Chapter

5 Operation of Vessels

5.1 Operation of Vessels

The Company's operations are divided into two major segments viz.

(i) **Bulk segment** which includes dry bulk, crude and product tankers, gas carriers and chemical carriers etc and,

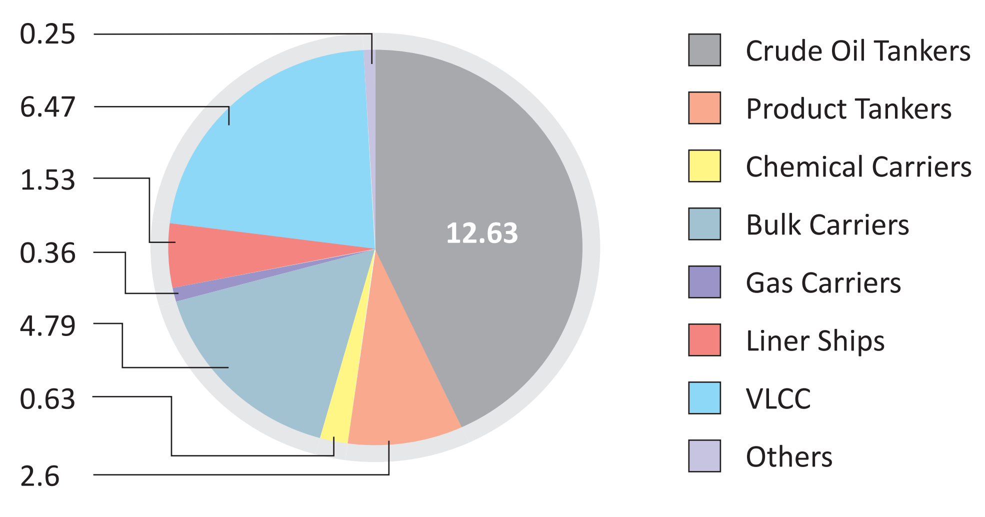
(ii) **Liner segment**, which includes break-bulk and container transport.

These two segments put together constitute about 95 per cent of the total operating earnings of the Company.

As is evident from the graph below, the major share belonged to crude oil tankers which was 43 per cent of the total capacity of 29.26 lakh GT as on 31 March 2010:

GRAPH - 9

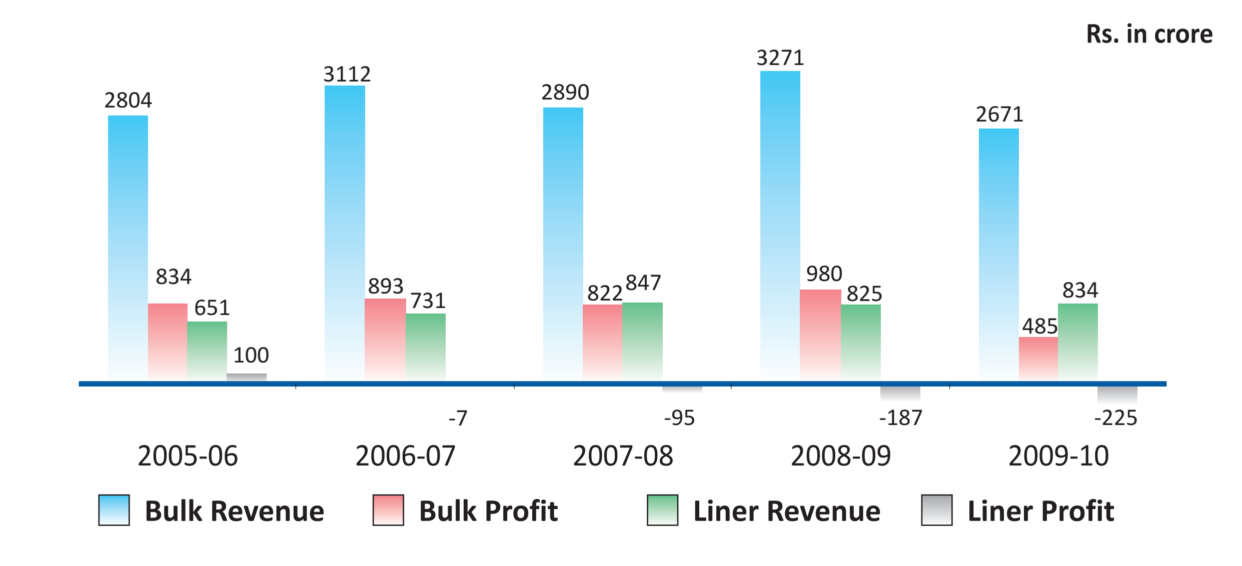
Gross Tonnage



The break up of the profitability of the Bulk and Liner segments during the period 2005-06 to 2009-10 is indicated below:

GRAPH - 10

Profitability of Bulk and Liner Segments



It may be seen from the table that though the bulk segment made sizeable contributions to the revenue earnings and profitability of the Company, the profit from this segment declined from `980.11 crore during 2008-09 to ₹ 484.93 crore during 2009-10. The liner segment which earned a profit of ₹100.29 crore in 2005-06 has been incurring losses since 2006-07 which is increasing gradually and has reached a level of ₹ 225.09 crore during 2009-10.

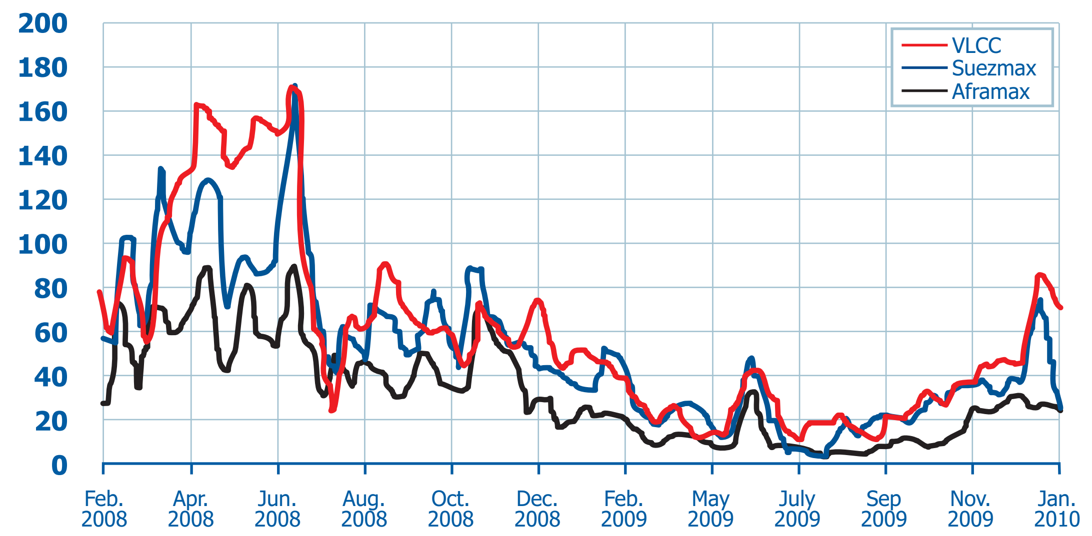
The Ministry stated (April 2011) that the reason for poor profit in 2009-10 was not stagnation of SCI fleet, but mainly the market conditions post global economic meltdown at the end of 2008, which affected the shipping markets severely. It further stated that shipping is a cyclic industry and slowdown would follow a period of boom. Accordingly, a shipping company cannot be expected to show growing profits over a longer period as it is affected by global demand and supply forces.

The reply does not address the core issue of growth of tonnage, which is not associated with the cyclical nature of the industry. In a span of 14 years as of 31 March 2010, the tonnage had actually reduced to 51 lakh DWT (76 vessels) from 54 lakh DWT (122 vessels).

Audit further analysed that fall in the charter hire rate of crude oil tankers was one of the reasons for decline in the profitability during 2009-10. The index for charter hire rate of crude oil tankers for the period February 2008 to January 2010 showed volatility and fell by about 88 per cent as could be seen from the following graph as reported in the Clarkson Intelligence Weekly:

GRAPH - 11

Crude Tanker Spot Earnings ($, 000's/day)



The other reasons, as observed by audit, which contributed to fall in operating income and profitability, are discussed below:

5.1.1 Deployment of vessels

Deployment of vessels was made by the Company either on time charter[10], or voyage charter[11], called fixture[12] or these were deployed to fulfil commitment under Contract of Affreightment (COA).

Audit noticed that vessels were deployed through brokers for which the Company as on 31 March 2010, was having a panel of 24 brokers (18 Indian and 6 foreign). A weekly meeting was held with the empanelled brokers to obtain quotes and the responses received were evaluated followed by negotiations for concluding the terms and conditions of the fixture.

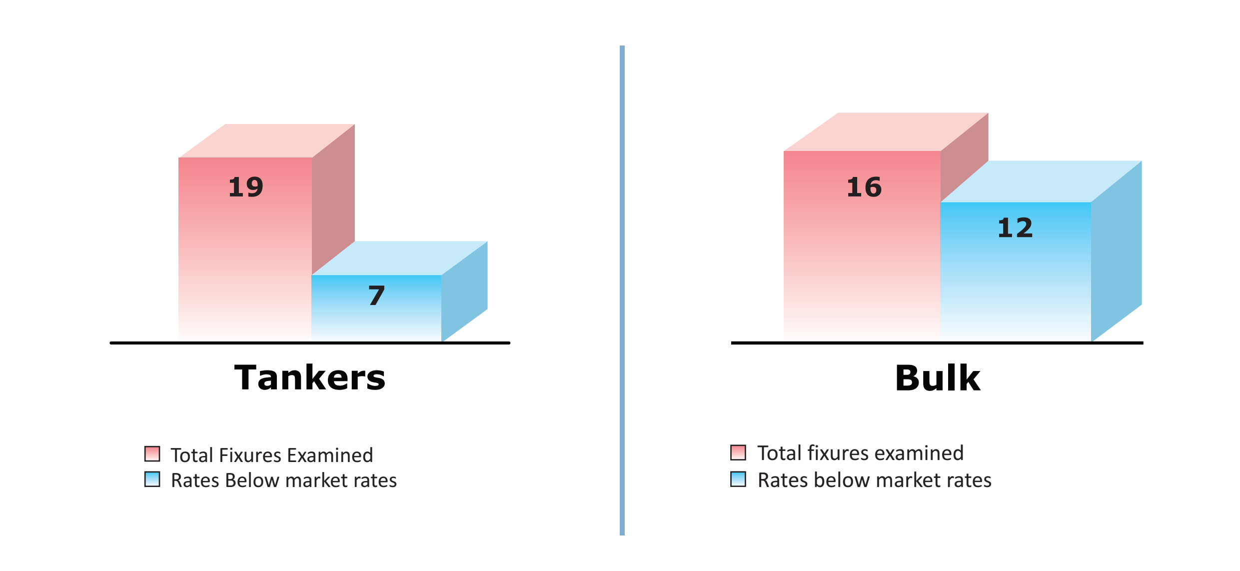
Audit examined a random sample of 35 fixtures out of a total of 546 fixtures concluded during 2007-08 to 2009-10, to ascertain the effectiveness of the system. The table and graphs below indicate the number of responses received for deployment of tankers and bulk carriers and the rates received as compared to the market rates:

[10] *Hiring of a vessel for a specific period of time.*
[11] *Hiring of a vessel and crew for a voyage between a load port and a discharge port.*
[12] *Conclusion of the contract with the charterer.*

Table - 5

No of brokers responded	Tankers	Bulk	Total
1	8	5	13
2	6	6	12
3	0	2	2
4	4	1	5
5	1	2	3
Total	**19**	**16**	**35**
Rate at par or above market rate	12	4	16
Rate below market rate	**7**	**12**	**19**

GRAPH - 12



It may be seen from the table and graphs that in 25 out of 35 cases, only one or two quotes were received and in 19 out of 35 cases, the rates received were below the prevailing market rates as published in the Clarkson Shipping Intelligence Weekly.

Audit also observed that there were no clear policy guidelines for placement /employment of vessels on short term or long term. Therefore, in the evolving situation of ships waiting for employment, the Company had to agree for charter hire rate below the market rate as the fixtures were concluded based on the discovery of price through the spot market. Further, as the proceedings of the negotiations with the brokers were not documented, audit could not get any assurance on the fairness and transparency of the process.

The Ministry stated (April 2011) that the negotiations which were done by the concerned Chartering Officers based on the exchange of negotiations normally through the brokers, either via mail or telephone, were captured by the broker and documented later which were made available to the Company. It further stated that this was the worldwide practice followed by all shipping companies.

Audit observed that IOC had voice recording system of tracking the entire negotiation process for chartering vessels. The Company was yet to follow the best practices to bring transparency in the system.

5.1.2 Idling of vessels

Idling of vessel necessarily involves incurring of standing charges besides revenue loss. During the last three years ending 2009-10; the Company lost 1978 revenue operating days incurring standing charges of ₹134.04 crore. The percentage of idle days to revenue operating days which was 1.33 only in 2007-08 had gone up to 4.46 and 3.25 in 2008-09 and 2009-10 respectively.

Though idle days were being reported monthly, there was no system in place for analysing the reasons for idling for taking corrective actions.

The Management attributed (December 2010) the idling days to the non-availability of cargo on vessel dates.

The idling of vessels when the global and national trade was growing at a faster pace is a cause of concern and therefore needed attention.

Noting the Audit concern, the Ministry agreed (April 2011) that the idling period needs to be analysed.

5.1.3 Operation of Very Large Crude Carriers

(a) The Company acquired two Very Large Crude Carriers (VLCCs) in January 2005 and August 2005 and two in October 2008 and June 2009 mainly to gain a share in the growing business of transportation of imported crude in the country.

Audit observed that Company could not get any business from Indian Oil Corporation Limited (IOC) during the period 2007-08 to 2009-10, despite the fact that IOC imported 92 million metric tonnes of crude oil through other VLCCs. The Company has no system of analysing reasons for not encashing such enormous business opportunity available within the country especially when earlier, most of the oil imports were being done through the Company.

The Management stated (December 2010) that the maintenance of database had no archival value as each fixture was specific in its context. The Ministry stated (April 2011) that price was the prime customer need and maintenance of database of customer needs may not help to secure orders.

To conclude, the country's total import of crude oil during 2009-10 was 159 million tonnes, of which SCI's share was only 9 per cent. The Company, therefore, needs to be aggressive in capturing the market share of import of crude oil and accordingly evolve a strategy for meeting customers' requirement for securing long term contracts.

(b) Audit examination revealed that the VLCCs owned by the Company were, however, engaged in cross trade.

Table below indicates the earnings and profitability of VLCCs during 2007-08 to 2009-10.

Table - 6

₹ in crore

Year	Earnings	Profit
2007-08	195.52	57.63
2008-09	269.11	123.97
2009-10	306.62	87.55

Though the Company made profits in the cross trade of VLCCs, audit observed that out of a total of 19 fixtures made during 2007-10, 13 were concluded through single broker of which four fixtures were with the charter rates below the prevailing market rates (Details in Annexure III).

While ignoring the fact of over dependence on a single broker for employment of VLCCs, the Ministry justified (April 2011) the difference in the rates obtained on the grounds of the possible continuation of existing fixture, fixtures of longer duration, better technical specifications of vessels and deployment of vessels on maiden voyage by the competitors.

The reply of the Ministry is to be viewed in the following context:

(a) The Company is predominantly depending on one broker only for fixing VLCCs.

(b) The comparable market rates quoted by Audit were based on rates published in the Clarkson Shipping Intelligence Weekly which indicated the then prevailing global market trends.

In sum, the Company needs to diversify the base of its brokers to ensure better market price for deployment of its vessels.

5.1.4 Non- fulfilment of commitment with Oil PSUs

The Company has been entering into yearly Contract of Affreightment (COAs) with Oil PSUs like BPCL and HPCL for transportation of crude.

A review of the COAs entered during the three years ending March 2010 revealed that the Company failed to fulfil the quantity commitments due to inadequate tonnage available with it as discussed below:

GRAPH - 13

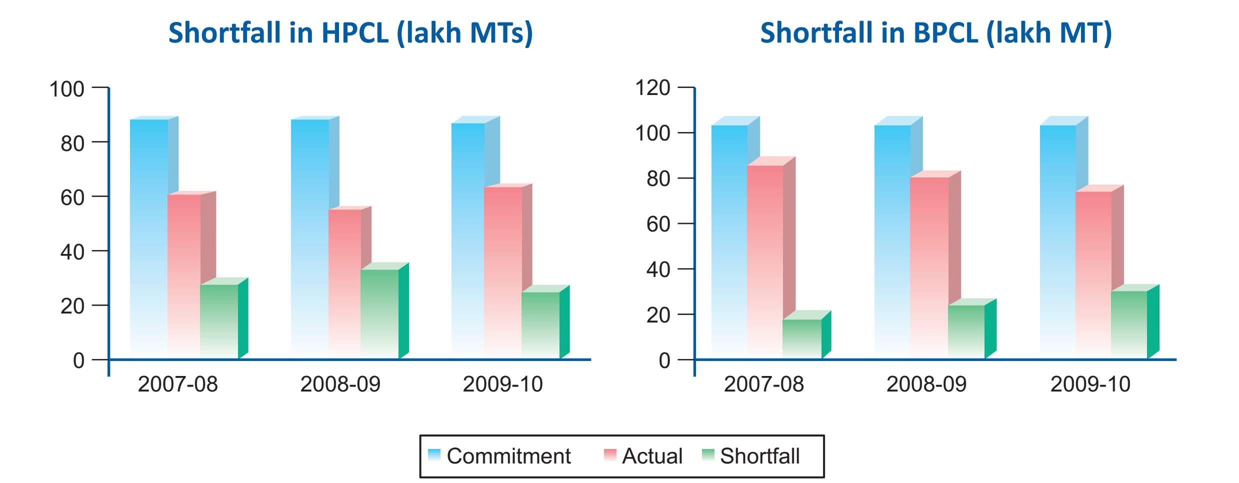


Table - 7

In lakh MTs

Particulars	2007 - 08 BPCL	2007 - 08 HPCL	2008-09 BPCL	2008-09 HPCL	2009-10 BPCL	2009-10 HPCL
Commitment	83.50	110.00	83.50	110.00	83.50	110.00*
Actual	57.15	91.08	52.09	84.89	59.76	78.17
Shortfall	26.35	18.92	31.41	25.11	23.74	31.83
Percentage of shortfall	32	17	38	23	28	29

*(*excluding transported through inchartered vessels)*

Audit observed that despite the fact that the Company was having an assured business in this segment from the oil PSUs; it failed to fulfil its commitment due to non availability of vessels. Audit noticed that while in case of HPCL, the Company had to incharter vessels at 105 times (112.04 lakh MTs of crude oil) at a cost of ₹ 448.40 crore for transporting oil; whereas for BPCL, as there was no such provision in the COA, the latter made their own shipping arrangements.

The Management stated (December 2010) that shortfall in lifting was due to mismatch in the dates of availability of vessel and the loading dates offered by BPCL/HPCL.

The Ministry stated (April 2011) that SCI's fleet of crude oil tankers was just enough to fulfil the COA commitments, provided the cargo lifting dates were given on vessels availability dates. However, the loading dates mainly depend upon HPCL/BPCL refinery requirements, congestion/waiting at load and discharge port and availability of product at load port, etc. Ministry further added that it was incorrect to state that the Company could not take advantage of the assured business as the company's crude tankers were gainfully employed under COA voyages with minimum idling between two voyages. Induction of any additional units, exclusively to perform COA voyages, would have only increased the idling days.

The fact remains that due to inadequate planning and coordination, the Company could not take advantage of the assured business. Ministry's contention of induction of additional tonnage resulting in idling days has to be seen in the backdrop of Company's meagre share of mere 9 per cent in the import of crude oil by the country.

5.2 Liner Container Services

Liner container services offer regular scheduled transport on specified and fixed routes. Containerisation permits the same cargo to be transported not only by ship, but also loaded onto a truck or rail car before or after the ocean transportation. Globally, 90 per cent of non-bulk cargo moved by containers is stacked on ships.

The Company acquired three container vessels of 1868 TEUs[13] (two in December 1993 and one in January 1994). After a gap of 14 years, the Company acquired two more container vessels of 4400 TEUs each in October 2008. As on 31 March 2010, the total capacity of the container vessels was 14407 TEUs, which was just 0.11 per cent of the world fleet.

Audit observed that though the container traffic handled at major ports in India grew from 22.66 lakh TEUs in 2005-06 to 65.86 lakh TEUs in 2008-09 (growth of 191 per cent), the Company could increase their share from 1.57 lakh TEUs to 2.82 lakh TEUs (growth of 80 per cent).

With its own and inchartered container vessels, the Company operated a total of seven container services during 2005-06 to 2009-10, as detailed below.

[13] *Twenty feet Equivalent Unit*

Table - 8

(Profit/Loss (-) in ₹ in crore)

Particulars	2005-06	2006-07	2007-08	2008-09	2000-10	Remarks
India US East Coast Service (IDX)	NA	NA	NA	NA	NA	Commenced - May 2006, closed - March 2008
Far East to Middle East (Hyper Galex)	NA	NA	NA	NA	NA	Commenced – November 2006 closed - April 2008
India Red Sea	NA	NA	NA	NA	NA	Commenced – Feb 2009 closed - Sept 2009
India Subcontinent Europe Service	8.92	8.92	8.92	8.92	8.92	Commenced in 1994
India Far East Cellular Service (INDFEX 1)	43.64	43.64	43.64	43.64	43.64	Commenced in June 2001
India Far East Cellular Service (INDFEX 2)	18.85	18.85	18.85	18.85	18.85	Commenced in June 2002
SCI Middle East India Liner Express (SMILE)	0.00	0.00	0.00	0.00	0.00	Commenced in March 2008
Total	**61.16**	**-23.15**	**-58.54**	**-150.06**	**-206.15**	

The Company incurred continuous losses on this segment since 2006-07, which had accumulated to ₹438 crore as on 31 March 2010. In fact, first three services commenced and closed within a span of less than two years. In view of the losses, the management in October 2009, reviewed the operations of this segment and assessed that exiting from the services would cost ₹782 crore.

The management attributed (December 2010) the losses to the operation of India - US Service during the year 2005-06 till 2008-09. Management further argued that exiting from this business would also not be in the national interest as SCI was the only Indian company in this business.

Audit is of the view that compromising on the commercial viability would not be financially prudent and the national interest would be better served only if the operations are self sustaining.

While agreeing with Audit that commercial considerations were important , the Ministry stated (April,2011) that as a long term player in the Liner Business, there would be periods of profits and losses, but overall, the Liner Business was beneficial to SCI. It further stated that SCI was mainly focusing on energy transportation business and in the Container Sector; it was mainly in the niche market, catering to India – Europe Trade and Far East – India Trade. **It added that the size of SCI's operations was very small as it was not having enough hardware and depended on the inchartered tonnage for its operations. SCI was affected by the vagaries of charter market, very adversely.** The container sector had, however, turned around during 2010-11, as it posted a profit of Rs.80 crore upto 31 December 2010.

Though the Company made a profit of Rs.80 crore during 2010-11, the fact remains that it made a cumulative loss of ₹ 438 crore upto 2009-10 and there is a need for continuous review of liner business to avoid any major losses in the future. There is also an urgent need to build up tonnage in the liner segment to protect the Company from the vagaries of charter market.

Audit examination revealed the following inadequacies:

(a) Loss on India- USA East Coast Service (IDX)

The Company, with four consortium members operated the India- US East Coast (INDAMEX) Service from March 2000 onwards. When the consortium partners put (March 2004) in higher capacity vessels the Company was not in a position to place a vessel of that capacity and thus decided (January 2005) to exit from the service. During the period of operation, the Company incurred a loss of ₹ 25.13 crore mainly due to low capacity utilisation. In addition, the Company was also expected to meet the estimated liability of ₹ 9 to ₹ 11.50 crore towards New York Long Shoreman pension fund due to withdrawal of service.

In February 2006, the Company decided to recommence the service as India -USA East Coast Service (IDX) on the same route with a minimum profit projection of ₹ 2.78 crore per annum. The Company inchartered two vessels for a period of 35/37 months and commenced the service from May 2006 in consortium with other partners. As the Service incurred heavy losses and the other partners pulled out from the service, the Company also closed down (March 2008) the service after incurring a loss of ₹ 107.63 crore.Audit observed that:

- The service was recommenced in May 2006 mainly to avoid the estimated pension liability of ₹ 9 to 11.50 crore, necessitated due to closure of the earlier service which ultimately increased to ₹ 17.67 crore.

- Company failed to place vessels as per requirement of the service and had to pay blank off charges of ₹ 12.74 crore (net) to other consortium partners as per the terms of consortium agreement.

- The capacity utilization in the service was far below the assumptions. It could achieve only 61 per cent in 2006-07 and 74 per cent in 2007-08 on the west bound journeys against 85 per cent assumed. Similarly, on the east bound journey, it could achieve 33 per cent in 2006-07 and 61 per cent in 2007-08 against 50 per cent assumed.

- The cost of inchartered vessel was higher i.e. US $ 22,000 each per day instead of US $ 20,000 each per day assumed.

While accepting the fact that SCI had to exit the earlier service due to inability to provide suitable vessel, the Ministry stated (April 2011) that the second service was withdrawn by all the partners mainly due to steep drop in freight rates as a result of recessionary trends in US Trade. It further stated that SCI had always been striving to have dedicated container services on India–USA sector, since USA was an important trade partner of India.

The closure and commencement of service in quick succession indicated that the Company did not have a well considered strategy. This also put at stake its own image as a reliable operator.

(b) Higher cost due to inchartering of vessels

During the period under review, the Company inchartered six vessels for periods ranging from 806 days to 1616 days involving a pay out of US $ 165.83 million (₹746.22 crore) as detailed in the Annexure IV.

Audit examination of one inchartered vessel, SCI Vijay (capacity 2800 TEU), revealed that the vessel was inchartered (October 2005) for five years at the rate of USD 30,000 per day and USD 48.45 million was paid till March 2010 as charter hire charges. Standing charges incurred by the Company for similar owned container vessels inducted (October 2008) was US $ 19,000 per day. Considering the standing charges for owned vessel, the additional cost incurred for this vessel worked out to US $ 17.78 million (₹83.55 crore) for 1616 days. Audit further observed that though the Company planned acquisition of three 3500 TEU container vessels at an indicative price of USD 43 million per vessel during 10th Five Year Plan period, the option of buying a new vessel was not evaluated while inchartering the vessel.

The Management as well as Ministry accepted (December 2010 and April 2011 respectively) the need for owned vessels for liner services and added that action for acquiring additional container vessels had been initiated.

5.3 Repair and maintenance of vessels

Repairs and maintenance of the fleet constitutes one of the major items of expenses and includes expenditure on repairs of deck and engine, consumption of stores and spares, chipping and painting and surveys.

In the absence of any norms, the performance of the Company with regard to repairs and maintenance was compared with that of Great Eastern Shipping Company Limited, the nearest Indian competitor and audit observed that the expenditure incurred by the Company was comparatively higher as indicated below:

Table - 9 **Repairs and maintenance expenditure (including consumption of stores) as percentage of operating earnings**

Company	2007-08	2008-09	2009-10
SCI	15	13	16
Great Eastern Shipping Company	9	10	10

The Management stated (December 2010) that it was not practical to draw benchmark or norms to evaluate performance. It added that the expenditure on repairs and maintenance was to be incurred constantly to maintain the vessels in seaworthy condition and to comply with statutory requirements, irrespective of the commercial use of the vessel.

The Ministry stated (April 2011) that there were no benchmarks or norms on repairs and maintenance expenditure fixed by the Company or by the industry and it would depend upon the type, age, condition of the vessel and trading pattern. It further added that comparison of overall repairs and maintenance cost of SCI vessels vis-a-vis Great Eastern vessels was unjustified as Great Eastern has lesser number of vessels, lower age profile thereby reducing the repair and maintenance expenditure.

The reply of the Management/Ministry is to be viewed in light of the fact that significant higher repair and maintenance cost reflects the operational inefficiencies of the vessels which have a cascading impact on its business opportunities and therefore, needs to be addressed for corrective action.

5.4 Dry-docking of vessels

For assessing the seaworthiness of the vessels, as per the statutory requirement of Indian Register of Shipping[14], the vessels are required to undergo major repairs called dry docking in an interval of two years and twice within a cycle of five years. The dry docking forms a significant part of the total repair and maintenance expenditure.

During 2007-08 to 2009-10, the Bulk Segment of the Company dry-docked 67 vessels at a total cost of ₹ 408.19 crore.

[14] *Classification Society for registration of vessels in India.*

Audit randomly selected nine vessels (contracts) out of 67 vessels dry-docked during 2007-08 to 2009-10 for examination. Details of vessels selected for examination are given in Annexure V.

Audit observed the following deficiencies in awarding, execution and payments:

- The Company received poor response from the ship yards for dry-docking and concluded contracts with reference to the limited quotes received. The maximum response received in all the cases test checked was only three.

- The bills received from yards for dry docking were 10 to 39 per cent inflated as compared to the settled amount. Further, the scope of work as envisaged originally and executed finally was not supported with any variance analysis.

- The inflation of the bills by the yards was not considered by the Company while evaluating their performance for awarding subsequent works.

- The supervising officers of the Company certifying the work were not made accountable for the large scale variations in the bills.

The Management stated (December 2010) that minimum number of quotations received during 2010-11 had improved to four.

The Ministry accepted (April 2011) the fact that the present manual system has limitation to analyze the variation in the scope of work during actual implementation and stated that SCI was implementing an IT project to address the issue. It further stated that SCI was finalizing a formula / process by which the yard performance rating would also take into account the inflation of bills.