

4

Acquisition of Fleet

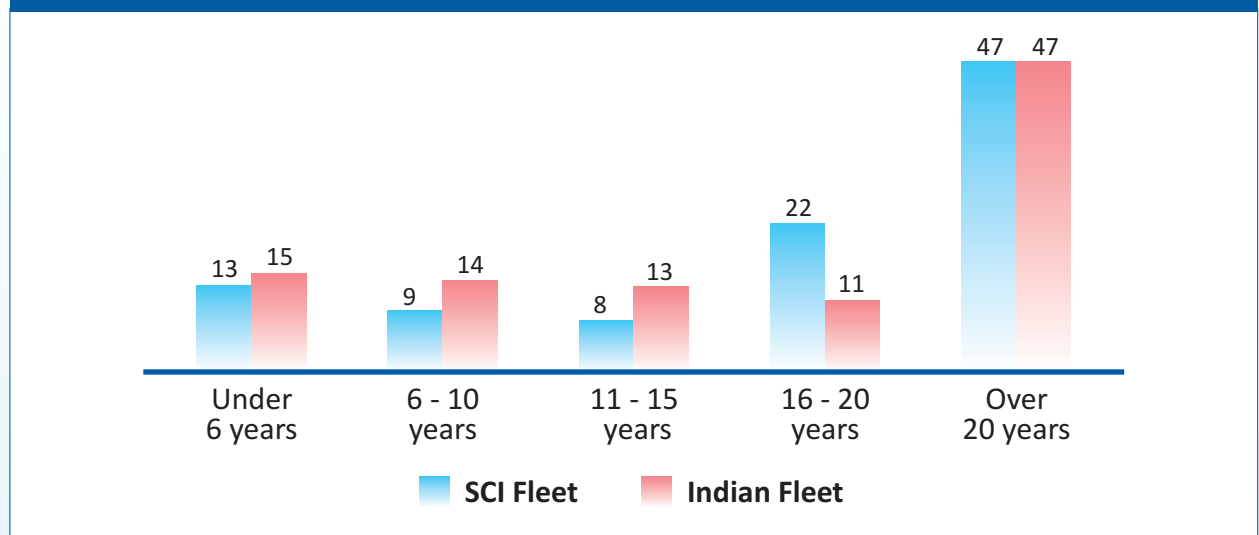
4.1 Fleet profile

The Company has a total of 76 vessels with 29.26 lakh Gross Tonnage, with the average age of 18 years. The age of the vessel plays a crucial role in the earning as well as in the cost of operation especially in the global competitive environment where the clients prefer younger vessels. Audit observed that as against the Company's average age of 18 years, average age of fleet of Great Eastern, its immediate competitor in the domestic market was 11 years.

A comparative position of stratified age profile of the Company's fleet and the Indian fleet as on 31 March 2010 is detailed below:

GRAPH - 6

Age profile of SCI fleet and Indian fleet (in percentage)



Audit analysis revealed that average age of the Company's fleet did not compare well either with their nearest competitor or the country's average age especially in the age group of 16-20 years.

Table - 2 Economic age of the various categories of vessel

In years

Category	Prescribed economic life	Age 0 -10	Age 11 -20	Age > 20	Total
Crude oil tankers	20	7	7	8	22
Product tankers	20	3	5	2	10
Very Large Crude Carriers	20	4	-	-	4
Chemical carriers	20	-	3	-	3
Gas carriers	30	-	2	-	2
Bulk Carriers	25	1	3	14	18
Container vessels	25	2	3	-	5
Offshore supply vessels	20	-	-	10	10
Passenger vessels	30	-	-	2	2
Total		17	23	36	76

It may be seen that out of a total of 76 vessels available with the Company, 20 vessels had already outlived their economic life and 16 other vessels were on the verge of completing their economic life prescribed by the Government. In fact, out of 36 ageing vessels, 24 vessels were tankers and bulk carriers which were critical for the operations of the Company. This adversely impacted the Company's competitiveness in the overseas trade and restricted the business opportunities.

The Ministry stated (April 2011) that the Government norms on economic life are only for guidance and more particularly for acquisition of second hand vessels and it is not mandatory to phase out the existing vessels in Indian fleet after the economic life norms indicated by the Government. It further stated that with the induction of new vessels and phasing out of older vessels during 2010-11, average age of SCI fleet has now improved to 15.63 years.

The fact remains that higher age of fleet has implications in form of greater operating expenses and lower charter rates.

4.2 Acquisition plans

The Company has been drawing up its own five yearly tonnage acquisition plans to synchronise with the respective national Five Year Plans. These are broken into annual acquisition plans. The target and achievement of acquisition plans during 10th (2002-07) and 11th (2007-12) Five Year Plans are given below:

GRAPH - 7

Shortfall in Acquisition

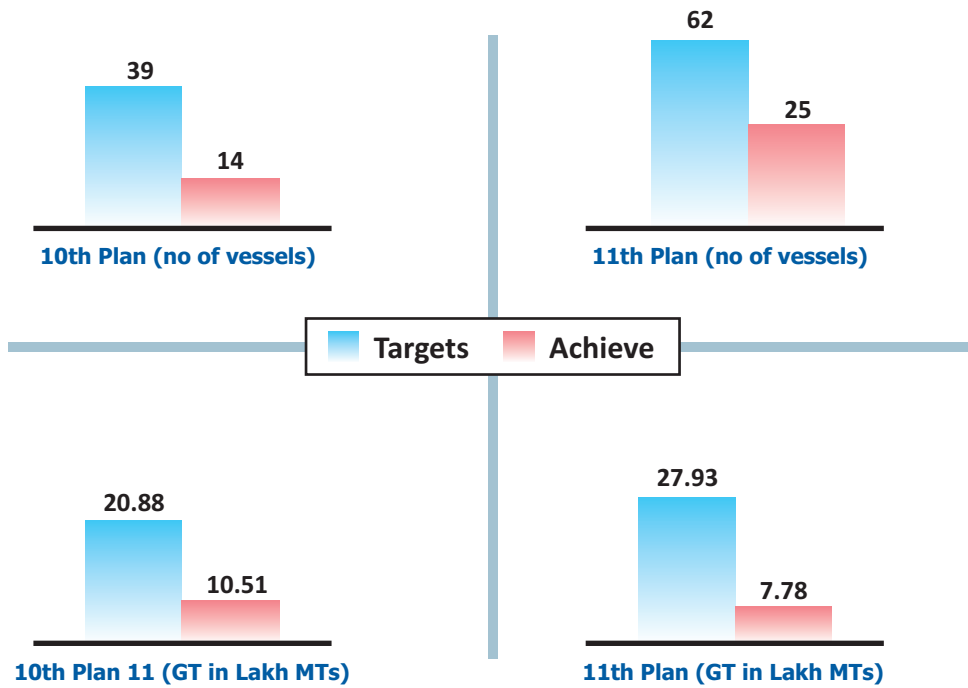


Table - 3

Particulars	10 th Five Year Plan		11 th Five Year Plan	
	No of vessels	GT in lakh MTs	No of vessels	GT in lakh MTs
Target	39	20.88	62	27.93
Achievement	14	10.51	25	7.78
Percentage of achievement	36	50	58	28

An analysis in audit revealed that the Company failed in achieving the acquisition targets set in 10th Five Year Plan and could not even reach half way mark. Similarly, based on the past trend, making good the shortfall of 37 vessels (20.15 GT) during the 11th Plan period appears to be an uphill task in the remaining period of two years.

The Ministry attributed (April 2011) the 10th Five Year Plan period shortfall to the restrictions imposed by Government (March 2002 to January 2004) on long term financial commitment in view of the proposed disinvestment in the Company. The shortfall during 11th Five Year Plan period was attributed to the global meltdown. It further stated that SCI had ordered 11 vessels during 2010-11 and as such, the backlog at present was only 26 vessels and some more proposals were already under process.

The fact, however, remained that the Company could not modernize and enhance its fleet capacity which in turn, adversely impacted its business growth especially when the country's seaborne trade was growing at a pace of 8.5 per cent annually and world fleet also registered a growth of 23 per cent.

4.2.1 Impact of delay in acquisition of vessels :

(a) Cost Escalation

The Corporate Plan 2005 of the Company outlined the broad strategies for vessel acquisition. As per the Plan, vessel acquisition was to be done to rejuvenate the fleet periodically and within the delegated powers of the Company. Till August 2008, the Company was enjoying the status of 'Mini Ratna' with financial powers up to `500 crore for capital expenditure and thereafter, it was conferred 'Navratna' status and was empowered to decide on investment without any financial limits. During the period April 2005 to August 2008, when the Company was a 'Mini Ratna', audit noticed that the Company exercised their delegated financial powers only for six out of 32 vessels ordered and the remaining 26 vessels were clubbed into seven projects which exceeded the financial powers necessitating clearance by Public Investment Board and approval by Cabinet Committee on Economic Affairs.

Though the Company took parallel action to invite technical bids, it could not place orders as the Government's approval was awaited. The Company finally invited commercial offers during May 2005 to July 2008, at a time when the prices of new building vessels were on the rise, as may be seen from the following graph⁹:

⁹ Clarkson Shipping Intelligence Weekly, publication of Clarkson Research Services Limited, UK

GRAPH - 8

Ten year trend in new building prices



Audit further observed that despite the commitment by the Ministry to clear/submit the investment proposal to CCEA within 14 weeks as provided in the MOU for the year 2007-08, it took 14 to 34 months to accord approval in respect of seven projects for acquisition of vessels.

As seen from the table below, there were undue delays at various stages in according approval, which ultimately resulted in acquiring vessels at higher cost besides loss of business opportunity.

Table - 4

SI No.	Project	Time taken for Govt. approval #	Holding of PIB Meeting	Queries from appraising agencies	Delay in number of months)	
					Re-tender	Delay on Company's part
1.	2 Very Large Crude Carriers	14	6	5	Nil	Nil
2.	2 Container Vessels	21	10	2	11	2
3.	6 Long Range 1 Crude Tankers	21	10	6	Nil	1
4.	4 Aframax Crude Tankers	17	3	9	7	Nil
5.	2 Long Range II Crude Tankers	17	Nil	9	7	Nil
6.	6 Handymax Bulk Carriers	34	10	8	14	1
7.	4 Panamax Bulk Carriers	30	10	8	12	2

based on the date of submission of proposal and date of approval by the Government

The delay in getting the approval from the Government resulted in steep rise in prices of 26 vessels by ₹2105.81 crore (Annexure-II) when compared with the indicative prices as reported by international agencies and indicated to the Government in the acquisition proposals.

The Ministry without furnishing justification for delay in according approval for the acquisition of vessels by the company stated (April 2011) that:

- Taking the indicative price for cost overrun was not appropriate as the actual cost depended on technical specifications, demand and supply situation, availability of steel, main engines and other major equipments, delivery schedule, payment terms, etc.
- As a going concern, it would not be possible for SCI to place orders for all the vessels at one point in time and the acquisitions have to be staggered.
- Timing all the acquisitions at the bottom of the cycle would be impossible for any organisation.

The reply has to be viewed in the light of the following facts:

- The Company adopted the same criteria i.e. published indicative price for assessing the reasonableness of the contracted price and for initiating negotiations with the suppliers.
- As a result of delay, commercial offers for 12 out of 26 vessels were invited in April – May 2007 when the prices were on the upswing. The bunching could have been avoided if there were regular acquisitions.
- Though it may not be possible to time all the acquisitions at the bottom of the cycle, periodic acquisitions would have helped the management in taking advantage of the lower prices.

However, the fact remains that the timing of asset acquisition is critical to the success of any shipping venture. On comparison, audit noticed that Companies like Great Eastern have been able to take advantage largely because of following such a strategy.

In essence, due to non-achievement of targets, the Company's fleet strength remained more or less static. The Company acquired eight vessels but it disposed off 15 vessels over a period of five years. Therefore, the net addition was only 2.51 lakh GT (9 per cent) against the country's fleet growth of 12.24 lakh GT (14 per cent). Further, 30 vessels (10.05 lakh GT) on order as on 31 March 2010 would not add substantially to the tonnage capacity as 24 vessels (7.55 lakh GT) would have to be replaced due to old age in the near future.

(b) Loss of business opportunity:

Audit noticed that delay in getting Government approval resulted in loss of opportunity earnings to the extent of ₹358 crore, considering the estimated charter hire rates assumed by the Company for these seven projects.

Audit further observed that post 'Navratna' status (August 2008), the Company took less than six months (in three projects comprising 5 vessels) in ordering vessels.

Ministry stated (April 2011) that such calculation of opportunity cost is not correct as the time taken by Government agencies to evaluate and appraise the proposals and grant final approval would only defer the project by that much period and as such cash flows (both cash inflows and cash outflows) would be shifted ahead. It further stated that operating life of the vessels was assumed as 25 years and time taken in getting approvals does not result in any shortening of economic operating life of the vessel.

The fact, however, remains that delay in acquisition of vessels besides impacting the present cash flows of the Company also impact the market share of the Company which gets captured by other competitors.