

## Summer Break

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Dear Readers, it is time for a little break and take stock of what we have achieved in the last nine (9) months in this column. The idea of “commercial knowledge for marine engineers” was conceived during the visit of our editor, Mr. Chidambaram to Hong Kong when the author discussed with him about the importance of “dollars and cents” along with the essential and very important engineering know how. MER(I) then started the ICS column in the student section.

Shipping is one of the rare professions where those involved come in such a close contact with each other that the relationships last a lifetime. One of the reasons coming to mind is the sharing of the difficult times together, as a close-knit team. Working together when the engine breaks down in the middle of the ocean for hours with a common aim to “make it work and that too work well” develops very close bonds. Almost all of us remember incidences in a “flash back mode” when we see someone who shared those difficult moments with us. This develops a high degree of intimacy. In other words we seem to belong to a different school all together. Let us take this a step before the working life. Studying together and living in the hostel, be it DMET, MERI, TMI, workshop training or any residential engineering or other professional college, we remember the difficult raggng times and those involved and the memories bring a smile to our faces. Mind you the incidences, when they actually happened, may not have been pleasant then and we may not like to relive them.

In addition to this wonderful team spirit and camaraderie, we also appreciate the basic purpose we are there onboard the ship for. This was the backbone or the seed of the concept called “commercial

knowledge for marine engineers’. We started this column in October 2004 and June MER carried the Ship Registration as the 9<sup>th</sup> paper.

A ship is a commercial enterprise. It is a huge investment and the investor looks for returns as in any other investment, commensurate with the associated risk. How much he gets rewarded depends upon the market, the entry and exit timing and prudent exposure management. We, the marine engineers, our navigation colleagues and the support staff onboard the vessels work hard to make this commercial enterprise a success. While we need not be experts in commercial shipping, it is helpful to have a reasonable understanding of how our efforts can and do translate into dollars and cents for the investor. Firstly, this chain of articles covered the need for training, giving you an idea of the broader definition of “maritime training”. Maritime training does not end with our becoming Chief Engineer or Master onboard the vessel. This stage is a beginning for those who want to take up shipping as a long term career ashore and want to expand their horizons in the areas of marine insurance, chartering (dry, wet, gas, liner), sale & purchase, shipping or maritime law, arbitration, surveying, port agency, shipping finance etc. etc. However, those who enjoy sailing and are content with their onboard career, there is absolutely nothing wrong with it. In the ultimate analysis, nothing else but h a p p i n e s s , satisfaction and contentment that matters.

Every day we come

across different situations onboard the vessels and in port where we deal with third parties, endeavouring to uphold the reputation of the organisation we work for. The experienced senior most personnel onboard the vessels turn out to be most valuable school of learning for the second in commands who may then aspire to develop career ashore. The topic of maritime training was then followed by basics of economics through an explanation of the theories of David Ricardo and Adam Smith. In this two-part article on Demand and Supply, we looked at the fundamentals of shipping market freight rates. If you can lay your hands on the “Maritime Economics”, you will find an article on “Shipping Cycles” by Dr. Martin Stopford (MD of Clarksons Research, UK). An excellent write up, which analyses the shipping cycles from mid 1800 till the beginning of the twenty first century. One of the most useful conclusions of this article is summarized in the following table –

Shipping fundamental trends (Dr. Martin Stopford)			
Period	Demand Tendency	Supply Tendency	Market Tone
1869-1914	Fast	Expanding	Competitive
1920-1930	Fast	Over-capacity	Weak
1930-1939	Falling	Over-capacity	Depressed
1945-1956	Very Fast	Shortage	Prosperous
1956-1973	Very Fast	Expanding	Competitive
1973-1989	Falling	Over-capacity	Depressed
1988-2000	Slow	Expanding	Competitive

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**Courtesy: Jagmeet Makkar, Education Officer, Institute of Chartered Shipbrokers – Hong Kong Branch.**

Thereafter we went on to recognize players in the shipping market e.g. owners, operators, charterers, port agents, liner agents, marine insurers etc. A brief understanding of voyage and time charter parties was the next. The structure of the charter party is simple while the clauses and what is agreed depends upon who has an upper hand in the commercial negotiation. This further depends upon the prevailing market, positioning and who is feeling the business pain. Higher the level of pain (the need), more will be the willingness to concede depending on the negotiation skills of course. Once the business is fixed, the fulfillment of the contract takes importance. This is where Master, Chief Engineer, other staff onboard and the operations & ship management departments ashore enter into the picture. Here we covered “what we promise – we deliver” – in the discharging of the charter party speed and fuel consumption warranties. This article was a reproduction, with some minor changes, from October 1999 issue of MER(I) by the author. It would not be out of place to mention here that each one of us must recognize that it the ‘Charterer’ who is the customer of our services. In turn traders and industrial utility companies etc. are the customers of the charterers. A breakdown onboard a vessel that disrupts the timely delivery of cargo only

translates as an unacceptable offhire for the ship-owner but more seriously may result in a loss of market share for our customer and his customer and this share may be very difficult to regain as their reliability and in turn reliability of the services of the ship-owner then become questionable. Finally the last article was a brief introduction to the subject of “Ship Registration”.

In the last nine (9) months since starting the column, the author has been receiving reasonable amount of feedback. One very interesting feedback was from a marine engineer preparing for his certificate of competency examination. His question was “how does a ship-owner decide when to scrap a ship?”. A very interesting question and the answer to this question can range from volumes of theoretical analysis to a single page practical write up and in some cases a single word with a couple of “subjects” could define it all! Here the “subjects” mean the “exceptions” and not the topics of study. Let this summer break be devoted to this reader and let us try to do justice to his question.

**Decision to scrap or not to scrap**

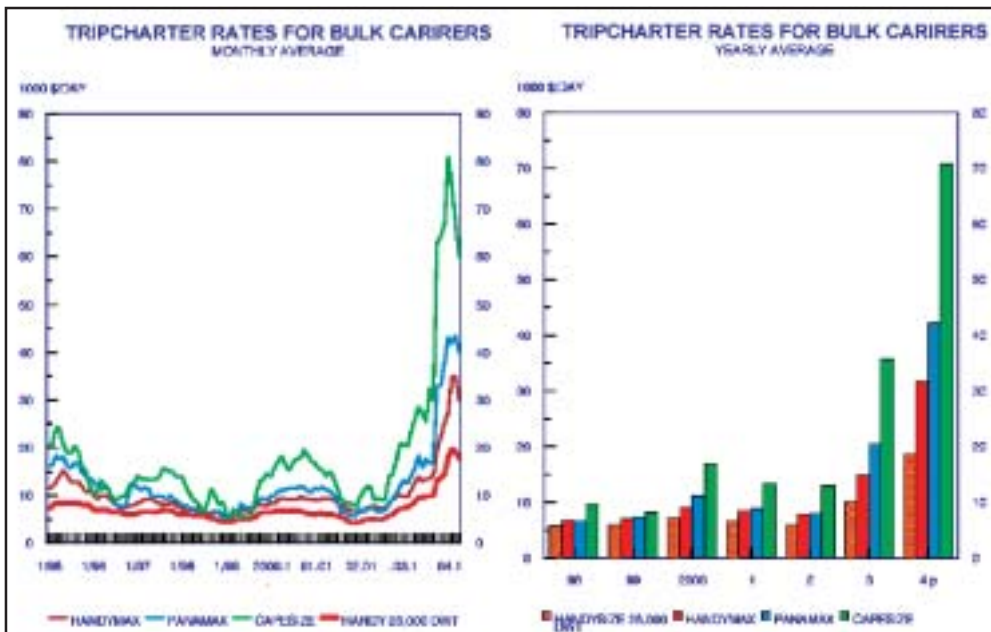
The scrapping of a vessel is regarded as little more than the natural end of its lifecycle, the ultimate fate of an asset which

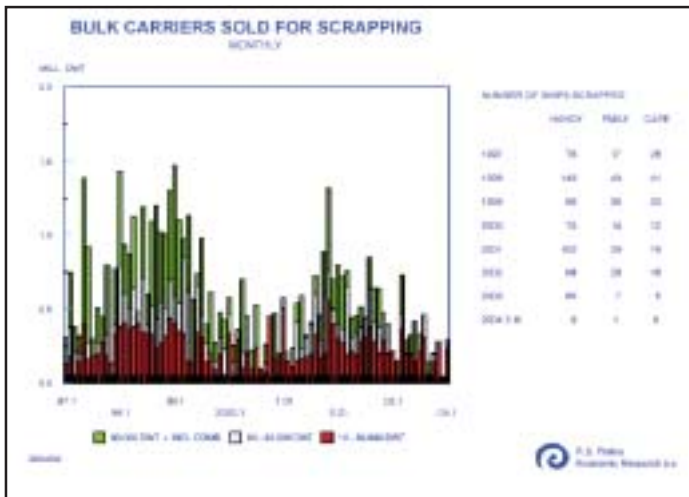
had outlived its commercial usefulness. How do we define this commercial usefulness? Some analysts mention parameters such as new rules and regulations, port state control coming heavily on the sub-standard ships, ability of the vessel to compete with the new and more efficient ships. An in-depth analysis will show these parameters to be secondary reasons with regards to the decision to scrapping.

If an owner foresees a healthy shipping market that justifies his incurring expenditure to carry out extensive repairs to inject a reasonable life into a very old vessel (say a scrapping candidate in traditional terms), comply with the new rules and regulations (there are always the “grandfather clauses not to make compliance unrealistic and extremely onerous for the ships built say 20+ years ago), he is then able to postpone the scrapping of the vessel. Evidence of this always found during the boom years. Please refer to the self explanatory boom and the scrapping trends above.

Author came across a good paper by Michael Perelman of the Economics Department of California State University on this subject. A part is being reproduced here to share with you

“Are we to believe that capital equipment is kept in operation for a fixed period of time, regardless of the prevailing long run macroeconomic conditions? Otherwise, the permanent inventory procedure is unjustified for estimating both the capital stock and models of investment.” Yet every empirical study of which I am aware suggests that the capital stock decays irregularly. Most observers agree current economic conditions affect the scrapping decision. For example, a number of British firms were asked to give the percentage of assets of different vintages surviving in 1957, as well as the percentage of assets of different vintages scrapped in the same year. The first question elicited survival rates and the second, mortality rates.





Survival rates constructed from current mortality rates were higher than the rates obtained directly, leading to the conclusion: *'This is consistent with the hypothesis that the rate of scrapping varies with the trade cycle and in boom years scrapping is postponed'* (Barna, 1957, p. 88).

Parkinson's data on the pattern of scrapping ships supports Barna's

finding of variable scrapping rates:

The first conclusion that emerges from a general survey of scrapping rates is that the service life of a ship is not rigorously determined by factors of a technical nature governing structural strength ...

*The decision to scrap a vessel will depend very greatly on anticipated movements of freight rates and the rising trend of repair costs with increasing age ... A sudden increase in the demand for tonnage at a time when new building cannot be increased is likely, therefore, to give rise to some postponement in the scrapping of those types of tonnage in demand, almost irrespective of age. (Parkinson, 1957, p. 79)"*

Author hopes that the marine engineer who sent his query is reasonably satisfied.

*For those aspiring to learn more about the commercial aspects of shipping, it is recommended they become student members of the Institute of Chartered Shipbrokers and pass the qualifying examinations to become full members. Additional information is available at [www.ics.org.uk](http://www.ics.org.uk) and [www.ics.org.hk](http://www.ics.org.hk).*

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