

COMBINING FORCES: STRATEGIC MERGER OF PSU SHIPYARDS FOR A STRONGER ECONOMY

Admiral Karambir Singh, PVSM, AVSM, (Retd.) and Commander Y Hemanth Kumar



Launch of the Second Advanced Stealth Frigate Warship of Project 17A at Mazagon Dock Shipbuilders Limited (MDL) (Courtesy: The Economic Times)

The Government of India's commitment to implementing significant reforms in Public Sector Enterprises (PSEs) has led to policies aimed at consolidating various sectors, with positive results. This paper explores the potential of strategic merger of Public Sector Undertaking (PSU) shipyards in India to improve their efficiency and competitiveness. The paper examines the problems in the present setup and argues that a strategic merger of PSUs can address these issues, leading to increased efficiency, cost savings, and enhanced competitiveness.

Shipbuilding - A Strategic Sector

The Economic Survey 2022-2023 [1], tabled in the Parliament on 31 January this year, recognises the shipbuilding sector as a "strategically important industry" for India's energy security, defence, and the

development of the heavy engineering industry. The shipbuilding industry has the potential to significantly enhance the contribution of the industry and services sector to the nation's Gross Domestic Product (GDP) [2]. The Survey also recognises the shipbuilding industry's immense direct and indirect linkages with other leading industries, such as steel, aluminium, electrical machinery and equipment, while highlighting the dependence of the shipbuilding sector on infrastructure and services sectors, thus making it a key contributor to the national mission of an 'Aatmanirbhar' India.

The Indian Navy's shipbuilding projects underway at Indian shipyards are expected to significantly boost the industry. More than 130 warships have been constructed at Indian shipyards to date, with 41 more ships and submarines under construction in domestic shipyards [3]. Indian Naval shipbuilding programme provides employment to thousands of skilled and unskilled workforce in the country. For instance, the construction of India's first indigenous aircraft carrier, INS *Vikrant*, resulted in direct employment for over 2,000 employees of the Cochin Shipyard Limited and indirect employment for about 12,000 people from ancillary industries and over 500 MSMEs[4].

The shipbuilding sector, with its strong links to other ancillary industries, has the potential to create a collaborative production eco-system, thereby benefiting small businesses and strengthening supply chain networks. Approximately 65 per cent of the value addition in ship construction is derived from the manufacturers of shipboard materials, equipment, and systems. Furthermore, the shipbuilding industry has one of the highest employment multipliers among manufacturing activities, with a multiplier effect of 6.4 [5].

The sector, therefore, has the potential to generate large-scale employment in remote, coastal and rural areas, thus providing a viable alternative to the migration of labour from agricultural pursuits to manufacturing facilities. The shipbuilding sector's investment and employment generation potential is also quite significant. For instance, an investment of approximately INR 1.5 lakh crore in Naval shipbuilding projects is expected to generate circulation of INR 2.73 lakh crore in the shipbuilding sector due to an investment multiplier of 1.82 [6], with a Marginal Consumption to GDP Ratio (MCGR) of 0.45 [7]. With its strong forward and backward linkages, the shipbuilding sector plays an important role in creating a self-reliant India. A strong indigenous shipbuilding industry not only creates massive employment opportunities and benefits ancillary industries but can also reduce forex outgo thereby contributing in reducing the current account deficit [8].

Shipbuilding Scenario in India

India has six central PSU shipyards and 24 private shipyards, of which three private shipyards are undergoing insolvency [9]. The combined shipbuilding capacity of Indian shipyards is 918,000 DWT, with PSU shipyards accounting for approximately 238,000 DWT, while private shipyards account for an estimated 680,000 DWT. However, only 90,000 DWT capacity is currently available, as three private shipyards with a total capacity of 590,000 DWT are under insolvency. As of 31 March 2021, Indian shipyards had 280 orders with a gross DWT of 279,080 tonnes, equivalent to 85 per cent of the effective shipbuilding capacity available.

Public sector shipyards had received orders for 125 vessels with a gross DWT of approximately 56,420 tonnes, representing only 23.7 per cent of their maximum capacity in terms of DWT. In contrast, private shipyards had orders for 155 vessels with a total of 222,660 DWT, exceeding their current capacity by 40.4%. While private shipyards showed better order booking, capacity utilization, and productivity the

reported profits were skewed in favour of PSU shipyards. This is because PSU shipyards get nominated for high-value, weapon-intensive projects with long build periods. Although these projects are primarily due to strategic considerations, in pure business terms, they provide buoyancy and float for PSU shipyards to achieve higher profits and aggressively bid for competitive projects.

This can lead to crowding out effect on private sector shipyards, which have to rely on high-risk commercial orders. It is essential to note that shipbuilding is a capital-intensive industry, and the profits of PSU shipyards may not always reflect productivity but assured access to capital. Additionally, capital inflows have not translated into build periods that match international market demands, modernising infrastructure to global standards, and capturing a reasonable market share worldwide.

Despite inherent productivity issues, PSU shipyards continue to produce warships and have been the backbone of India's maritime security. Enhancing productivity of PSU shipyards is critical to becoming competitive on the world stage, capturing export markets, and ensuring that our investments bring in more value.

New Public Sector Enterprise (PSE) Policy for Aatmanirbhar Bharat

The government of India has announced a “New Public Sector Enterprise (PSE) policy for Aatmanirbhar Bharat” [10] in 2021. The policy aims to make PSEs more efficient and competitive in the global market while providing better services to the citizens. The policy emphasises promoting private sector participation and encourages strategic mergers, privatisation or subsidiarisation of PSEs. The aim was to increase the efficiency of PSEs by introducing corporate governance reforms, professionalising management practices and leveraging technology. The policy sought to create a level playing field for PSEs by removing administrative controls and providing them with greater operational freedom. It also intended to promote PSEs as engines of growth and job creation and to make them more competitive. In order to achieve this, the new PSE policy identified strategic sectors - Atomic energy, Space and Defence; Transport and Telecommunications; Power, Petroleum, Coal and other minerals; and Banking, Insurance and financial services. The policy is to retain only a bare minimum number of PSUs in these strategic sectors, there would be a minimum presence of public-sector commercial enterprises under government control.

The government's recent merger of Public Sector Banks (PSBs) [11] has been a pivotal policy implementation aimed at fostering more efficient financial institutions on a grander scale. Through the ongoing consolidation initiative, numerous PSBs have been merged, resulting in a plethora of benefits, such as heightened magnitude, national reach, cost-effectiveness, enhanced risk management, and amplified competitiveness. These larger entities can embrace superior practices and harness digital technologies, endowing them with an upper hand in the swiftly digitising banking milieu. The PSB merger is poised to play a pivotal role in supporting the government's objective of achieving financial inclusion and propelling economic growth. It will culminate in improved financial capacity, cost-effectiveness, and wider access to a talented workforce. Furthermore, in addition to the PSB merger, the government has been advocating for the disinvestment and privatisation of various state-owned enterprises to enhance efficiency and competitiveness. The recent corporatisation of the Ordnance Factory Board intends to elevate profitability and self-reliance in defence preparedness. Also, several CPSEs are slated for privatisation in the forthcoming fiscal year.

Shipbuilding through New PSE Policy

As already brought out, the Indian shipbuilding industry has faced many challenges in recent years. While private shipyards have struggled financially, public sector shipyards have seen productivity issues. The new PSE policy has the much-needed answer to this seemingly out-of-control problem. To improve the efficiency and effectiveness of PSUs, a merger of these shipyards can be considered. The merging of shipyards offers several benefits, including optimising workload, better utilisation of infrastructure, cost savings, improved efficiency, increased workforce mobility, stronger vendor relationships, and enhanced global competitiveness. By consolidating resources and redistributing workloads, the newly formed entity can achieve economies of scale and scope, allowing for the efficient use of resources, reduced delays in ship delivery, and cost savings through the elimination of duplicated functions. The merger would facilitate the sharing of best practices, technology, and skills across different yards, leading to a more skilled and diversified workforce. Furthermore, the entity would be better equipped to compete in the global market and take on larger projects, potentially driving revenue growth. Several countries with major shipbuilding industries have combined their shipyard operations to enhance efficiency.

China. In 2019, China State Shipbuilding Corporation Ltd. merged its two subsidiaries [12], China Shipbuilding Industry Corporation (CSIC) and China State Shipbuilding Corporation (CSSC), to create a competitive global player in the maritime industry. The new entity retained the brand name of China State Shipbuilding Corporation Ltd. and has a combined workforce of over 3 lakh and total assets of \$112.29bn. The merger was aimed to eliminate low-end backward production capacity, improve the industrial structure of the shipbuilding industry in China, and accelerate the development of high-tech and high-value-added research and industrial capabilities.

Japan. Japan had been reportedly [13], exploring the possibility of integrating its 15 major shipyards into a single entity under an All-Japan Shipbuilding merger plan. According to the report, the plan is being led by Japan's Ministry of Land, Infrastructure, Transport and Tourism (MLIT), which has entered preliminary discussions with several domestic yards. Further, the largest two shipbuilders in Japan, Imabari Shipbuilding and Japan Marine United (JMU), have been reported to have already declared their intention to form an alliance and enter a capital tie-up, with the formation of a joint venture to integrate sales and design business for bulker and tankers. In addition, Mitsubishi Heavy Industries had announced a plan to sell one of its largest yards to Oshima Shipbuilding, and two other major Japanese shipbuilders, Mitsui E&S and Tsuneishi Shipbuilding have entered a business partnership for commercial shipbuilding.

South Korea. Following the course steered by China and Japan, Hyundai Heavy Industries Company and Daewoo Shipbuilding & Marine Engineering Company of South Korea planned to merge to create a behemoth controlling 20 per cent of the global market for new ships [14]. The merger was aimed to create a super yard that will be the biggest shipyard in the world. However, the EU Commission has disallowed the merger [15] due to the potential establishment of a dominant market position for constructing large LNG carriers, limited supplier options, and increased prices for EU customers and energy consumers.

Russia. JSC United Shipbuilding Corporation is the largest shipbuilding company in Russia, with more than 40 subsidiaries [16], including shipyards, design bureaus, and ship repair yards. The corporation was established in 2007 in order to integrate the core of the Russian shipbuilding complex and meet the requirements of Russian and foreign customers for high-technology and competitive products while strengthening Russia's defence capability and economic security. With around 82,000 employees, USC and its subsidiaries perform 95 per cent of Russia's contracts on providing naval equipment and rendering services to foreign customers. The merger of these subsidiaries has allowed the corporation to

consolidate the biggest part of Russia's shipbuilding complex and to offer a comprehensive range of products and services, from design to production and repair, to both the domestic and international markets. As a result, in 2016, USC generated revenues of 341 billion roubles and a net income of 6 billion roubles, demonstrating the benefits of its merger strategy.

Merger/ consolidation of shipyards is also a promising option for India as it can lead to improved coordination and resource utilisation, resulting in reduced costs and increased competitiveness in the global market.

Conclusion

The proposed merger of PSU shipyards presents a unique opportunity for the Indian shipbuilding industry to modernise and increase its competitiveness globally. By bringing together the strengths and resources of multiple shipyards, a larger, more efficient entity can be formed, resulting in cost savings, shared resources, and increased competitiveness. However, it is important to recognize that this merger requires careful planning and execution to ensure its success. Given the government's recent efforts in modernising public sector enterprises through its new PSE policy, the merger of shipyards aligns with this goal and has the potential to bring about transformative change. With 50 years of experience with the previous model and limited success, it is time for disruptive changes in the shipbuilding industry. The government should take bold action towards implementing this merger as a part of its PSE policy, without hesitation and bring about positive results for the industry and the economy.

Disclaimer: Views expressed are of the authors and do not necessarily reflect the views of Govt of India.

About the Authors

Admiral Karambir Singh, PVSM, AVSM (Retd.), was India's 24th Chief of the Naval Staff. He is currently the Chairman of the National Maritime Foundation, New Delhi.

Commander Y Hemant Kumar is posted at Warship Design Bureau, New Delhi. He is an Alumnus of Naval War College, Goa. He may be contacted at hemanthnavy@gmail.com.

[1] Economic Survey. 2023. "Shipbuilding Sector: Achieving Self-Reliance and Promoting Make in India." New Delhi.

[2] Ibid, Chapter 9, Box IX.4.

[3] Ibid, Chapter 9, Box IX.4.

[4] Ibid, Chapter 9, Box IX.4.

[5] Ibid, Chapter 9, Box IX.4.

[6] Ibid, Chapter 9, Box IX.4.

[7] Ibid, Chapter 9, Box IX.4.

[8] Ibid, Chapter 9, Box IX.4.

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