cost of acquisition is less than the potential damage that would be caused if the troubled company is taken over by some rival. This fear was the motive behind Hanjin's take-over of perennial loss maker DSR-Senator lines in 1997 and Maersk's take-over of Sealand last year.<sup>10</sup>

One interesting observation related to the three mergers mentioned has been that while the industry has always complained that the alliances have made liner shipping a commodity business, brand names have played a very important role in all of these mergers. P&O Nedlloyd realised that both the individual names of P&O and Nedlloyd were respectable names among shippers and decided to keep both the brand names alive. On the other hand P&O Nedlloyd also acquired Blue Star Lines in 1998, but erased the Blue Star name altogether, bringing all trades under P&O Nedlloyd. In the case of APL's acquisition by NOL, APL was a very strong brand in North American trades, hence NOL had to swallow the bitter pill of bringing its liner operations under the APL brand and letting the NOL name disappear from liner shipping. Maersk-Sealand has moved very cautiously with brands when taking over companies, and while taking over Safmarine it let the company continue as a separate entity, as Safmarine is a very strong brand in South Africa, and Maersk could not risk to lose the loyal customers of Safmarine who may not associate themselves with a new name had all of Safmarine's activity been brought under the Maersk umbrella. While the strategy for Safmarine has been different, for Sealand, Maersk followed the same strategy as P&O and changed its identity from Maersk Line to Maersk-Sealand.

### **3.3 The other face of mergers**

Mergers and acquisitions are glamorous and we have seen so many companies jumping on the bandwagon. But companies need to tread cautiously as a bad acquisition can easily pull a financially strong company into the red due to the lack of a proper planning process. Even in the most favourable circumstances, mergers are risky manoeuvres and companies need to have a clear strategic focus before

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<sup>10</sup> Drewry Shipping Consultants. 1999, October.

making any bid. The digestion period is quite tumultuous and without a detailed plan for the whole process both partners can fall.

Merging companies always dream of regaining the existing market share of both the entities, but this is never achieved in real life. In the case of a merger 1 plus 1 does not result in 2. It is 1.7 or something in that range<sup>11</sup>. This is due to the fact that there is lot of overlapping in services, and some customers are lost in the process. Some of the clients may be competitors in their own field, and would not like their goods to be shipped by the same carrier as their rival's. Thus partner selection needs careful study in order to maximise synergies and minimise risks. On the post-merger scenario, mixing of the operations of two companies may be easy, but when it comes to the software side i.e. people and the work culture, a proper detailed execution plan is required, as non-compatibility can be chronic. Moreover, proper pre and post merger integration is necessary to achieve a timely realisation of synergies. Non achievement of this will lead to the companies being locked in a time trap, and will make them pay heavily as the costs of acquisitions are pretty high in the short run.

### **3.4 How long will it last**

The current wave of consolidation was triggered by the creation of P&O Nedlloyd, and the industry then predicted that a number of companies would follow suit. The question now is how long will this last? Are the happenings of the last five years enough or do we still have few more surprises to come? Drewry<sup>12</sup> opines that countries that are home to several major operators might be on the verge of a national rationalisation. Thus Japan, Taiwan and also China are to be watched closely.

Another opinion is that we can expect consolidation within the alliances. Alliance partners have been operating in close co-ordination and their services complement each other, hence it makes sense to target one's own alliance partner which would

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<sup>11</sup> Lim, S.M. 1998.

<sup>12</sup> Drewry Shipping Consultants. 1999, October.

be a perfect fit, rather than going for a cross-alliance merger. However, the paradox here is one would like to buy out a company from the rival alliance so as to create trouble for that alliance set-up, and unbalance competitors. Hence it is a debatable opinion and rumours keep on constantly being floated of some company or the other up for sale.

Most of the mergers in the past except P&O-Nedlloyd, NOL-APL, and Maersk-Sealand, have been relatively small. The focus has largely been on north-south 'niches' rather than the main east-west trunk trades. The motive behind these small-scale mergers has been to gain entry or a stronghold in new market areas. However, if rationalisation has to come to the industry, there has to be mergers among the big players. The industry still remains fragmented with the top twenty players controlling a little over half of the world capacity, and just one operator controlling over 10 percent capacity<sup>13</sup>. A shake-up within the top league is, therefore, imminent as operators aim to progress in the rankings. Changes in the top ten league since 1992 can be seen at Table 3.4.

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<sup>13</sup> Fossey, J. 1999, November.

**Table 3.4**

**World's Top Ten Liner Operators**

Rank	1992	2000
1.	Evergreen	Maersk-Sealand
2.	Sealand	Evergreen
3.	Maersk Line	P&O Nedlloyd
4.	NYK Line	Hanjin
5.	Mitsui OSK Line	Mediterranean Shipping Company
6.	Cosco	American President Line
7.	Royal Nedlloyd	Cosco
8.	K-Line	NYK Line
9.	American President Line	CP Ships
10.	Hanjin	Zim Line

Three of the top ten companies of 1992, Sealand, Nedlloyd and APL have been taken over by other big players. Of the current list, rumours about one company or the other up for sale keep flooding the market. It is a wait and watch game as board rooms all over the world discuss who will make the next move in this take-over rush.

Another aspect of the big league is that half of the top ten players of 2000 have taken recourse of the mergers and take-overs route to become big. Maersk-Sealand and P&O Nedlloyd are the amalgamated entity of parts of their name itself, while Hanjin has taken over DSR-Senator, APL is the merged entity of NOL and the earlier APL, and CP Ships has been very active taking over Lykes Line, Contship Containerline, Ivaran line and ANZDL in the past four years. Thus for companies dreaming of gaining supremacy and climbing up the super league table, this is the easier route than having organic growth. One strong believer of this strategy is P&O Nedlloyd as its management has always expressed its desire to seek industry consolidation and drive down unit costs through takeovers.

As merger and acquisition news continue to flood the cover pages, the question remains as to who will be the next candidate.

## 4.

### Global Trends

In this chapter are discussed some trends which have and will in the future affect liner business in a big way. While some have affected all businesses, others have had a dramatic influence on the liner industry that has led to major changes in the way business is being conducted.

#### 4.1 Current Forces affecting liner shipping

4.1.1 Globalisation - The GATT/ WTO system has brought a significant reduction or elimination of barriers to trade, through eight rounds of multilateral trade negotiations. Lower trade barriers have allowed companies to globalise production structures through investments in foreign land, which has boosted trade. The technological evolution has increased information flows, which had a profound impact on a firm's decision to locate different components of its production processes in various countries and regions, and still maintain a corporate identity. Today it so happens that a car sold in one country has been assembled from parts coming from ten different countries. This has been possible due to the WTO.

1998 marked the 50<sup>th</sup> anniversary of the GATT, with the world trade witnessing a seventeen-fold increase since the foundation of this system. On an average annual basis, merchandise exports grew by 6% in real terms from 1948 to 1997 compared to an annual average output growth of 3.7%. In other words trade multiplied by the factor of 17, while GDP grew approximately six-fold during this period. Merchandise shipped internationally is estimated to have amounted to increase from 490 million metric tonnes in 1948, to 4,491 mmt in 1997, a ten-fold increase. Countries propagating the liberalisation policy have realised the benefits of inter-dependence

upon nations, while the technological revolution has led to an explosion of productivity and slashed transportation costs. The unit cost of sea freight has declined by almost 70% in real terms since the mid-eighties, while the unit cost of air freight has fallen by 3-4 percent over the same period.<sup>1</sup>

The emergence of global production chains have placed a new set of demands on liner operators. To the general constraints of providing a regular and frequent service of adequate quality, a list of other requirements have been added, with global coverage dominant among them, making liner operations a more extensive, integrated, faster but not necessarily expensive operation. The globalisation effect was also able to penetrate the closed and protected world of conferences, with the emerging low cost operators putting pressure on the conference system. Globalisation was also one of the major forces behind the evolution of world-wide alliances as the spread of production facilities and markets required an integrated global network of services, the pace and magnitude of which made going-it-alone practically impossible for a carrier. While consortia and pools were the outcome of investment pressures arising out of containerisation, the alliances are the responses to the globalisation of production and distribution processes. Globalisation of the world economy has thus opened up a wide array of opportunities and challenges for the liner industry to adjust to.<sup>2</sup>

4.1.2 Deregulation - The world economy is increasingly being deregulated, which is opening up new trade frontiers for the shipping industry. Markets that were earlier regulated by national regimes are thrown open to competition. Deregulation measures like the 'Ocean Shipping Reforms Act' (OSRA) 1998, which came into operation on 1<sup>st</sup> May 1999 in the USA, has changed the rules of the game completely and is expected to bring drastic changes in the functioning of liner companies. Major provisions of the Act are:<sup>3</sup>

- Of the service contracts to be filed with the Federal Maritime Commission, certain terms-rates, service commitments, intermodal origin and destinations, and penalties for non-performance can be kept confidential.

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<sup>1</sup> WTO, 1998.

<sup>2</sup> Thanopoulo, H.A. 2000.

- Tariffs need not be filed with the Federal Maritime Commission, but must be made publicly available.
- Carriers allowed to negotiate service contracts individually, as a conference or alliance. Conferences required to permit individual member lines to enter into service contracts, and contract terms can remain confidential.
- 'Me-too' service contract terms no longer mandatory for similarly situated shippers.

This Act has started an era of individual contracts between carriers and shippers. In addition, since the terms and rates are now allowed to be different for different shippers, it is expected that fatter clients will have a price advantage over small shippers, who can no longer demand 'me-too' contracts. Such de-regulations will change the shape of the liner industry in future.

4.1.3 Alliances - Alliances in the shipping industry have already been discussed in chapter 2 of this dissertation, and the situation in other industries is discussed here.

Alliances have been a major feature of services industries where companies want to achieve wider service coverage, without losing individual identity. The airline industry has identical alliances as shipping. There is the 'Star Alliance' of SAS, Lufthansa, Singapore Airlines among other airlines, and 'One World Alliance' of British Airways, Cathay Pacific, Qantas and others. Benefits of these have been substantial in terms of overheads as for example SAS looks after Lufthansa's clients in the Scandinavian countries in return to Lufthansa looking after SAS's clientele in Germany. Both companies thus save on office establishment costs upto some extent, at common locations. Shipping alliances just share the operational costs and they can learn from these alliances and try to share the administrative overheads too.

Alliances have always been shaky not only in shipping but elsewhere too. In telecommunications first 'Unisource' was created by major telecom companies in Sweden, Holland and Switzerland and was later integrated into the 'World Partner

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<sup>3</sup> Federal Maritime Commission, 2000.

Alliance', which involved about 25 telecom companies. Then there was the 'Concert Alliance' which started as a partnership between British Telecom and MCI and grew to include almost 50 companies by 1998. Finally, 'Global One' was launched in 1996 by Sprint, Deutsche Telecom and France Telecom. These world scale alliances did not last long and by the late nineties, all were in disarray. British Telecom has partnered with AT&T, World Partners is largely defunct and Global One was wrecked by financial problems.<sup>4</sup> There seems to be an identical pattern in the shipping alliances.

4.1.4 Mergers and Acquisitions - Mergers in the shipping industry have been discussed in chapter 3 of this dissertation, and the pattern in other industries is looked at here.

Cross-border mergers have become a do-or-die proposition as companies believe that to become winners, they have to share economies of scale in manufacturing, marketing and research and development. One or the other mega merger is reported on the front pages of the Wall Street Journal or the Financial times everyday, as every industry is witnessing its share of action:<sup>5</sup>

- Automobiles - Daimler-Benz and Chrysler, Ford and Volvo, Renault and Nissan.
- Oil - Exxon and Mobil, BP and Amoco and Arco.
- Pharmaceuticals - Glaxo and SmithKline.
- Communication - Time Warner and America Online.
- Telecommunication - MCI Worldcom and Sprint, Vodafone and Mannesmann.

The impact of this pursuit for consolidation is having wide repercussions on the shipping industry. The increasing size of these merged entities gives them greater bargaining power and they are able to dictate terms to the shipping companies. As cost reduction is the basic objective of most of these mergers the search for further cost cutting goes to transportation costs too, and these companies bargain for lower rates. Thus the era of the low freight rates continues.

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<sup>4</sup> Ghemawat, P. and Ghadar, F. 2000.

<sup>5</sup> Carey D. 2000.



4.1.5 Downward trend in freight rates - Incessant price competition has been a major force in this industry, and freight rates have been going down on all routes with each passing year. Freight rates usually fall due to over capacity in any sector, and unfortunately rates in the liner industry hardly crawl back when slot utilisation increases. Gains accruing from cost cutting measures and declining vessel prices have quickly been passed over to shippers, and many production facilities and international markets have been established on the back of low freight rates only. The industry has to contend with the downward slide in freight rates in the future, as estimated in Table 4.1.

**Table 4.1**

**Estimated and Forecast average unit rate, East-West market**

(Weighted average of transpacific, Europe-Far East and transatlantic trades, inclusive of THCs and some intermodal charges.)

	US\$ per teu	% change over previous year
1996	1,445	- 5.6
1997	1,294	- 10.4
1998	1,276	-1.4
1999	1,380	+ 8.2
2000	1,361	- 1.4
2001	1,397	+ 2.6
2002	1,400	+ 0.2
2003	1,393	- 0.5
2004	1,392	- 0.1
2005	1,383	- 0.5

*Source – Drewry Shipping Consultants*

4.1.6 New Vessel Designs – Innovation in containership design has been an active feature of this industry. Vessel sizes have increased in the past as shown in Table 4.2.

**Table 4.2**

**Generations of Containerships**

Generation	First	Second	Third	Fourth
Period	Domestic coastal services, before 1966	Short international services across one ocean, since 1966	Long international services over two or more oceans, since 1971	Round-the-world services since 1984
Territory	USA, Australia	Advanced countries, such as USA, Europe, Australia, Japan etc.	Developing countries in South-East Asia, Middle-East	World-wide, including China, India and countries in Africa
Containers	Pre-ISO, sizes 17', 24', 35' long	ISO standard 8'8"6"x8x20'40'	High cube type 9', 9'6" high	Deviation from ISO standard sizes, e.g.45'
Ships	Mainly converted ships with on-board cranes	Purpose built ships of 700-1500 teu	Purpose built ships over 2000 teu	Purpose built ships over 3000 teu

Source: Wijnolst, N., & Waals, F. 1999.

Vessel designs had been restricted to Panamax dimensions till 1998 when the first post-panamax vessel rolled out. The success of this let designers target the next geographical constraint, the Suez-Canal and the Suezmax container vessel is expected to come into service soon. The Suez-Canal is becoming deeper having been dredged to 17 meters in 1999, from the 6.76 meters when it was inaugurated in 1869. If the deepening continues, it is expected to reach 21 meters by 2009 which can allow the Malacca-max, the ultimate container carrier, to be brought into service.<sup>6</sup>

<sup>6</sup> Wijnolst, N., Scholtens, M. & Waals, F. 1999.

The Malacca-max, a concept designed by Prof. Niko Wijnolst and a team of students of the Delft University, is the latest in container vessel designs which dwarfs the current largest carrier, Maersks' S-Class. The main dimensions of these vessels will be as shown in Table 4.3.

**Table 4.3**

**Mega Containership Specifications**

Parameters	Malacca-max	Suez-max	S-Class
Loa	400m	400m	346.9m
Lwl	390m	390m	-
Lpp	380m	380m	331.5m
Breadth	60m	50m	42.8m
Draft	21m	17.04m	12.1m
Depth	35m	30m	19.3m
Cb	0.62	0.62	-
Displacement	313,571 tonnes	212,194 tonnes	-
DWT	242,800 tonnes	157,935 tonnes	104,750 tonnes
Capacity	18,154 teu	11,989 teu	8,700 teu
Vship	25 kn (at 90% MCR)	25 kn	25 kn

*Source: Malacca-Max by Prof.N.Wijnolst, and Fairplay Database*

The Malacca-max is expected to have approximately 30% cost advantage over a panamax vessel and 16% over the currently large 8,000 teu vessel. This has enticed a lot of interest from the shipping community. Critics, however, point out the limited scope of such a vessel as few ports in the world can accommodate it. Of the European ports only Rotterdam can accommodate a vessel with 21m draught and in Asia only Singapore. On the ports, the current gantries have a maximum outreach of 60m, while the Malacca-max requires an outreach of 74m. Next there is no engine currently available which can deliver the required power and some argue why not have two vessels which will provide flexibility, instead of having one vessel with two engines. Apart from the design aspects, the shore-based operations should also be equipped to handle the fast turn around of so many containers. While these arguments are currently impeding the introduction of the Malacca-max, the industry may have to contend with the Suezmax container vessel as Lloyds Register has

recently released the concept of such a vessel and ship owners have shown interest in the project.<sup>7</sup>

4.1.7 Supply Chain Management - Globalisation of the world economy enhanced the established international exchange networks of finished goods and raw materials, and the focus has shifted from mere shipping to the organisation of distribution. Managing the entire process of movement of materials and goods has become more important than providing just transport. Thus shipping or road haulage has given in to the more fashionable concept 'logistics'.

Global shippers demanding fast just-in-time deliveries, now look for carriers which can handle the whole of their distribution network, and not just provide port-to-port service. Shipping companies, therefore, have to transform their business operations and in addition to providing slots on vessels will have to provide value added services like packaging, warehousing, distribution, logistics consultancy etc. This is an entirely new business area for liner companies and they face stiff competition from non-shipping majors like UPS and Federal Express, which are developing as large supply chain management firms.

4.1.8 Increasing Containerisation - Containerised cargo is the fastest growing segment in sea transportation (other than cruise) registering a 8.9% per annum growth during 1980 to 1997, as against 2% by dry bulk, 0.9% by liquid bulk and 0.9% by non-containerised cargo. The conversion of break bulk cargo to containers has been rising and from a 21% share of containerisation in 1980, 50% of general cargo moved in containers in 1998. The trend towards putting bulk goods in containers is accelerating and we see today the pressure on reefer carriers as bananas and other fruits is increasingly being carried in containers. Operators, instead of repositioning empty carriers try to put in bulk cargo at cheap prices and we have waste paper moving in containers into Asia from Europe, and there was an extreme case of Maersk shipping 20,000 tonnes of wheat in containers from Denmark to Vietnam in 1998.<sup>8</sup> The degree of containerisation is expected to

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<sup>7</sup> Gray, T. 2000, June.

<sup>8</sup> Drewry Shipping Consultants. 2000, October.

intensify in the future as carriers encourage stuffing in every type of goods they can in these boxes.

4.1.9 Transshipment - The hub and spoke system is being extended to the relay system whereby ports are developed at the intersection of the east-west and north-south route to facilitate transfer of cargo. The ports of Algeciras and Freeport have been developed as major relay ports in the world. The increasing size of vessels and the pressure for faster turnaround has led to the development of pure transshipment hubs, where most of the containers never pass through the terminal gate. Hubs like Gioia Tauro in Italy, Salalah and Aden in the Gulf have been developed without any hinterland transport traffic or infrastructure. Singapore is the transshipment port of the world, handling almost 10m teu more transshipment traffic than any other port in the world. With transshipment volume accounting for over 80% of container moves in ports like Gioia Tauro, Algeciras, Marsaxlokk, Khor Fakkan, the trend towards shipping companies cutting down on port calls and relying more on transshipment is set to accelerate.<sup>9</sup>

## 4.2 **Futuristic Market Forces**

It is foreseen that the industry will also be influenced by the following major evolutions, which can be termed as global trends, stage II.

Global Village - The WTO is going to have a more profound effect on the world economy, pulling down trade barriers completely. The whole world will be one dreamworld society like the European Union, where national boundaries have almost been removed and some head-way has even been made with a common currency. Regional organisations like the NAFTA, ASEAN will integrate countries into one world and there can be a free flow of trade in future.

Virtual Planet - Functions carried out by humans are now performed by computers and more and more systems will be automated in the future. Organisations will not be required to deal with human beings in as many instances as at present, as

artificial intelligence takes over the human factor and personal relations will play a smaller role in businesses.

Virtual Competition - Shipping companies will in the future have to face stiff competition from auction houses on the internet which will attract the small shippers. Net exchanges like [www.gocargo.com](http://www.gocargo.com) are increasingly being used by small shippers, due to the platform they provide for striking a cheap bargain. These auction houses are slowly gaining acceptance and in future will be a major force liner companies will have to face.

Customised Services – The growing size of shippers due to mergers gives them higher bargaining power, and for shipping companies taking up the job of logistics management, services will have to be customized as per each clients needs. Shippers will be more demanding and carriers will have to engage their personnel with the logistics department of shippers and plan their services in synchronisation. Big clients will demand constant attention and this will evolve into an era of customised one-to-one marketing for each shipper.

High Powered Propulsion - From steam turbines, the industry has come to diesel technology for its vessels. Further inventions have covered the use of hydrogen for generating power and this concept may be extended to the use of nuclear power for propulsion. This can boost the speed of vessels, but nuclear fission is not eco-friendly and only if the radio-active wastes from this can be controlled in the future, will ships be propelled by nuclear technology.

Disposable Containers - Empty container movements is a big expense for carriers. An expected 15 million teu empties were shipped in 1997, producing 33.5m terminal lifts. Speculatively this would have cost carriers about US \$6.5 billion<sup>10</sup>. The imbalance in trade continues and the empty repositioning cost has been rising every year. Cheap disposable containers which need not be repositioned and boxes which

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<sup>9</sup> Boyes, J.R.C. 2000, March.

<sup>10</sup> Drewry Shipping Consultants. 1999, October.

can be folded and stacked one over the other so that repositioning becomes cheap, have been experimented with and these will be extensively used in the future.

Futuristic Handling Operations - Gantry cranes currently being operated will pave the way for a more mechanised container handling operation which will increase productivity dramatically. Due to single movement of the boxes at a time there is no more than about 30 movements an hour per gantry. A suction technology whereby containers can be picked up and placed on the conveyor belts of the gantry, can lead to a post-panamax carrier emptied and filled in a span of a few hours, and we may see such handling operations in the future.

Emergence of the Freight Forwarder - While some predict that freight forwarder will vanish from the transportation scene and the liner company will take care of the entire transportation chain, another opinion is that they will grow stronger. As shipping lines target big clients, the freight forwarder playing the role of intermediary aggregating small parcels will be able to have the small shippers on his side. By accumulating, the forwarder can build big cargo volumes and bargain for discounts. Agencies like UPS, FedEx and DHL are the potential players and the business of cargo accumulation is set to boom in the future.

E-Commerce - The full potential of the internet is yet to be unleashed in commercial parlance and in future there will be more business transactions on the net. Few companies source components over the net today and it is more of business-to-consumer transactions, rather than business-to-business transactions that are taking place currently. Success of e-stores like Amazon.com encourages companies to build up a b-2-b virtual network that will integrate vendors, whereby each is connected to a shared platform for transacting business. This will require investments in systems, which will result in long-term vendor-client relationships since the cost of switch-over will be high for both. Thus b-2-b will be a major IT revolution in the near future.

These are some of the issues, which are expected to have a profound effect on the liner industry. Shipping companies have been forced to undergo major changes in

business operations and organisational set-up in the past, and these trends are going to drain out substantial sums of money from companies in the future. Profit will, therefore, be always under pressure and at the end of the day it will be the customer who will reap the benefits of these.



## **5.**

### **Indian Scenario**

#### **5.1 Development of trade and fleet**

Shipping plays a vital role in the development of the Indian economy as it has a geographic advantage of having about 6,000 km coastline that is studded with 11 major and 139 minor and intermediary ports. It also has a strategic location athwart one of the world's main sea routes. Indian trade has been very dependent on shipping and maritime policies have been framed over the years to pursue the aim of having sufficient domestic tonnage to cater for at least part of the national trade in the following proportion:<sup>1</sup>

- 100% of coastal cargo.
- 100% of strategic cargoes like crude oil and oil products on the coast and also overseas.
- 50% of dry bulk cargoes in overseas trade.
- 40% cargo in liner trade.

The above objectives have been aimed at so as to eventually reduce the dependence of national trade on foreign ships, ensuring availability of transport facilities at competitive rates to Indian traders. Indian tonnage, however, has not grown as has been envisaged and from a tonnage strength of 59 ships of 192,000 grt on the eve of independence in August 1947, the fleet had grown to 510 ships of 7.05m grt (11.49m dwt) by the end of 1999. Participation of Indian bottoms in carrying national trade has been hovering around 28~30 percent for the last few years, down from over a 40 percent share achieved in 1987-88.<sup>1</sup> The maritime industry, as well as the state, has adopted a series of measures to increase the participation of Indian lines in catering for the Indian trade by adopting cargo

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<sup>1</sup> INSA, 2000, & SCI, 2000.

reservation schemes and a policy of buying fob and selling cif by government departments and public sector enterprises. Regrettably, these measures have not been successful in enhancing Indian lines participation, which is shown in Table 5.1.

**Table 5.1**  
**Share of Indian Lines in India's Overseas Trade**

Year	Gen Cargo		Dry Bulk		POL & Products		Total Indian lines		Total Trade mt
	Mt	%	Mt	%	Mt	%	Mt	%	
1990-91	2.27	12.6	15.68	24.2	20.91	61.8	38.86	35.5	109.35
1991-92	2.49	12.9	15.14	28.9	23.38	58.2	41.01	36.7	111.80
1992-93	2.47	14.4	13.79	23.3	26.40	57.3	42.66	34.9	122.30
1993-94	2.29	8.8	11.54	20.0	32.24	60.6	46.07	33.6	136.97
1994-95	3.18	9.0	9.78	17.0	29.06	54.3	42.02	28.7	146.55
1995-96	3.56	10.4	10.35	14.5	32.09	53.3	46.00	27.8	166.10
1996-97	4.44	9.8	9.56	16.1	37.28	55.3	51.28	29.8	172.18
1997-98	6.52	12.4	10.98	14.4	46.03	62.3	63.53	31.4	202.44

Note: Percentage figures are the share of Indian ships in respective commodity groups.

Source – *Indian National Shipowners' Association Annual Review, 1998-99.*

The Indian fleet has been slow to enter the emerging shipping sectors. This is evidenced by the fact that while 36 percent of the fleet is comprised of dry bulk and 47 percent of tanker tonnage, cellular container ships aggregating 0.18 m dwt constitute a mere 1.5 percent of the total tonnage.<sup>2</sup> The current state of Indian tonnage can be described as the stagnation phase as there has hardly been any increase in tonnage in the last five years. The lack of proper fiscal incentives and requisite cargo support measures from the state, coupled with the dismal freight market, are the principal causes for this condition. A large proportion of India's overseas fleet (about 26 percent) is over 20 years old while another 25 percent (approx.) is between 15 and 19 years. India can, however, take pride in having a younger tonnage as the average age of its cargo carrying fleet is 15 years vis-a-vis

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<sup>2</sup> DG Shipping, 2000.

18 years of the world cargo carrying fleet<sup>3</sup>. Fleet profile of India as on 1.01.2000 is at Table 5.2.

**Table 5.2**  
**Indian Tonnage Profile as on 1.01.2000**

<b>CATEGORY</b>	<b>NOS</b>	<b>GRT</b>	<b>DWT</b>
<b>OVERSEAS</b>			
Dry Cargo Liner	31	385,391	524,379
Cellular Container	10	137,849	179,906
Dry Cargo Bulk Carrier	104	2,453,381	4,145,883
Ore Oil Bulk Carrier	3	171,101	311,975
Crude Oil Carrier	35	2,058,069	3,709,325
Product Carrier	42	922,031	1,522,742
Passenger-cum-cargo Vessel	1	8,279	8,820
Acid Carrier	7	110,230	158,983
Timber Carrier	2	7,486	12,564
LPG Carrier	6	118,738	138,122
<b>TOTAL OVERSEAS TONNAGE</b>	<b>241</b>	<b>6,372,555</b>	<b>10,712,699</b>
<b>COASTAL</b>			
Dry Cargo Liner	49	54,372	83,900
Tugs	61	18,964	3,261
Dry Cargo Bulk Carrier	12	193,614	305,827
Crude Oil Carrier	2	50,080	82,249
Product Carrier	11	80,038	132,042
Passenger-cum-cargo Vessel	11	66,343	27,882
Passenger Vessel	11	1,879	45
Ethylene Gas Carrier	3	8,725	6,960
Ro-Ro	1	956	1,386
Dredger	13	55,263	0
Offshore supply Vessel	68	72,701	81,188
Specialised Vessel for Offshore	27	76,772	57,187
<b>TOTAL COASTAL TONNAGE</b>	<b>269</b>	<b>679,707</b>	<b>781,927</b>
<b>TOTAL INDIAN TONNAGE</b>	<b>510</b>	<b>7,052,262</b>	<b>11,494,626</b>

Source: Director General of Shipping, India.

<sup>3</sup> INSA, 2000.

## 5.2 The Shipping Corporation of India Ltd.

The history of Indian shipping dates back to 1919 when the first Indian shipping company The Scindia Steam Navigation Co. was founded. After India gained independence in 1947, the government felt the need for state involvement in this industry that was so important to the development of the national economy, and thereby formed a joint venture company, Eastern Shipping Corporation, in 1950, in partnership with a private shipping major Scindias. The government founded another shipping company, Western Shipping Corporation, as a fully state owned venture in 1956. Eventually, in order to secure co-ordination in policy, economy and efficiency in the long run, both the shipping companies ESC and WSC were merged to form The Shipping Corporation of India Ltd. (SCI), on 2<sup>nd</sup> October, 1961 as a fully owned state venture. Upon incorporation, SCI was predominantly a liner company with a total fleet of 19 vessels.<sup>4</sup>

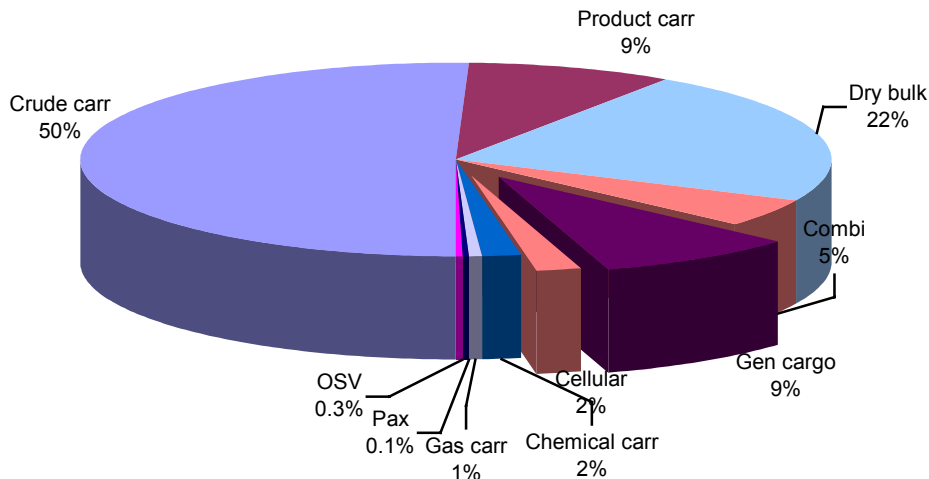
Subsequently two more shipping companies, viz. Jayanti Shipping Company and Mogul Line Ltd., were merged with SCI in 1973 and 1986 respectively. SCI grew in conformity with international trends, while managing to stay truly Indian, catering to local needs and environment. It is the country's premier shipping line today owning a fleet of 112 vessels of 2.95 million grt (4.94 million dwt), which is over 45 percent of Indian tonnage in dwt terms. In addition, it mans/manages 27 vessels on behalf of other agencies. Composition of SCI's Fleet is at Figure 5.1.<sup>5</sup>

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<sup>4</sup> SCI, 2000. [www.shipindia.com](http://www.shipindia.com)

<sup>5</sup> SCI, 2000. Fleet position booklet.

**SCI's Fleet Composition**  
(in dwt terms as on 1.04.2000)



**Figure 5.1**

Financially SCI has been stable and due to its presence in more than one sector of shipping, and the government patronage it has enjoyed in the past, it has been drawing good returns for its shareholders over the years. As on 1<sup>st</sup> April, 2000, it has a paid up capital of Rs.2.82 bn (US\$ 62.73 mn) and has Rs.16.9 bn (US\$ 375.8mn) in reserves.<sup>6</sup>

The liberalisation of the Indian economy in the early nineties saw the government divesting part of its holding in SCI. It sold off 19 percent of its holding in favour of financial institutions and public in two tranches in 1992 and 1993. The government is now looking for the strategic sale of part of its holding so as to bring down its stake in SCI to 40 percent. Major international and Indian groups have envisaged interest in picking up the stake.<sup>7</sup>

On the organisational front, SCI is divided into 3 profit centres and 2 service centres according to their function. The profit centres are Liner and Passenger Services, Bulk Carriers and Tankers, and Technical and Off-shore Services, and the service

<sup>6</sup> SCI. 1999. Annual Report, 1998-99.

<sup>7</sup> Nadkarni, S. 2000, July 10.

centres are Finance and Personnel and Administration Divisions. The liner and passenger services division manages the liner operations of the company.

### 5.2.1 Liner operations

Of the total of about 80 Indian shipping companies, only 3, viz. Shipping Corporation of India, Scindia Steamship Navigation Co., and Indian Steamship Co., are licensed by the government to operate on overseas liner routes. In view of the heavy investment needs and nonviable operations in an intensely competitive and over tonnage trade with low freight levels lately, SCI remains the sole operator offering a network of break bulk and container services. With just one national player to hold forte, Indian shipping has a dismal record in the liner sector. The share of Indian lines in India's liner trade is a far cry from the 40 percent target set by the planners and has been languishing at around 10 percent for the last few years as shown in Table 5.3.

**Table 5.3**

**Share of Indian Lines in India's overseas Liner Trade**

YEAR	TOTAL TRADE (mt)	INDIAN LINES SHARE		FOREIGN LINES	
		(mt)	(%)	(mt)	(%)
1990-91	18.01	2.27	12.6	15.74	87.4
1991-92	19.30	2.49	12.9	16.81	87.1
1992-93	17.15	2.47	14.4	14.68	85.6
1993-94	26.02	2.29	8.8	23.73	91.2
1994-95	35.33	3.18	9.0	32.15	91.0
1995-96	34.23	3.56	10.4	30.67	89.6
1996-97	45.30	4.44	9.8	40.86	90.2
1997-98	52.58	6.52	12.4	46.06	87.6

Source – Indian National Shipowners' Association, Annual Review - 1998-99.

SCI has offered a range of services from the Indian sub-continent to all parts of the world in the past, but the absence of adequate cargoes and advent of containerisation made it pull out of some sectors. SCI has been a late entrant into containerisation and had acquired its first cellular container vessel in 1993. Its liner

fleet as on 1<sup>st</sup> April, 2000 comprised 4 container and 27 general cargo vessels<sup>8</sup> and the company currently offers services in these sectors:

Break-bulk services

- India - UK Continent
- India - Japan
- India – USA
- India - Mediterranean/Blacksea

Container services

- Nhava Sheva - UK Continent
- Nhava Sheva - USA
- Nhava Sheva – Colombo –  
Singapore
- Chennai – Colombo
- Calcutta – Colombo

In tune with the trend of forging alliances in the liner industry, SCI has slot sharing arrangements with the Zim Line of Israel and Yang Ming Line of Taiwan in the India-UK continent sector, and Contship Containerline in the India-USA sector. The company has similar arrangements with other companies for its feeder services.

SCI is a member of a few liner conferences and the government has done its bit in helping SCI secure Indian cargo by implementing the Modified Cargo Support Scheme in lieu of the mandatory 40:40:20 cargo support provisions of the UN Code of Conduct for Liner Conferences. The UN Code, however, has hardly made any difference for SCI due to the voluntary nature of the government's scheme, which is not binding on shippers. One of SCI's strongholds is the India-UK Continent sector where it has a market share of 15~18%, the highest among members of the India Pakistan Bangladesh Ceylon (IPBC) conference<sup>9</sup>. SCI provides a weekly service in this sector and has received the Lloyd's publication award in recognition of its efficiency and as a provider of fast service in this sector.<sup>10</sup>

SCI has been operating in the Indian market for the last 38 years and has built up an expertise few Indian companies can match. The Indian National Shipowner's Association has noted that<sup>9</sup> *"in view of heavy investment needs and unviable operations in an intensely competitive and over-tonnaged trade with low freight*

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<sup>8</sup> SCI, 2000. Fleet position.

<sup>9</sup> INSA, 2000.

<sup>10</sup> SCI, 2000. [www.shipindia.com](http://www.shipindia.com)

*levels, no Indian shipping company has so far come up with any proposal to enter the liner trade on any overseas routes.”* Being the sole operator for so many years in the big market the company today has the following strengths:

- Only Indian company operating in the liner market.
- Fleet suited to Indian conditions (market/cargo).
- Extensive network of agents in India and abroad including marketing agents for cargo canvassing.
- Better understanding of the Indian market due to long-standing contact with shippers and consignees.

SCI, being a public sector company, has not been market responsive due to the government patronage it enjoyed in the past, and is unable to protect its market from being taken away by competitors. International players have been very active in India and have marginalised SCI on most trade routes. The company's liner division seems to be saddled with the following problems:

- Vintage fleet with average age of 19 years with very few container vessels.
- Low level of containerisation, with few owned containers.
- Failure to stick to regular schedules in the combi sector.
- Frequent switchover of ships from various sectors leading to erosion of customer confidence.
- Lack of market responsive culture.
- Multi-window functioning resulting in confused customers.
- Absence of a proper marketing plan for services. Too much reliance on outsiders for securing cargo.
- Low adaptation of information technology tools to speed up decision making and also routine office operations.
- High overheads due to high manning scales on board vessels and at shore establishments.

The depressed market conditions in the liner sector have taken a heavy toll on all liner companies in the world and SCI is no exception to this. Its liner operations have been performing badly in recent times, which has affected the company's overall



performance. It registered an operating loss of US\$ 9m while contributing US\$ 90m to SCI's total turnover.<sup>11</sup> The liner business the world over is passing through a tumultuous phase and future performance of the sector is not rosy. Experts predict that only the big efficient players may survive the current phase of low returns and the industry will see more consolidation in the future. SCI will have difficulty treading in its current form and the company needs to decide upon the place that it wants to secure in the industry. In the wake of falling margins and the resulting consolidation taking place in the industry, the options available to SCI are analysed in the next chapter.

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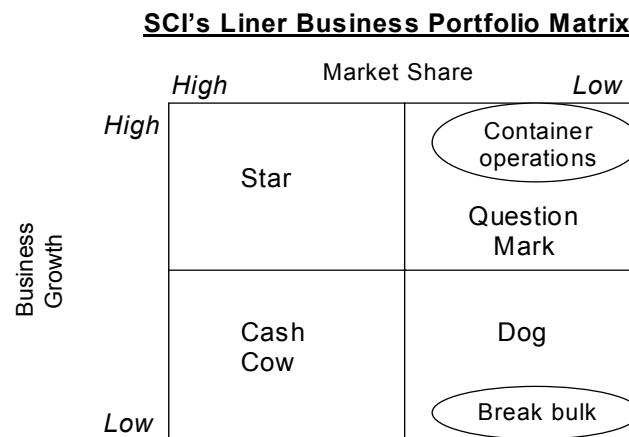
<sup>11</sup> Nadkarni, S. 2000, March 30.

## 6.

### Business Options Before SCI

#### 6.1 Business Portfolio Matrix

Liberalisation of the Indian economy in the nineties fuelled growth of liner trade in the country, which attracted new global operators to this market. These operators have been eating into SCI's market share, which is alarming for the company. The company has to find out the cause for this loss of market share and try to recoup its dominant position as before. Placed on a growth matrix, more commonly known as the BCG matrix<sup>1</sup> SCI's liner business would be as shown in Figure 6.1.



**Figure 6.1**

As per the BCG matrix, business operations of a company can be categorized under four heads depending on the growth rate of the industry and the firms' position thereon. Businesses in the 'question mark' quadrant having weak market share in a high growth industry deserve immediate attention and investment so that they can become 'stars', the business in the high growth position. The

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<sup>1</sup> Porter, M.E. (1998). Competitive Advantage.

question mark segment has the greatest potential for growth and profits, and the cash required for the turnaround is to be provided by the 'cash cows', which are well established having a strong competitive position in a low growth market. This business is able to offer services at low input costs due to its established position, and since much growth is not expected in this business, the surplus generated need not be re-invested. The 'dogs' are businesses with a weak market share in a low growth industry, which makes them non-profitable. These businesses should, therefore, be disposed off.

SCI's liner operations when viewed on this matrix would fall in the 'question mark' quadrant, posing the question as to why the company has a low growth rate when the industry is witnessing strong growth. SCI's liner operations are of two types viz. break-bulk and container operations, and the break-bulk business currently witnessing low growth, falls in the 'dog' segment. This business is not profitable and it does not make commercial sense in putting further investments in this dying industry. Break-bulk business is disappearing worldwide paving way for containerisation. Break-bulk today is suited more for project and heavy lift cargo which is a specialised field, and currently major liner operators have exposure in container shipping only. It is, therefore, recommended that SCI dispose off this dying business from its portfolio.

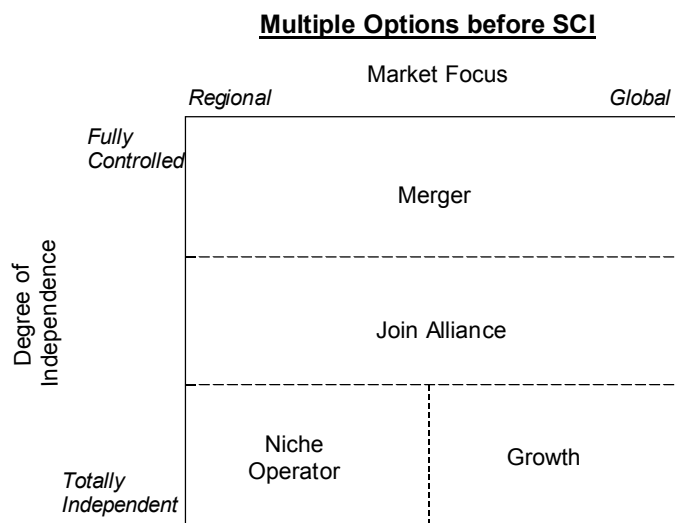
SCI's container business, falling in the high growth segment is the business of future. The company has a low market share in this industry and this needs immediate attention. The potential for growth and thereby profits in this business is high and the company should thus invest further into it, so that this business becomes a 'star'. The required cash has to be provided by the 'cash cow'. Unfortunately, it is difficult to identify a cash cow in SCI's business portfolio as its other major business areas viz. oil and dry bulk transportation, are very competitive segments in themselves, and the surplus generated therein has to be reinvested in that category, so as to maintain their positions.

The liner industry, meanwhile is experiencing the consolidation phase where an increasing number of companies have merged or been sold off to financially

strong competitors. In order to survive this merger phase, SCI may decide on any of the options as discussed hereafter.

## 6.2 Options Available

Container shipping industry has been the platform for series of experiments as operators adopt varied strategies for success, and there are a number of case studies available for benchmarking. Success stories have varied with some making it to the big league alone, while others finding success in joining hands. The path to success has not been a cakewalk and SCI has to be prepared to sustain low returns for years. The option adopted depends upon the market the company wants to focus and also the degree of independence it wishes to enjoy. Based on these two functions, the options available to SCI can be seen in Figure 6.2.



**Figure 6.2**

### 6.2.1 Niche operator

A niche has always been the most defensible segment in any industry. The focus here is very clear on the target customers. SCI can chose upon a niche where it can be the market leader, and protect its position by raising entry barriers. Such a niche can be developed either in a regulated market where the government grants SCI a monopoly, or by offering a unique service in a competitive market.

SCI has identified a number of niche markets in the Indian Ocean where it offers feeder services. Due to the poor quality of port infrastructure in India, modern liner vessels avoid India as a port of call on their east-west itinerary, which leads to containers destined to and from India to be transshipped through major hubs like Singapore and Colombo. Indian Cabotage law restricts foreign operators to move these containers along the Indian coast, and SCI has taken advantage of these market conditions and built up a huge market of moving containers between India and Singapore/Colombo.

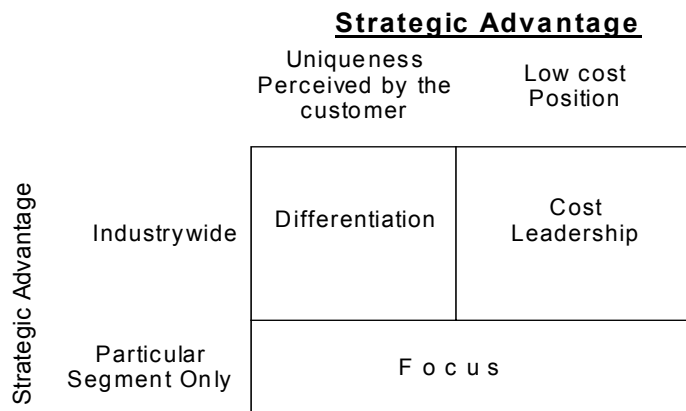
By adopting the niche option, SCI can concentrate on operating in such niches where it has locational advantage, and withdraw from mainline routes where profitability is under pressure. This is a huge market as inter-Asia trade is one of the biggest markets of container shipping, accounting for more than 20% of the total container trade in the world<sup>2</sup>. While most of this trade is concentrated in the far-east region, SCI can identify the sectors where it can make a breakthrough, and increase its exposure in those segments.

SCI may also consider building up defensible niches having few big customers as the focus. Michael Porter has identified three generic strategies shown in Figure 6.3<sup>3</sup>.

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<sup>2</sup> Drewry Shipping Consultants. 1999, October.

<sup>3</sup> Porter, M.E. (1998). Competitive Strategy.



**Figure 6.3**

In liner business a cost leadership strategy is easily emulated by competitors, and a differentiated service is difficult to build<sup>4</sup>. SCI can, therefore, adopt a focussed strategy where a market will be developed keeping a particular customer segment as focus. This will involve a tie-up with some manufacturing facility in India, which can entrust its logistics operations in this part of world to SCI. In return SCI will have to offer guaranteed sailing schedules, warehousing and such facilities so that the manufacturing plant can operate on very low inventory. The company will have to commit punctuality of schedules and even run vessels with an extra engine so as to meet any exigencies. This innovative approach will build up a defensible niche for the company.

**Advantages** – Operating in such a niche will not be as difficult as trying to make an impact in the main routes. The Indian market comes as a natural market for SCI due to its continued presence there in the past, and SCI is also a strong brand in this part of the world. It would, therefore, be prudent for the company to identify similar market niches and start its services for the Indian subcontinent. Stakes involved in this strategy will not be high, as the vessels operated in such niches will be smaller in size and the number of vessels required will be less too due to the short services routes leading to quick turnaround time. This will also mean in operating with less number of containers even. Thus this market focus may be ideal for a company the current size of SCI.

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<sup>4</sup> Kadar, M.H. & Proost, D.D. 1997, June.

Limitations - Although companies in the past have focussed upon building up defensible niches and have smooth sailing thereon, the niche strategy suffers from limitations discussed below:

Destruction of niche markets - The recent spree of mergers and take-overs has seen a number of small and medium sized operators in defensible niches disappear. These niches were earlier presumed to have defensive strength but it was a fight between David and Goliath and the niche operators made an exit while the business was worth some value. The destruction of niche markets in the second half of nineties are shown in Table 6.1.<sup>5</sup>

**Table 6.1**  
**Invasion and Destruction of Niche Markets**

Niche Market	Example	Factors Responsible
<b>Indefensible Niches</b>		
North-South	US/Europe – S.America	Shipping deregulation Trade liberalisation Transshipment
Reefer Cargo	New Zealand – Europe Caribbean - Europe	Transshipment Sophisticated reefer containers
Protected Markets	Europe – Pacific Islands Europe – French Caribbean	Deregulation Globalisation
Wayport Regions	Europe / FE - Mid East	Capacity surpluses Directional imbalances Transshipment
<b>Defensible Niches</b>		
Deep sea Ro-Ro	Worldwide	Mixed traffic types Project cargoes Vehicles
Difficult Markets	West Africa	Infrastructure limitations Port inefficiencies Regulation
Domestic Markets	USA (Hawaii, Alaska etc.)	Regulation

<sup>5</sup> Drewry Shipping Consultants. 1999, October.

With global operators continuing to target small players, it will be difficult for SCI to defend its niches for long. Few carriers in the world can survive in a niche market as the UASC operating in the Middle-east heartland, and sooner or later the big players will have an eye on SCI's market and the company may not have the resources to indulge in a fight thereupon.

Susceptibility to take-over - Global carriers in their expansionist mood are scouting for prey to make an entry into new markets. Such niches are attractive targets as apart from a readymade market that the predator gets, at times the take-over is forced due to the brand name. Thus a strong SCI in a niche market will be more prone to take-over.

Low entry barriers – Since a niche is a small market requiring small capital outlay, more operators will be forthcoming to make an entry due to lower stake to risk. Thus the threat of competition runs very high and this will restrict SCI from charging premium for its services. Super profits will, therefore, not be possible in such a niche unless protected by government regulations.

### 6.2.2 Growth Strategy

SCI is a major player in the India-UK sector where it has a market share of over 15 percent in the IPBC Conference<sup>6</sup>. The company entered this segment with its own cellular container vessels in the early nineties and has been able to command this position due to its ability to sustain losses suffered in the initial years, and built up a strong base thereon. The success of this service gives the confidence for recommending SCI to spread out its services to other mainline routes. A growth strategy will mean the company changes its focus from being a regional player to a major force in the global market. It may sound too ambitious, but there have been success stories like the Mediterranean Shipping Co.<sup>7</sup> and China Shipping Co.<sup>8</sup>, which have made it to the big league on their own in a short

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<sup>6</sup> INSA. 2000.

<sup>7</sup> Mediterranean Shipping Company. 2000.

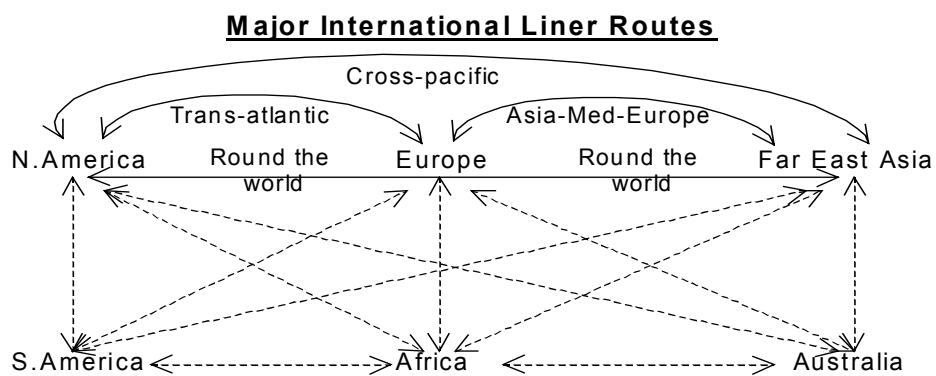
<sup>8</sup> Cosco Container Lines Co. Ltd. 2000.



time. SCI can aim for making it to the big league on its own following either of the two paths:

- Organic growth
- Acquisition strategy

**Organic growth** – By adopting this strategy, the company will increase its services profile and penetrate some of the main trunk routes shown in Figure 6.4.



**Figure 6.4**

Apart from the international routes shown inter regional trade is also a big market and SCI will also have to increase its presence thereon. This is a long term business plan whereby detailed targets will have to be set for each of the following areas:

**Fleet expansion** – SCI currently owns just 4 container vessels, which is a very small number compared to international standards. Of the top ten list, the world's tenth largest operator Zim Line owns 27 container vessels and has a substantial number on charter<sup>9</sup>. SCI to make it to the big league will have to embark on an expansion spree and start new services. Moreover the mainline routes are serviced by the post-panamax and SCI will have to operate those so as to achieve scale economies.

<sup>9</sup> Zim Israel Navigation Company. 2000.

Containers – World's largest operator Maersk controls over 700,000 containers and the tenth largest Zim Line controls 180,000 containers. In contrast SCI controls less than 20,000 units. For offering global services the company will have to take control of a huge number of containers through a mix of ownership and leases.

Marketing – Shipping has traditionally been an industry lacking the glamour as other services industry like aviation or financial services. Marketing was, therefore, never paid enough attention in this industry as operators relied upon brokers and freight forwarders to bring in business. The advent of containerisation and the fierce competition thereon has, however, made shipping executives to refer back to lessons learnt at business schools, as operators now target for big shippers themselves. SCI will thus have to draw out aggressive marketing plan focussing on the sales and brand building exercise.

Talent - Shipping is not a glamorous profession like information technology, and SCI is not a company business graduates look forward to. Thus it becomes very difficult for SCI to attract talented professionals. In order to be competitive, SCI will have to go in for recruiting professionals from top business schools and groom them for taking up responsible positions in the company. SCI is blessed with an in-house training institution, Maritime Training Institute, which is primarily being utilised for imparting training to seafarers. This academy can design special training courses based on the lines of institutes like the McDonald's Hamburger University near Chicago or Maersk's International School in Denmark.

Terminals - Global operators depending on the hub and spoke system rely on transshipment for smooth operation of their services. Container shipping being highly time sensitive, operators are at risk during transshipment as they lose control over the boxes during transshipment and are dependent on the port for fast movement. Although ports are highly efficient and provide the best of services, some operators do not risk depending upon some outside party like the port authority, and operate their own terminals. By having own terminals, the liner operator is in total control of the transportation chain and is able to provide

guaranteed services to its clients. P&O Nedlloyd, Maersk-Sealand, Evergreen, Cosco, OOCL, Hanjin and Hyundai are some major companies operating terminals at ports in strategic locations to their services. The port sector is being privatised all over the world and SCI can pick up stake in few terminals around the world to augment its services.

Agency Network - Shipping business has thrived over the years within a set-up whereby agency functions were performed by third parties located in respective countries. Apart from attending to the needs of the vessel upon arrival at the port, the agency also acts as sales agent in respective market. However, the concept of establishing a brand name for its services has induced major operators to bring in agency functions in-house, or set-up joint ventures with former agents. The trend started with companies pressing for exclusive agency functions first, and then the pressure for having stricter control over the complete transportation chain is bringing the agency function in-house. This approach has benefited companies through lower unit overhead costs, and also the freedom of a selective and flexible rate setting mechanism. The in-house agencies also brings the company close to its customers and have better understanding of their needs, and SCI should adopt the same policy.

Systems – The alliances have made it difficult to differentiate between the services offered by different operators as they share the same vessels offering the same schedules. Operators in a bid to offer superior services have taken the fight to the systems platform. They have embraced the latest technology, which will be of help to shippers to gain competitive advantage. To face global competition, SCI will have to be IT savvy and offer valuable information to its clients, which can help them plan out their logistics more efficiently.

Acquisition strategy – Not many companies can claim a growth like the Mediterranean Shipping Co. which in a span of 30 years has become fifth largest operator without taking over any company. SCI can follow the takeover path as adopted by companies CP Ships and embark on a take-over spree, purchasing existing players. Many promoters are increasingly getting disenchanted with the

dismal returns of the liner industry and companies are put up for sale at frequent intervals. SCI can make a move when it finds strategic targets and spread its exposure to other parts of the globe and thus climb up the ranking very fast.

While the growth strategy can make SCI a formidable player in the international market, it definitely comes at high costs. First and foremost the company needs to have the requisite funds for adopting this strategy. The company has to be careful so as to not to fall into a debt trap. The business plan has to be carefully formulated and execution of the same may take years. The industry will have quite a few business cycles during these years and the business plan should not fall apart in turbulent times. This can make SCI a global player in the liner shipping industry.

### **6.2.3 Join Alliance**

Co-operation within the industry has been a distinct feature of container shipping, and today almost all major carriers co-operate with their rivals in some form or other. SCI in a pursuit to offer wider service coverage with higher frequency can take this option which will save it from making as large investments as in the growth option. By this the company can become a respectable player in liner business and also hold on its forte in the Indian market. Objective of joining an alliance will be to achieve:

- Wider port coverage
- Higher frequency
- Lower slot costs

SCI has successfully tried co-operation schemes in the past and currently has slot sharing arrangements in its India-UK continent, India-US mainline routes and also in its feeder operations. These arrangements have resulted in higher service frequency without incurring the cost of bringing in extra vessels. On its weekly India-UK service, SCI is able to provide space on 7 vessels although it has just 3 vessels of its own. Joining an alliance will similarly result in improved services without bearing the whole investments needs.

One shortcoming of arrangements currently followed by SCI is, these remain relatively short term. The partnership is valid on one trade route only and SCI has different partners on different routes. Working with so many partners does not result in long lasting relationships and the chances of one or more partners giving up remains. What the company needs is to have a co-operation stretching beyond one route or one string, extending up to global coverage. In other words joining one of the so-called global alliances. By this SCI will be working in tandem with global players and will have a global coverage. Major advantage coming out of this will be that SCI will not have to build up a huge fleet to offer global coverage with higher frequency, and can manage with a modest fleet only. Thus seeking membership of one of the alliances is proposed as an alternative to the company.

Joining an alliance, however, will not be easy as SCI is a very small operator in comparison to the existing alliance members. The numbers are astounding with the largest alliance, the Grand Alliance operating in 14 loops with 105 vessels, controls over 400,000 slots.<sup>10</sup> SCI to bid for membership of such an alliance will have to grow up in size to be eligible for membership. Membership in the alliances is constituted on the basis of the capability of the members, and it runs on the give-and-take principle. Any member expecting to derive some benefit from the alliance has in turn to offer something to other members. And that's slot capacity in this case. If SCI does not have sufficient slots to offer, then it cannot expect the alliances to take it as a partner.

Next by joining an alliance SCI will have to forgo the operational independence it currently enjoys. As a member of one of the alliances, SCI's route and fleet expansions will have a bearing on the services offered by the alliance and the company will have to take this into consideration. Moreover, its existing services schedules may be amended to suit the requirements of other partners. Next even if the alliances are long term partnerships, past record has been opposite and the industry has seen operators switching membership in search of a perfect fit.

Stability of such alliances, therefore, remains questionable and finding an appropriate alliance would be difficult for SCI.

#### 6.2.4 Merger

An extreme option that can have wide ranging repercussions on SCI's overall structure is to jump onto the merger bandwagon. A merger will entail the current owners to lose either total or partial control of SCI's liner business, as the partner picks up a share of SCI's equity. For the merger to take place SCI's liner division will have to be spun off into another entity and its financial worth be evaluated. Next, the owners will have to decide either on selling the liner business in total, or just a partial sale leading to merger or joint operations. Both the options are discussed below.

**Sell-Off** - A sale of SCI's liner business will mean the exit for Indian operators from international liner scene. Liner shipping is different from other shipping areas like oil and dry bulk transportation and many countries have seen their domestic companies die, paving the way for big European and Asian operators. The latest one has been the sale of Sealand last year, which was the last of America's global liner operator. The dismal returns from liner business has deterred successful shipping nations from committing their funds to this industry, like the Greek and Norwegians notably known for their skills in shipping have hardly any significant presence in liner shipping. So India having no presence in liner shipping will not be any exception. Moreover India does not have much to lose even, as almost 90% of its overseas liner trade is currently carried on foreign ships.

Selling-off the liner business at this point of time makes sense as the owners can get a better price when the business is not doing that bad. Global players are too big in size and have the power to kill small businesses like SCI (liner operations). SCI certainly does not have the capability of continuing a fight (a price war or offering add-on services) with these majors if it ever arises. So SCI's

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<sup>10</sup> Hapag Lloyd. 2000, May.

shareholders can opt to strike a good bargain now. Finding out a taker will not be difficult as there has been a mad scramble for consolidation in the industry and bigger players are looking for takeover opportunity. The recent sale offer for 40 percent stake in the company by the government attracted good response from some international groups.<sup>11</sup> SCI is an attractive investment for any international operator as it has a good market share in some routes and a brand that is strong in the Indian sub-continent.

**Merge** – In case an outright sale of a strategic business like liner shipping does not find favor with the Indian government due to the support it accords to Indian trade, SCI may consider the option of merging with some global operator, so that jointly they can withstand the challenges posed. This can be in the form of a joint venture company between SCI's liner segment and the other company. An equal sized operator will mean both companies equally represented in the new company and their combined fleet with an acquisition spree can place them at some respectable position in the major players league.

SCI already has close co-operation with other operators in sailing schedules but these arrangements lead to savings in operational cost only. There is repetition of other land based administration overheads, which are performed by the individual partners separately. A merger between such partners will mean that in addition to the common vessels, they will be having the same establishment, personnel and other systems, which will mean huge savings in overheads. These savings will come valuable in expanding the services base of the new entity, and in few years time the new company can grow up to a major liner operator in the world. The risk involved under this option will be shared and SCI can bank upon the experiences of its partner.

Both these options are an extreme case of surviving in this industry and currently this has been the trend in liner shipping. A number of companies have taken the right decision of quitting the business when the going started to get tough so that they could strike a good bargain, and not wait till they get marginalised and are

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<sup>11</sup> Nadkarni, S. 2000, July 10.

forced to go for distress sale. SCI has to decide how long can it continue with a business that has been providing negative returns for the past few years. Fortunately, SCI has business interests in dry bulk, oil and oil products transportation and these have been able to compensate for poor performance of the liner business. This brings down the company's overall earnings. Additionally, the Government of India is the largest shareholder in SCI and governments usually do not think in terms of return on equity. Hence shareholders are not hard pressing, and SCI has been continuing with this business with low returns when many of its counterparts around the world have given up. This, however, may not last long as the government of India has plans for divesting substantial part of its stake in SCI to some strategic partner, and the new shareholder would certainly calculate the returns on its investments. We may then see a forced sell-off of SCI's liner business.

SCI does not have a huge containership fleet, or other big assets like containers, chassis etc. Moreover it is saddled with a huge manpower which may deter potential companies from taking over. For the organisation as a whole, SCI has a very low market capitalisation with its share price currently hovering around 50 percent premium over the face value. It had a market capitalisation of about Rs.4,500 mn (US\$ 100 mn) in July, 2000<sup>12</sup>. Thus a sale will not bring in substantial revenue for the shareholders and they may defer this option for the time being.

On the other hand, the problem of excessive workforce and lack of substantial tonnage will deter international players from putting forward proposal for merger too. Big operators will certainly not be interested in a joint venture and will prefer a controlling stake in the company. Thus a merger with some major operator may not be forthcoming in the near future.

These are the various strategic options available before this Indian behemoth, if it wants to survive the consolidation phase in liner shipping.

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<sup>12</sup> Capital market. 2000.



## 7.

### **Conclusion and Recommendations**

#### **7.1 An economic evaluation of options**

Of the options discussed, SCI's owners and management may consider the one best suited for the company.

Niche operator - SCI is already a dominant player in feeder routes in the Indian sub-continent and strengthening its position thereon may be a strategic option. The company currently operates these feeder services on chartered tonnage and to be a long term player in this market, SCI should commit funds and come up with owned tonnage. Charter rates for a 1000 teu geared vessel have increased in recent months reaching US\$ 9,000 p.d., against a low of US\$ 6,200 p.d. in July 1999, and US\$ 8,000 p.d. in July 1998. Newbuilding prices, on the other hand have come down to US\$ 18 mn currently.<sup>1</sup> Estimating a 20 years life for the vessel, capital cost per day at 10 percent interest rate will be about US\$ 5,800 per day. Other costs per year will be in the range of US\$ 720,000 for manning, US\$ 300,000 for repairs and maintenance, US\$ 250,000 for stores and supplies, US\$ 120,000 for insurance and about US\$ 100,000 other expenses.<sup>2</sup> These amounts to about US\$ 4,100 p.d. Owning the vessel will, therefore, cost US\$ 9,900 p.d. which is 10 percent higher than the prevailing charter hire rate. The company can, therefore, operate with a mix of both owned and chartered tonnage, whereby it can take advantage of the fall in newbuilding prices and by having tramp tonnage it will be relieved of making big investments. Funds required for owning the vessels will be small in magnitude and even if it were to own all the 7 vessels it is currently operating on its 3 feeder routes, this will be an investment of less than US\$ 150 mn. This option may thus be a strategic fit for a company the size of SCI.

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<sup>1</sup> Fearnleys. 2000, July.

By adopting this option, SCI will, however, be limited in size and remain a regional player in Asia. Moreover, the company has been successful in this market due to the Indian cabotage law, which restricts foreign companies from operating in the Indian domestic market. Due to the ongoing deregulation all over the world, India may be forced to relax this law in future. SCI will then face strong competition from foreign operators, and it may be difficult for a small sized SCI to defend its market then. As niche markets all over the world are increasingly being destroyed by global players, it is suggested that SCI avoid this option.

Growth Strategy – By opting for the growth strategy, SCI will have to increase its span of services. It will have to operate in some of the major east-west and north-south routes where it does not have a presence at present, which will give it a global coverage. This will mean the company will have to embark upon an acquisition spree and bring additional tonnage under its command. As has been stated earlier, for one Asia-Europe string the company will have to bring in at least 8 vessels in the range of 6,000+ teus, and at a cost of US\$ 66 mn for one vessel,<sup>3</sup> an investment of US\$528 mn would be required for vessels alone. Additionally, assuming a set of 3 containers per slot the company will have to acquire about 150,000 containers, which will mean a total investment of about US\$750 mn for just one Asia-Europe string. Next the company will have to invest in terminals and setting up own offices to replace agents. Thus a growth option will mean investments of huge magnitude for the company.

SCI already has an acquisition plan for 44 vessels at an investment of US\$ 1.3 bn for the five-year period 1997-2002<sup>4</sup>. This plan is, however, for the whole organisation, and given the poor track record of raising finances by Indian companies in the recent past, it is doubtful if SCI can embark upon an expansion plan of such magnitude for its container shipping business only. Thus, investments required for this option may prevent SCI from considering this option.

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<sup>2</sup> Drewry Shipping Consultants. 2000, May.

<sup>3</sup> Clarkson Shipping Intelligence Network. 2000.

<sup>4</sup> SCI. Annual Report, 1998-99.

However, SCI can still follow the growth strategy as there is an increasing trend of companies relying more on chartered tonnage in the bigger size range, and SCI can start new services with chartered vessels. By adopting this strategy, SCI will not be obliged to raise finances for fleet acquisition, and it can follow the same strategy for acquiring containers. Additionally, due to lack of resources it can postpone the proposal for owning terminals for a few years, and currently it needs to stress upon gaining stricter control over the marketing and agency functions only.

This option may seem too ambitious, but a long-term business plan can take SCI to the big league in few years. The company already has experience in offering break-bulk and container services in major trade routes from the Indian subcontinent. It can build upon the expertise developed in these sectors and extend its services to other trade routes. Moreover, the company has successful operations in dry bulk and oil transportation, and these strengths form the basis of proposing this option to SCI.

Join Alliance – Among the major alliances in existence today, a small member like MISC of the Grand Alliance controls 39,000 slots, and Cho-Yang of United Alliance controls 52,000 slots.<sup>5</sup> SCI currently controls less than 10,000 slots and to join any such alliances will have to go in for vessels and containers acquisition to be of some respectable size. Existing alliance members will then see some benefit in having SCI in their alliance and consider its membership. On the operational front, SCI will have to have control over its terminal operations and agency functions too. Next it will have to strengthen its marketing capabilities and office systems to make this venture commercially successful. Therefore, the company will have to follow the growth path before planning to join an alliance. Thus this option may not be adopted by SCI with its current size and operations.

Merge – As already stated a merger will mean an overhaul of SCI current organisational set-up separating its liner operations. Due to unavailability of

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<sup>5</sup> Hapag Lloyd. 2000, July.

separate financial information for the liner division, an estimation of the value of SCI's liner operations is beyond the scope of this dissertation.

As stated earlier, SCI's presence in the liner industry is of strategic importance to the Indian economy, and the Indian government may not accept the proposal of a sell-off of SCI's liner business. Next due to a low market capitalisation, the shareholders will not reap substantial benefits out of a sale, and may not be interested in going for it. Thus the sale option may not find favour with SCI's shareholders and management.

As of merging SCI's operations with some strategic operator, the partner SCI will be seeking may be of an identical size as SCI. A stronger partner will be difficult to find as no big operator will be interested in a company like SCI saddled with problems of insufficient vessels, and lack of marketing acumen. On the other hand forging a partnership with a weaker partner will not result in any benefits for SCI. A merger with an identical sized partner will also not result in sufficient gains for SCI as the company will still remain a small sized operator as per global standards. SCI currently owns just 4 container vessels, and after merger the new company can expect to own say some 10 vessels. Thus the gains will not be sufficient, but on the other hand, the company will have to forgo the operational freedom it currently enjoys. A merger will be of benefit to SCI only if it results in a company huge in size and diverse in operations. Thus SCI may avoid this option for the present.

It is, therefore, proposed that SCI follow the growth option in the short term with the aim of eventually joining one of the big alliances in the future. This will mean a long-term business plan focussing each of the areas discussed hereafter.

## **7.2 Fleet**

SCI today owns just four container vessels with a total capacity of less than 7000 teus. In contrast just one S-class vessel has capacity in that range. For competing on the mainline trade routes SCI needs to operate larger vessels and it has a long road to cover in this respect. Vessels sizes have been growing bigger in recent times and the major east-west trade routes are today served by the post-

panamax. Major operators are overhauling their fleet profile, inducting the 6,000+ teu vessel. There were 62 vessels of that size range on order as on July 14, 2000.<sup>6</sup> At present SCI lacks the financial muscle for an expansion of this magnitude.

However, while vessel ownership was the in thing in the late eighties, outsourcing has increasingly been adopted by the industry as an attractive strategy in the 1990's. Almost all major operators in the world including Maersk-Sealand, P&O Nedlloyd, MSC, CMA-CGM, Zim, K-Line, Hapag-Lloyd, APL, Cosco, Yang Ming rely heavily on tramp tonnage. SCI can follow the same strategy of reliance on chartered tonnage. While the containership tramp market was almost exclusively restricted to vessels below 1,500 teu until 1990, it changed dramatically thereafter and currently tramp owners are active in the larger size segment including the post-panamax sector. Bremen based NSB has recently built five 5,600 teu vessels for Hanjin, while Piraeus based Costamare has become the third largest tramp operator by building five 6,200 teu vessels for Maersk-Sealand and three 4,800 teu vessels for Hapag Lloyd.<sup>7</sup> The onus of developing such a huge containership charter market goes to tax saving investment schemes in Germany known as 'Kommandit Gesellschaft' or the 'KG' investment fund. The trend towards non-carrier interests supplying capital for fleet expansion is increasing as can be seen in Table 7.1.

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<sup>6</sup> Fairplay Solutions. 2000, August.

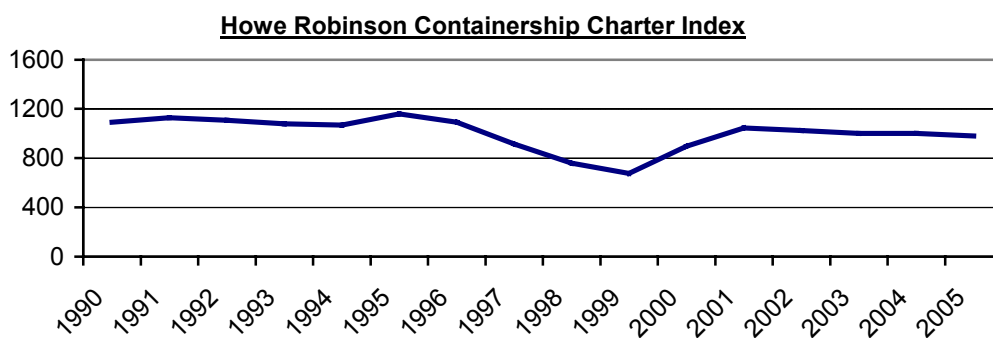
<sup>7</sup> Drewry Shipping Consultants. 2000, October.

**Table 7.1**  
**World Container Fleet Ownership Structure - Actual and Forecast**

Year	Carrier Fleet (teu)	% Share	Tramp Fleet (teu)	% Share	Total Capacity (teu)
1991	1,330,991	75.8	424,985	24.2	1,755,976
1992	1,460,473	76.2	455,823	23.8	1,916,296
1993	1,561,204	74.3	540,123	25.7	2,101,327
1994	1,694,344	71.5	676,393	28.5	2,370,737
1995	1,871,149	69.7	812,871	30.3	2,684,020
1996	2,065,135	67.8	983,014	32.2	3,048,149
1997	2,319,876	65.3	1,233,165	34.7	3,553,041
1998	2,616,595	64.9	1,414,937	35.1	4,031,532
1999	2,738,119	64.0	1,540,678	36.0	4,278,797
2000	2,908,493	64.3	1,617,782	35.7	4,526,275
2001	2,999,293	63.4	1,730,707	36.6	4,730,000
2002	3,285,026	62.6	1,965,974	37.4	5,251,000
2003	3,555,771	61.7	2,207,229	38.3	5,763,000
2004	3,780,002	60.9	2,431,998	39.1	6,212,000
2005	3,988,200	60.0	2,658,800	40.0	6,647,000

Source: Drewry Shipping Consultants Ltd/Howe Robinson Research

Activity in the tramp market has increased lately as charter rates have come down in recent past and as per Howe Robinson, containership charter rates will prevail lower than that in the early nineties as shown in figure 7.1.



Source: Drewry Shipping Consultants/ Howe Robinson Research

**Figure 7.1**

SCI has been a late entrant in the tramp market, hiring in some tonnage recently for its new services. The company can emulate the bigger operators and adopt the policy of taking vessels on charter and free capital resources for other activities. Benefits from this will accrue in the form of:

- Ability to undertake expansion and modernisation without any capital outlay
- Free capital resources for investments in other important activity
- Free itself of debt upto some extent
- Enjoy more flexibility which helps in unpredictable market conditions
- Enjoy the security of guaranteed and predictable slot provisions cost

It is, therefore, recommended that SCI take large vessels on long-term charter with an option for purchase, and for smaller vessels it can be active in the spot market.

### 7.3 Containers

Starting new services will mean requirement for extra containers for the company, and SCI will have to augment its fleet of containers. The service pattern of the company will determine the type of containers it has to acquire, as the Indian trade is catered more by twenty footers, while forty footers are more in use in the major east-west routes, and some trades using the forty-five footers even. Operators have built up competitive edge in providing different types of boxes, with inventions like the controlled atmosphere reefer and temperature probe fitted containers. SCI will have to similarly find out shipper's requirements and come up with suitable equipments.

Container prices have gone down substantially in recent times with China evolving as a major production centre. As against a high of US\$2,500 for a twenty-footer, prices were down to US\$1,350 in the first quarter of 1999. It is currently hovering in the range of US\$1,500. In consonance with this decline, lease rentals for containers have come down too in recent times, prevailing at US\$0.65 per day in 1999, as against a peak of US\$1.30 in 1995.<sup>8</sup>

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<sup>8</sup> Containerisation International, Yearbook 2000.

Ownership of world container inventory is almost equally distributed between shipowners and container leasing companies and in line with the world trend, SCI should adopt a mixed approach of owning and leasing containers.

#### 7.4 Marketing

The concept of marketing did not exist at SCI due to the government support it had in the past. So when competition arose, it had to depend upon third parties like agents to bring in business and today apart from a small in-house marketing team SCI has an outside agency, which performs majority of the sales function in India. Agents perform this function in the foreign market. To be a global player, the company will have to draw out an aggressive marketing plan stressing upon its sales activity and the brand name.

##### Sales:

The sales function has become increasingly critical to liner shipping in recent times due to the following:

Lack of service differentiation – As the alliances have made container shipping a commodity business, there is very little differentiation in services offered and the salesman has a tough time selling the same service as his alliance partners.

Inability to maintain service advantage – Liner market is very fragmented having fierce competition and operators do not take the risk of being a late entrant. Thus any service edge developed by one is emulated by all very fast.

Customer Expertise – The growing number of mergers between multinational companies, which happen to be major clients of liner companies, gives them huge bargaining power. These clients need constant attention and shipping services have to be customised to meet their requirements.

Globalisation - Globalisation of the world economy has evolved new markets for shipping and the fight to capture the emerging markets is fierce, as each operator wants to have a bigger share of the new market.

As sales function at SCI is performed by outside agency, the company is in a vulnerable position. It is not in direct contact with its clients and does not know who



its customers are. Its customers are not loyal to SCI but to the sales agent, and the company can easily lose them if there arises any friction with its selling agents.

It is therefore recommended that the company takes up the mantle of sales and devise a long-term strategy, which should be proactive, creating a market out of every available opportunity, and not be a laggard coming after competition has already established. It has to be developed with the customer in focus so that they identify the benefits of shipping with SCI. Ultimately it should result in a win-win situation for both the parties.

By undertaking the task of evolving a sales strategy, SCI needs to identify the needs of its customers, both existing and potential. This is a difficult proposition as liner shipping has a huge customer base and it may be difficult to devise and offer custom-made services to each consumer. To overcome this, the company needs to adopt a detailed Consumer Relationship Management Program (CRM). It can be based on the lines of CRM program adopted at Maersk-Sealand.<sup>9</sup>

Sales staff at Maersk earlier followed a policy of selling individually to each customer irrespective of the volume of business generated, thereby paying almost equal attention and time to all type of customers. This did not make commercial sense and the sales team was hard pressed for time as most of that was used in replying to incessant queries of small shippers. The company, thus segmented its 1998 list of 85,522 customers, and found that:

- 5% of customers accounted for 78% of its revenue, and 70% of profits.
- 13% of customers accounted for 14% of its revenue, and 16% of profits.
- 82% of customers accounted for 8% of its revenue, and 14% of profits.

Maersk has now reshaped its sales approach and the top 5% of its clients have been designated super premium status. They are now treated like kings and since their number is few (less than 5,000) it is easy for senior executives at Maersk to pay constant attention to these. The next tier of 13% clients are taken care by middle level executives, and for the occasional shipper i.e. 82%, the company is

developing a web based system and which will cater to their needs. This way the company makes optimum utilisation of its sales team and also pays attention to its client in accordance with what they deserve.

SCI will have to adopt a similar approach and identify the demographics of its customers. The 80:20 formula is applicable to all companies, whereby about 20 percent of clients account for 80 percent of a shipping company's revenue. The picture will be more or less similar at SCI and it should allocate majority of its resources for the 20 percent segment. This selected batch of clients should be prerogative of SCI's senior management, and the company should strive to build up partnership with those. These clients need to be assured that SCI is capable of taking care of their needs, and an occasional call from senior SCI executives will bring home this point convincingly.

Big clients like Walmart, McDonlad's or IKEA follow a policy of global sourcing and do not believe in wasting time dealing with sales people down the line who need to run back and forth to the office for getting a nod to their decisions. For SCI to become a global player, its senior staff need to start making customer calls. For the sales team down the line, there has to be delegation of authority allowing them to take decisions on the field. This delegation can be on the basis of financial criteria, whereby the sales team is given the guidelines on how much of bargaining power they have.

### Branding

Container shipping is not industrial shipping business like other shipping segments, but is a commodity business. The importance of a brand name in this industry is evident from the huge premium NOL paid for acquiring APL. Liner operators have off-late realised the importance of a brand name, but the industry has a long way to go before there's a brand like Coca-Cola or Marlboro in this industry.

SCI will have to formulate a 'brand vision' and aim for the top of mind slot among its clients. This is an expensive proposition, but it pays handsomely in the long run.

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<sup>9</sup> Maersk-Sealand. 2000, March.

Advertising is a major brand building avenue and SCI has embarked on a successful ad campaign in the last few years, which has increased the company's awareness in the market. This exercise has to be continued with aggression so that the SCI name records high recall among shippers, and they call SCI first whenever they have a shipment.

The brand building exercise has to be looked in as an investment and not expense. It will create brand loyalty ensuring long term partnerships between SCI and its clients.

### **7.5 Talent**

A company is as good as the people it has, and SCI in a bid to become a global player needs to attract the best people. The company is blessed with some of India's best professionals in this field already, and drawing out a career path for them, which would involve rigorous training programs and varied responsibility, will be beneficial in building up expertise. Training at all levels should be a priority and special courses may be devised at its training institute in Mumbai.

New recruits and sales executives before being allowed to deal with established customers should undergo courses at the training center, learning about the company's systems and procedures. Each personnel should follow a defined career path, moving across the company's different locations and departments. By this they will develop a hands-on-experience of working in different fields, and learn about the company's policies and values.

Retaining good professionals will always be an arduous task, and the company has to provide benefits, both monetary and otherwise to prevent the best of its people from quitting. Providing stock options is the most preferred form of retaining talent and SCI may consider offering the same to its employees.

### **7.6 Terminals**

Of the top five container port operators in the world, two viz. Maersk-Sealand and P&O Ports have liner interests. SCI to be in control of its operations will have to start

operating its own terminals. This will be a strategic fit for the company as being in control of the terminals it can accord berthing preferences to its vessels and manage transshipments efficiently.

Ports all over the world are being privatised and this is an attractive opportunity for SCI to pick up stake in a port in a strategic location to its services. To make a start the company should target ports in the Indian subcontinent. P&O Ports is a strong player in this region operating container terminals at Nhava-Sheva, Karachi and Colombo and winning the rights to build at Cochin, Chennai and Kandla.<sup>10</sup> SCI will have to bring in investments and start bidding for terminals offered for private participation in future so that terminals do not become a bottleneck in its container operations, and provide synergy in operations.

This is a very expensive proposition as the pace of technological change in ship designs is very fast and ports have to constantly upgrade equipments to meet the challenges of changing ship designs. The P&O owned terminal in Nhava-Sheva handled 345,000 teus during 1999-2000.<sup>11</sup> If SCI were to build and operate a terminal with say 200,000 TEU annual capacity the investments required for constructing the quay, stacking yard and purchasing the equipment would be in the range of US\$ 37 mn. Additionally annual operating costs which includes labour charges, port royalty, insurance, overheads etc. will be in the range of US\$ 40 per teu.<sup>12</sup> Thus investments required would be huge and SCI has to have strong funds position before it makes any serious move in this field.

The company may thus consider deferring this aspect in the short term and aim for owning and operating terminals in future.

### **7.7 Agency**

SCI to become a global operator will have to establish its own agency which will give the company greater control of its operations, and also a global name. To make a

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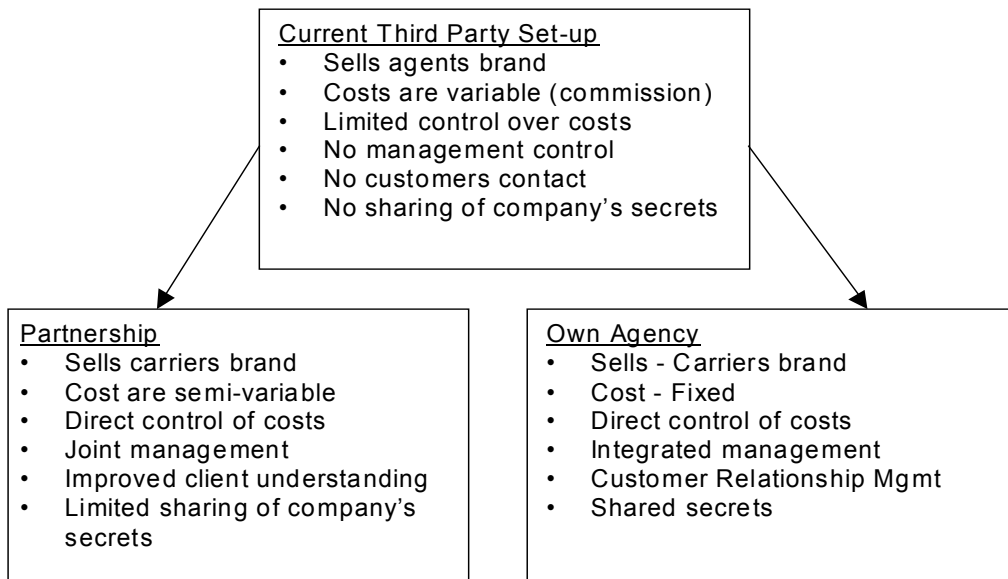
<sup>10</sup> Nadkarni, S. 2000, July 10.

<sup>11</sup> Jawaharlal Nehru Port Trust, 2000.

<sup>12</sup> Drewry Shipping Consultants, 1998, April.

start the company should take up agency functions in India, as it is conversant with the local market conditions, and once established the company can extend this arrangement to other parts of the world. While the switchover from third party agents to ownership will take time, the company in order to have a global identity can meanwhile have partnership agreements with its agents. Benefits accruing from different arrangements will as shown in Figure 7.2.

**Advantages accruing from different Agency Set-ups**



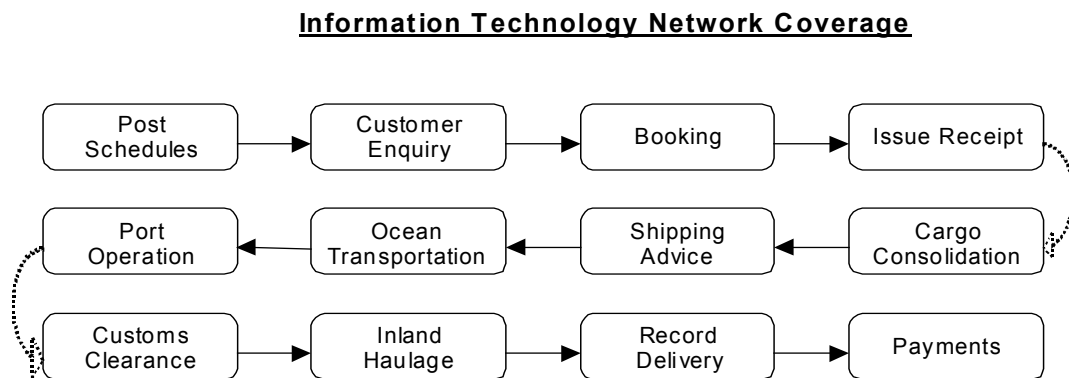
*Source: Derived from Drewry Shipping Consultants*

**Figure 7.2**

SCI has always been working with third party agents, and it is difficult to predict how successful will the company be in having these functions in-house. Since the agents work on commission, the motivation at times is higher than having own personnel at the location, who run the risk of getting complacent. Thus the strategy of owning and having partnerships would require a strong management control from the head office. Moreover, in the end it is not necessary to force agents all over the world to have partnerships. Their past performance may be seen and the company should continue the existing set-up with selected trustworthy agents who have been giving excellent service to the company in the past.

## 7.8 Systems

There has been a mad scramble for adapting the best IT systems and some liner companies have set up separate IT companies for this purpose. Since ships cannot be made to sail faster, SCI should aim at gaining competitive edge on the IT platform. The company needs to assess its core competencies and leverage those in the e-business environment. An ideal system will be the one which can take care of the functions mentioned at Figure 7.3.



**Figure 7.3**

The challenge before SCI in developing such a system is a big one, as it has to think in terms of benefiting its customers by offering these tools. Apart from the necessary cargo information the company should supply customised options like shipment analysis and performance data to its customers, which will help their company in supply chain planning. This will win customer loyalty for SCI.

Embarking upon the growth strategy will be a big challenge for SCI. In addition to raising finances, steering the company through the growth path will be a big task for the management. The company should not underestimate the power of the competition, which will be posing new challenges for SCI to cope with in future. There has to be, therefore, a strong commitment on the part of the management and strong backing of the owners, for making the plans successful. This can make SCI a major liner operator in the world in few years.

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