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## Competition Works!

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### SYNOPSIS

In this paper we look in depth at the present structures of the harbour towage industry with regard to competition. We will include discussion of the specific services some operators (claim to) provide; the arguments that some ports are too small for more than one player; the interests of the customers who want to have a choice in a port; the advantages and disadvantages of a monopoly and the costs of competition. We ask if there is a return to profitability and what would be the optimum model to secure the maximum service at minimum cost and where can we find those models. The paper concludes with some recommendations on how best to address these issues.

### INTRODUCTION

Competition indeed does work, many will say – and certainly in a consumer’s market where you want to buy the best product at the cheapest price. Next to the big supermarkets, with many different brands of products competing to get the best place on the shelf, you notice the boulevards for furniture, the streets known for the amount of shoe shops etc. But even closer to us, car fanatics will want to visit the automobile exhibition where all the brands in the world are represented. In business-to-business it is the same story – we only have to look at ourselves here in Vancouver. We see shipyards, naval architects, towing line and engine manufacturers highlighting their best features and their edge over a colleague manufacturer. And why?

The answer is very simple.

They all want to sell their products or services, but the customer who pays the bill decides what he wants, on what conditions and at what price, and in order to come to that decision the customer wants to have a choice. For a long time our industry has thought: “OK, but this does not count for us”. Up came a lot of arguments as to why we as service providers were in the very special position that we, or in conjunction with the port authority, could dictate the terms to port users.

In the present difficult times for the global economy and the maritime industry in particular, we see a lot of public initiatives directed to a (further) liberalisation of ports and specifically in those markets where the recent harvest years for the ports seem to have passed unnoticed. It is not easy in such a situation to change philosophy and as a consequence we notice that old habits are rather difficult to overcome. It specifically concerns those markets where ports are directed by public-, or worse, politically-driven entities and where the marine service provider lies back and ‘enjoys’ a monopoly.

This paper will underline the importance of listening to your customer and in this way ensure the continuity of your business. Some of you will recognise or remember similar situations at home. Others simply will not like it. We want to review the arguments and sometimes justifications for a monopolistic market and compare, in our view, its shortcomings in relation to the open-competition market. We will be looking at the development of the markets after the so-called Tug-War years and the lessons learned.

### MONOPOLY MODEL

A simple definition for a monopoly would be:

*“The market situation in which there is only one supplier providing services to several demanding entities”.*

Reports have been written on the history of port towage and we all know the family-run, one- or two-boat companies, developing into a controlling operator in a port by either buying up competitors or forcing others out of the market. Critics of an open market still use this evolution as an argument in defence of a monopoly, but they ignore the fact that not only have the markets changed, but so have the characteristics of the clients. To mention a few:

- from emotional ship owner to global player;
- a ship has become a financial asset;
- client has become an integral part of an extensive supply chain;
- protection of marketing name and quality service required.

Can any market size justify a long-term monopoly situation? Monopoly situations in our opinion can only persist in those ports where a government or port authority has *regulated* the entrance for a second player. Ports with six or more tugs in operation and

where a monopoly is sustained, should seriously consider reviewing its entrance conditions. Some well known but unacceptable barriers are:

- ‘assure continuation of service’ (as if the historical provider would leave);
- ‘port security is at stake’ (as if the entrant’s service would be below standard);
- ‘OK, but at the same competitive conditions as the incumbent operator’ (its same historically high costs?)

After a long period of a monopolistic towage service in a port, there are all kinds of non-issues being brought up in order to protect the existing situation. Most of the time, the incumbent service provider will have helped to draw up the (protective) entry requirements. It always gives proof of the non-competitive situation of the existing service. In other words, commercially, operationally and certainly not in matters of tariff, the towage provider will be able to meet the conditions of the new entrant. What it in fact means is that the port has not really checked its port entrance cost level with neighbouring competing ports. Comparing the official tariffs does not give a lead to the net price invoiced. Ship owners and container lines, however, can easily highlight the real cost level and on that basis demand the port authority to take action.

In larger *open* towage markets, say six tugs and up, the market will develop into a competitive model thanks to market forces. Below this size of port activity, and in the absence of sufficient market regulation, ports should make sure to license the towage operations in their port with a tender process every five years. There is no need for special protection of the incumbent operator as in principle no specific long-term investment will have to be made. Tugboats are floating assets. Only in the event of very specific port requirements, e.g. assistances to submarines or specialised environmental services, fire-fighting duties etc, could the port consider a yearly compensation in costs.

In smaller ports we would insist upon a licensing model, as the normal cost increase and tariff verification is not sufficiently transparent for the authority and/or client’s representative. There are several examples of this available and not only in towage. What to think about the yearly cost increase for pilotage and mooring services. There is often little attention to economy of scale and other efficiency improvements. Are there requirements for continuous improvements? Penalties when they are not met?

### **Advantages of a monopolistic market**

We have not been able to come up with one serious argument here – in our opinion there are none. Only in the short term may the monopolistic service provider be able to make a very good return. The moment your organisation starts to notice that they are master in the port, the cancer starts and you will only be able to protect your position with the help of (port) authorities

and/or unions. As from that moment you are no longer in control and you will have to fear judgement day from your customers.

### **Disadvantages**

- Complacency/arrogance;
- no commercial development; no need for contracts;
- no market pressure to improve quality of services; no innovation;
- as a result no market pressure to invest (more tugs – more money);
- no bench marking of operational costs in port;
- therefore no basis for CLA negotiations;
- never as efficient as a competitive model;
- having a destructive impact on other maritime activities within the group.

Whether you like it or not, when there is no need to excel or to compete, arrogance will get a foothold in the daily operations. There are a variety of examples most of us know, but for us the most striking remark came from a customer, claiming that in certain ports you really have to plan your ETA in order to avoid all kind of surcharges. Some monopolistic operators still maintain a four-hour notice and surcharges of between 25 and 100 per cent for fog, night (18.00-08.00hrs), weekend, national holidays etc. Clients are not visited and deals are made with local agents, sometimes with a high degree of mutual back scratching. A general sense of commercial and service complacency reigns in the port. From this position, it becomes very difficult, if not impossible, to maintain an efficient organisation. No new initiatives are being undertaken as even the slightest extra effort demanded from employees will have to be negotiated and remunerated. We know of an example where 14 months of salary were paid for 100 days of work.

This development gradually erodes the bottom line and no new investments will be possible without entering into a cost and tariff increasing spiral. Any negotiation for new labour conditions will have a similar outcome – accept or strike. We have seen examples where monopolistic port towage operations with excessive labour conditions, have become pariahs within their own group of companies.

The social pressure together with the demands of the port means that the monopolistic model will develop into an inefficient operation where the ‘entrepreneur’ is increasingly squeezed between public authorities, unions and stakeholders, dreaming of a ‘white knight’ that might save him.

### **COMPETITION MODEL**

As stated earlier, the towage market in the early and mid 20<sup>th</sup> century was characterised by small, mostly family-owned operations with a strong local content. Competition was fierce to the level of survival and therefore risks were taken. It became the first period of tug-wars. It also was the era of real entrepreneurship

as most port towage operators needed extra income. Ship owners and public institutions were offering these opportunities, amongst others with charters overseas.

The maritime commercial development also brought competition between the ports and in order to gain investors and regular calls from shipping lines, competing port service companies were forced to agree on a joint strategy with the port authority. Growth of the markets, demand for investments and weak (financial) management of the smaller towage companies brought about survival of the fittest. In other markets, operational cartels were formed.

In bigger ports in the world, and particularly in Western Europe, monopolies in port towage were established and there to stay for several decades. For new entrants it became more and more difficult as they were not sufficiently local, lacked the backing of an important ship owner, or were just not well-prepared.

While monopolies were showing signs of having reached a state of upward-spiralling costs and downward-spiralling returns, the market started to change drastically with the introduction of the container. The identity of a ship owner, specialised in a certain type of cargo, for a certain market, with all the emotions that go with it, changed rapidly into a box calculating financial and economical wizard, calling into several ports of similar size, with comparable cost structures. This easy port user of before, accepting the social pressure and costs of sometimes five tugs per move, transformed into a cool calculator who discovered that the (operational) costs of the port marine services for his ships were way out of line. He found out that together with the port authority, he not only needed to change the structure of the terminal operations, but also needed to bring back competition in harbour towage. The consecutive years of social demand leading to excessive pay schedules and benefits needed to be brought back to reality. The ship owner and port user became customers again.

Combined with new developments in tugboat engineering, engine manufacturing, propulsion innovation and, last but not least, modern communication, the second tug-war period began.

### **The effects of change from monopoly to competition model:**

- temporary unstable towage market may lead to social unrest;
- temporary eroding of revenue due to massive discounts;
- heavy losses with monopolist due to years of un-attended cost structure.

It is clear that a new entrant in a local market dominated for years by a monopolist with established connections at all levels, will try to gain quickly as much market share as possible. The incumbent operator's organisation will be in disarray most of the

time, not knowing what to expect. Conflicting advice will destabilise the operation even further and setting priorities for a defence or attack is most problematic. They will realise that in the case of a well-prepared intruder it has more to do with damage control than anything else. Reduction in fleet and personnel, combined with an insecure future will be the basis for social unrest.

The new operator gets most of the attention from customers, authorities and press, thanks to a daring project with more modern tugs, supported by motivated crew. A fight for market share will erode revenues and leave tariffs untouched for several years. Multi-port contracts, if applicable, may somewhat share the burden with other operations within the group. This situation will last until a kind of status quo is reached on the basis of the number of units in the fleet and the effectiveness of the measures taken by the historical operator. Is he quickly realising what is happening to his operations? Is he capable of taking immediately drastic measurements to adjust his company to the new reality? Will he manage to keep some of his core clients?

Finally the market will settle again and the advantages of the competition model will become clear.

### **Advantages of a competitive model:**

- differentiation between clients;
- differentiation between providers; seeking expertise;
- continuous improvement;
- development of adjacent services; barge/offshore/ETV;
- leverage in social disputes;
- conditions for subcontracting/increase efficiency.

As the revenue pie needs to be shared between at least two parties in this model, clients will use the commercial advantage this will bring him. A bigger client will demand more discount than the occasional 'one-off. Costs generally go down as negotiations take place directly with the ship owner's head office or regional office and multi-year and multi-port contracts are in favour on both ends. Sometimes customers demand, and the operator accepts, a 50/50 contract share, realising that 50 per cent is better than nothing. It may also not be ideal to have 50 per cent market share consisting of only three customers.

Fleet configuration, expertise and background may also lead to differentiation between service providers. Kotug, for example, has built up a name for handling car-carriers, attending more than 50 per cent of the car-carrier liners in all its ports of operation. Others have historically specialised in tanker-handling etc. It is essential to have a good distribution of types of customers in your portfolio. What would happen to the operations if an important customer was lost? A take-over or merger of one of your clients by a client of your competition? Maersk's take-over of Sealand, Safmarine

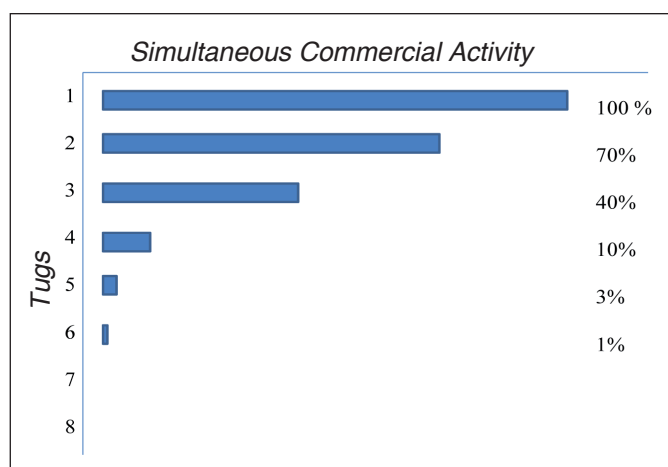
and of P&O Nedlloyd did create havoc for service providers in some markets.

The competition model brings the need for continuous improvement, otherwise the competitor might take advantage and consequently gain more market share. It also stimulates the creativeness and search for alternative use of the tugboat in times when there is less demand, mostly in summer. Barge towing, offshore duties, ETV contracts, parcel service etc can be developed next to the irregular demand for ship docking. The reputation as a reliable service provider needs to be established, also in other types of marine services.

It is clear that the management of port towage companies need to know their fleet utilisation and more importantly, 'what represents a contract with liner XYZ to our operations, in market share, in profitability?'. ILO has presented directives as to sailing and rest times, with important consequences for some operators. All kinds of management tools are being developed in order to bring commercial service availability as close as possible to demand. A tug with idle time brings unrest and gives a downward pressure on tariffs. We all know that all income above the cost of fuel is cash.

In search of finding a solution to the optimum fleet configuration for the towage activities in a port, subcontracting between competitors was introduced. As long as clients team up with each other, filling empty slots on their vessels against a fixed tariff, towage companies should be able to sign operational co-operation agreements. With the aim of assuring the client of the best service at all times, towage companies lowered their cost by deciding to assist the competitor at peak moments, ie on a case-by-case basis.

The following example will explain this reasoning and make immediately clear why the competition model is far more efficient than a monopoly. In the competition model you have a possibility of sharing the inefficiency built into the general service model, i.e. sharing the unpredictable demand at unpredictable times, in unpredictable weather.



Anyone can calculate the economics of a tug which only works 10 per cent of the commercial hours of a fleet during which one or more tugs are simultaneously

commercially active. In this example, the fifth and sixth tug will never break-even but may have to be there, either because of customer demand or because of (social) port regulations, like security – a cost that will eat away your bottom line. In a monopolistic model, you can only share this cost with the client, who will certainly not be pleased. In a competition model you may be able to compensate matters with your competitor. It is better to share and with it reduce the pain, rather than each company staying with inefficient idle time.

But there is a much more positive side to this. In the competition model it even creates money as it generates cash and lowers cost, as generally at least two tugs can be sent to other jobs. It brings the efficiency of the standard fleet to the optimum level, provided that you have made your calculations correctly. In that case, there will be a balance in the cross-utilisation, meaning over a year there should be almost a break-even in the hire-in of tug jobs. The national competition board would have no objections given the fact that the occasional sub-contracting takes place against market tariff based upon a formal agreement between operators.

## GLOBAL SITUATION

If we consider the overall towage market and the way it is structured in the different parts of the world, we see a lot of different models. Fortunately, the complete maritime industry has seen fundamental changes over the past decade. Stronger demand, thanks to economic growth and pressure from ship owners have made port authorities, whether public or private, realise the need for further commercialisation and liberalisation of their services. Towage companies have generally followed suit and demonstrate a more liberal image and have taken special interest in marketing their services. There remain, however, considerable differences around the world – from very open markets to fully-closed shops. Some harbour towage companies are interested to learn from competition. Others fight to the extreme to protect their monopoly.

### A tour d'horizon

In the Far East, markets like China and Japan maintain their specific character, although some changes are noted. In China, next to the publicly run port services, we see some small sized JVs develop, allowing the first foreign tugs to operate in the ports and at terminals. In Japan, all harbour towage operations are rather complex in its corporate structure with many cross-holdings between Japanese ship owners and some private operators. Although companies are said to compete in an open market, in reality it is not as transparent as we are given to believe.

Taiwan has seen its first foreign tugboats operating at specific terminals, based upon a JV with a local company and supported by internationally operating shipping lines. Singapore maritime authority opened up the market in the '90s by giving out five operating permits for harbour and terminal towage, predominantly

to the existing operators and ship yards. Take-overs and mergers have reduced the effective competition to two operators who also are active in Malaysia and in the region.

Australia's harbour towage market has seen some drastic name changes and, as to be expected, competition. As stated before, it is clear that not all ports can sustain more than one towage operator, but in such a case of a 'natural monopoly, it is even more important to avoid an attitude of market dominance.

At the beginning of this decade, there were several signs that clients were irritated about monopolistic pricing behaviour and even national regulatory institutions made investigations and came with specific recommendations. Arrogance was stronger than common sense and with competition around the corner, the classic monopolistic behaviour and follow up of events could be predicted. Now competition is established in the bigger container ports, but also an increased interest from oil and mining companies in the know-how of modern ship handling has urged more newcomers to the Australian maritime market.

Operations in India and Pakistan have become more regulated and transparent in recent years with the creation of private ports and (LNG) terminals. Several contracts have been drawn up with foreign tugboat owners in joint ventures for general port assistance and/or at terminals.

In Latin America, we saw a good deal of competition pressure at the end of the last century and particularly on the west coast. In more recent years in Brazil, apart from the already existing local competition, we see a dominant position being attacked in all major ports. In the Caribbean, positions have been consolidated with fleet renewals in the major ports. Mexico held on to its concession structure in the major ports along both the Gulf and Pacific coast.

The US harbour towage market has traditionally seen little international interest because of the Jones Act restrictions. In general during the last decade, the bigger ports maintained their operational structure with occasional competitive arm-twisting. As far as we can see, competition has, most of the time, been the result of a local or regional quarrel, which eases down after a short time. On occasion, a merger of operations or take-over is the final result.

A great deal of efficiency can be achieved with a so-called operational pool arrangement (ie Houston/Galveston/Corpus Christi). It concerns ports with an additional irregular demand for towage over a large area, like barge towage on the river, next to the standard ship docking operations. In those cases, our example of a subcontracting arrangement has been put into practise, optimising the usage of the total available fleet.

In Europe, the introduction of competition in the north-western ports on the continent had quite some impact

on the historically operating towage companies, but also on the marketing of the industry as a whole. We will comment on this aspect later in this paper.

In the past decade and after the tumultuous '90s, the harbour towage market in Europe has more or less consolidated its position. Exceptions to this statement have been the Baltic, the rivers Humber and Scheldt, Amsterdam and in Le Havre. The operating model in the ports in Italy, France, Spain and UK remain monopolistic to a large extent. Due to pressure of the shipping lines and the reconsideration of national legislation in favour of liberalisation, we have also noticed some changing of positions here. Social restrictions and procedures, as well as legislation as to port security, are being revisited in some of these markets in favour of eliminating artificial competition barriers for harbour towage.

## FROM A PASSIVE PROVIDER TO A MARKETEEER OF TOWAGE SERVICE

This paper would not be complete without paying attention to the introduction of marketing in our industry. The conventional way of providing services to our clients (exceptions make the rule) was pretty much laid back: "This is what you get, this is what you pay, and you can take it or leave it".... New investments were only considered when there was an almost guaranteed return on investment, predominantly motivated by pressure of the client in combination with the port authority, and used as a negotiation element with the unions.

The six modern and strong tugboats steaming up the river Nieuwe Waterweg to Rotterdam in 1987, combined with a publicity campaign, could have been the first signal of a new marketing era. The open fight for the customer's preference was on and towage companies needed to present themselves differentiating from each other in style, colour, culture etc. Talking 'tugknowlogy' to captain's rooms at ship owners' offices and convincing pilots of better moves with fewer tugs, also brought an innovative and creative flow of information.

Shipyards, specialising in standard types of quality tugboats, started to compete with in-house designs. We now know, of course, the result – Hvide Marine's SDM, Kotug's Rotortug, PSA/RA Z-tech, Damen's Stantug etc and some more innovations in the making. We now race to be the first and most innovative in all kinds of green applications, whether or not (yet) economically feasible. In the 16 years that we have been attending the *ITS* conventions we have noticed the increased interest of the different equipment manufacturers in sponsoring this event, stimulating the investments in new developments. Harbour towage as a service has become a **product**.

## THE KOTUG EXPERIENCE

The basis for the successful business plan for the Kotug organisation has been 'listening to the customer'. The

operating structure in the ports did not allow for easy start-up of towage activities, even though there were lots of unsatisfied customers. As a newcomer in the ship docking business, it took several trips around the world to make the plan known to the management of the major shipping lines. Their confidence in the project was underlined by accepting contracts for up to three years and by an important launching customer, who was ready to confront established networks.

The excellent relationship with the customer also opened up opportunities for other activities and allowed the operational department to understand and appreciate the KPI's of each client. The exchange of this information led to improved designs and timely logistics. The biggest reward has been a firm partnership with several customers and also in other ventures and projects for new ports. There is a genuine desire in the Kotug organisation to provide good customer service, as we are convinced that the client is there for us.

Perhaps the biggest bonus of the whole Kotug project was the social development of the crews and crewing in general. Thanks to the same transparent

approach towards our clients and agents, we have been able to become partners with our crews on board. Every Kotug operation is fully national, and long-term working conditions are negotiated with employees' representatives without the interference of national unions. For more than 20 years we did not lose one hour due to social unrest, union meetings etc. This has been a very important asset for our bottom line as well as our commercial relations. As an example, even our competitors in the ports where we operate, have seen improvements in their working relations on board to a degree never thought possible.

## **CONCLUSION**

The towage industry has gone through an important period of development. Technical, nautical and safety improvements are of daily concern to all of us. It is time that we accept the fact that we are offering our customers a product in a modern marketing environment. That environment should also offer the market conditions needed to be able to provide a quality service at a competitive price.

Competition works!