TIPS

POLICY BRIEF

Restructuring ports for improved investment

Policy Brief by Wen-dy Nyakabawo, TIPS Intern. Based on a presentation by Dr Sheila Farrell of Sheila Farrell Associates Ltd and Imperial College London.

INTRODUCTION

The change in the traditional role of ports in the global logistics supply chain has necessitated restructuring in many ports worldwide, leading to the revision of national port strategies as well as the legislative and regulatory environment. These changes have been done to focus on developing partnerships between public and private sectors in port operations (Juhel, 2001). Ports are national strategic assets, which are still mainly public sector owned, but not necessarily public sector operated.

The main objective of the restructuring of ports worldwide is due to their important role as an economic development tool. A relevant example is the Netherlands, where 8% of its gross domestic product (GDP) is port related. However, there are differences in ports worldwide as a result of their geography or market position, the history of their administration as well as policies or institutions governing the ports. According to Van Niekerk (2002), ports have different reasons for restructuring with reasons including improving productivity; obtaining financial independence; rationalising port structure and minimising bureaucratic intervention in decision making; moderating the role of government in the operations of ports to the landlord function only; becoming more business-orientated to be able to compete in the free market; deregulating the labour market; and introducing business-based agreements to attract private capital.

South Africa has embarked on a drive to attract private investment in ports, with the objective of not only acquiring investments but also as a means to build up local expertise and develop capacity. Due to its strong regulatory and legislative framework, as well as solid entrepreneurial culture, South Africa has an advantage compared to many other African countries in attracting private investors. Nonetheless this leads to the question of why there is not more private investment in South Africa's ports. Issues such as labour conflicts and the relationship between private investors and political structures have affected the prospects of private investment in ports. However, according to Dr Farrell, focusing on achieving Transnet's economic objectives and making it more integrated into the national economy could improve private investment in many different sectors. In addition, there are opportunities for Transnet to invest in container terminals outside of South Africa. The country is also well positioned to act as a distribution centre for Sub-Saharan Africa through Free Trade Zone (TFZ) developments.

THE ROLE OF PORTS IN THE ECONOMY

Ports have different functions depending on individual countries' policies and business environment, but their most basic role is in unloading ships. Most countries use ports as logistics service providers, and others have FTZs attached to ports. Some also use ports as nodes for industrial development. Recently there have been redevelopments of city centre ports for other uses, where the focus is on urban regeneration.

Ports are also used as guardians of waterfront land, are responsible for corridor development into the interior, and increasingly ports are involved in exporting their capital and expertise to provide services to other countries. In other countries, ports act as leaders of maritime clusters and attempt to bring together associations in the maritime industry to try and create centres of excellence, which can attract further investment.

PORT RESTRUCTURING OVER THE PAST YEARS

Analysing the basic function of ports in unloading ships over the last 20 years, there has been a major change from service ports in which there is a single port authority that provides the entire infrastructure and services, to landlord ports in which the port authority provides basic infrastructure such as channels and road-rail access, but leases the land to a series of private operators to set up terminals.

October 2013

The main reason for this public-private partnership is to allow in private investment and management expertise. Private investment is essential for ports to increase their access to capital. This may lead to some reduction in public sector budgetary requirement, although the scale of this is debatable. Moving port services into the private sector does not necessarily remove investment requirements from the public sector budgetary system, as the achievement of an increase in competition often results in the need for the port authority to provide the infrastructure for additional terminals. Dr Farrell estimates that if South Africa shifts all of its public services within ports into the private sector, for example, this would save only US$100-US$200 million a year in budgetary requirements, which is not a lot in relation to the total government budget.

EXPERIENCE IN OTHER COUNTRIES

When considering the revenue implications on public sector budget, few countries have managed to privatise all their port services in all ports at the same time. Examples of such countries include Nigeria, Saudi Arabia and Brazil. However, what tends to happen is that ports privatise their container terminals because they generate substantial revenues, which makes them easier to privatise. Many African countries end up with a hybrid port authority, which is partly a landlord port with a private sector container terminal, and partly a public sector service port. Such port authorities are often financially weakened by the privatisation process and this may have adverse effects since it restricts the flow of funds to other port activities, particularly if the proceeds of the privatisation go to the treasury instead of the port authorities.

Another problem that happens when introducing private investment into ports is that few ports focus on introducing tariff reforms before privatisation. For instance, within a service port tariff structure, there is cross subsidisation; with high cargo handling charges, while charges for the basic infrastructure are low.

Private investment in ports generates significant capital inflows from overseas. It is rare for local companies to provide private investment in ports, particularly in Africa. The main area where local companies have invested in ports is South America, where governments in countries such as Brazil for example have favoured local companies over international ones, and which international investors have viewed as presenting many challenges with issues such as restrictive labour practices, policy uncertainty, and corruption. Thus there has been a bias towards local investors in the bidding process. While private investment can lead to capital inflow, the question that arises is whether the objective is only acquiring private investment or as a means of building up local expertise and develop national champions. Malaysia is an example of a country that has had success in local expertise development. It has applied this concept by selecting successfully managed companies within the economy and assigning them to run the ports as well.

One of the arguments for not having private investment is the traditional view that money is always cheaper in the public sector, because the public sector in most developed countries has a good credit rating, is seen as a low risk by banks, and is able to pay back loans from tax revenues. However, public finance is not necessarily cheaper in the port sector in developing countries, particularly for container terminals. South Africa currently has a BBB country credit rating, but several large international container terminal operators have better credit ratings than South Africa, and are therefore able to raise money more cheaply. They are also able to raise money for longer periods and have experience using sophisticated bond issues in which repayments are tailored to cash flows. Large container terminal operators with global portfolios are also able to achieve economies of scale in procurement, unlike Transnet at present.

When focusing on the efficiency of private investors relative to public port authorities, the scales are balanced in the sense that there are exceptional players in both sectors. In the public sector, for example, Singapore and Dubai have public sector ports that are outperforming the private investors, but they are rare. This is because private sector terminals have greater flexibility in staff issues, and in negotiations with the labour unions. Private investors also tend to focus more on developing local managerial skills, by training and sending delegations to their most successful ports to build capacity.

Another key benefit of private investment is it brings about innovation as well as investment in research and development to improve the technology in ports. Changes in technology have resulted in leading ports using sophisticated IT systems. Therefore one of the reasons for attracting private investment to ports, especially container terminals, is to have access to IT technology and knowledge, keeping up to date with developments within the industry.

Private ports tend to have marketing strength and global contracts with shipping lines. They are able to discriminate between customers to a greater extent than public ports, which have to be non-discriminatory and work on a first come first serve basis, providing a standard service and price. Private investors are able to offer different packages to different shipping lines, such as lower prices during

Port of Ngqura near Port Elizabeth *Photo: Coega Development Corporation*

off-peak periods. This allows them to tailor service offerings to suit market conditions while ensuring their assets are highly used.

Private investors can enter into partnerships with shipping lines, and some shipping lines become important terminal operators. This concept has become more acceptable over the past 20 years. Initially, there were great concerns that if a container terminal was operated by a leading shipping line, the other shipping lines would avoid it due to concerns about the commercial confidentiality of data on their customers. Nonetheless this has proven not to be an issue because of strict guidelines applied to commercial confidentiality of data.

Recently, more governments are keen to have shipping lines operating the terminals because it offers opportunities of capturing transhipment traffic. An additional advantage of having private investors operating in ports is that they offer greater security in emergencies, for example in a case of a major accident they are able to bring in equipment and management from other operations.

PORT SECTORS OF PRIVATE INVESTMENT SUCCESS: CONTAINER TERMINALS

It is evident that several countries are restructuring their ports to attract private investments, but how successful have they been? Most private investments have been directed to the container terminals, mainly because they have high financial returns, strong market growth, standardised contracts and they are easy to implement because they have known set of suppliers, assets and resources.

South Africa is focusing on container terminals for possibilities of private investment in the future According to Dr Farrell, the operating structure of container terminals worldwide consists of 65% private operators, 24% public monopoly, 6% public-private and 5% joint ventures (based on a 2008 survey). The public sector terminals are generally in service ports where the container services are integrated with the infrastructure. These are generally smaller than the privately operated terminals, partly because private investors are not interested in small terminals and partly because most of the small terminals are in islands such as Indonesia, Philippines or the Caribbean where there is a big strategic interest in maintaining the container terminal in the public sector to avoid dependence on private operators.

Port authority container terminals that compete directly with private sector terminals within the same port are relatively rare because of conflicts of interest, since port authority – because of its high proportion of shared costs – can adopt a pricing policy that can push the private operator out of business. This is an issue in relation to the port of Ngqura near Port Elizabeth, since the possibility of having a private company compete with Transnet Port Terminals (TPT) – a sister company of Transnet National Ports Authority (TNPA) – is under consideration.

An alternative that combines public and private facilities is a joint venture, the commonly used model in China, Indonesia and North Africa. The public sector in joint ventures is mainly a portfolio investor, but this structure also provides an alternative to regulations. This model strongly depends on the level of trust as well as alignment of interests between the public and private service provider.

	Public sector		Private sector
	Transnet National Port Authority	Transnet Port Terminals	
Marine services	100%		
Containers		97%	3%
Bulk		37%	63%
Break-bulk		78%	22%
Automotive		100%	

Public versus private market share in South Africa in 2010

The container industry has one of the highest levels of global concentration. The top 10 private investors in container terminal operations control 36% of global port container traffic, and five out of the 10 are shipping lines. Large independent operators such as Hutchison Port Holdings, DP World and PSA International typically run about 50-60 terminals worldwide. According to Dr Farrell, their turnovers are similar to the GDP of small African countries such as Ghana (US$40.17 billion), and typically have a capital expenditure of about US$500 million to US$1 billion a year. They are highly profitable, with EBITDA (earnings before interest, tax, depreciation and amortisation) margins of about 35%-45%. These levels of high profitability have caused resentment in host countries such as Tanzania where they have been made public. Political problems arise when the private investors generate huge profits out of local port operations and do not reinvest them in the host country.

SOUTH AFRICA'S POSITION IN RESTRUCTURING PORTS FOR IMPROVED INVESTMENT

In terms of restructuring ports for improved investment, South Africa is progressing slowly in introducing private investment into the ports, although the enabling legislation already exists, which is something that many African countries do not yet possess. Most African countries are plagued by weak legislative and regulatory frameworks, but private investors remain interested in investing in African ports. Therefore South Africa tends to be more attractive to investors since it has the advantage of a strong legislative framework relative to other African countries. South Africa also has a strong entrepreneurial culture, a good banking sector and engineering and logistics companies, but statistics on public verse private market share in South African ports continue to show low levels of private sector participation, particularly in the container sector (see Table).

This poses the important question of why there is not more private investment in South African ports, given the advantages it has over other African countries. One of the main reasons put forward by Dr Farrell as to why there is not more private investment in South African ports is because Transnet is focused on financial rather than economic objectives. During the period in which Transnet was facing huge financial problems, the main objective of the government became to ensure Transnet's financial stability. This phase has mainly been completed, and Transnet is financially stable at present. Therefore, the focus now should be placed more on using ports to achieve national economic objectives.

According to Dr Farrell, too much emphasis is being placed on issues concerning physical cargo handling instead of the economic impact of ports. An interesting example is the port of Rotterdam in the Netherlands, which has annual reports that reveals their shift from just benchmarking itself physically, to having its key performance indicator targets expressed in terms of local value added, employment creation in port related industry and environmental indicators. It focuses on the externalities of ports and the external impact on the economy.

It is unusual that South Africa has an independent ports regulator, since few other countries have them, and only a small number use multi-sectoral regulators. Some countries regulate ports through their competition commissions, but most countries regulate private investors through concession agreements that are enforced by the port authorities using contract law. Regulatory regimes are much weaker in other countries, and the South African regime has been actively interventionist.

One peculiarity of the South African system is that the ports regulator regulates TNPA but not TPT. TNPA is a public institution responsible for port planning, which should be driven by the needs of the economy and its parent ministry rather than the port regulator. Regulation would be more effective if directed towards TPT because the structure of port tariffs reveals that the big ticket item is cargo handling charges. Regulating TPT as well as TNPA would therefore lead to a more flexible ports system that responds better to the needs of the local economy and is able to attract more private investment.

Another key issue in regulating TNPA is that the focus should be on regulating access to port facilities as well as handling charges. This is because a private port service provider that is refused access to the necessary infrastructure by TNPA has no forum in which to appeal.

In the past, there has been some overselling by foreign investors to Transnet and the Department of Public Enterprise, which are naturally wary. However, another reason why there is little private investment in South African ports is because the market is small relative to global standards. It is also growing fairly slowly, with limited scope for capturing traffic from other ports because they are widely dispersed. There are also few opportunities for gateway traffic to neighbouring countries except at Durban. This suggests that it is not only institutional issues but also market-related deterrents that limit the level of private investment in South African ports.

MOVING FORWARD

The two main questions are whether or not South Africa should engage more private investment in ports, and what the long-term role of Transnet should be in the port sector.

A public perception is that there is a significant lack of trust between government and private sector, particularly with international investors. Thus apart from technical issues, the starting point for increasing private investment is improving the political environment in order to cultivate a higher level of trust between international companies and the government. In addition the vision for Transnet is to drive investment, productivity and transformation in the supply of services and to play a more significant role in driving economic growth rather than just optimising its financial performance.

Transnet's view is to emulate the success of Singapore, by applying the model it used for private investment in ports. The aim should not be to only acquire large private investment, but to focus on how to get the best benefits from attracting private sector investment. Transnet's future goal is expanding into emerging markets through developing terminals in emerging African markets to become the gateway to these markets. At home, the question that arises is whether South Africa is ready to absorb or accumulate private investment.

One of the changes taking place in other ports is that concessions are becoming more flexible. So far only a 5% failure rate has been reported worldwide on container terminal concessions. The standard World Bank container terminal concession model was one commonly used,, but there is a realisation by governments that they have different expectations about the outcomes from private investment, so there are attempts to try and adjust contracts to reflect local circumstances.

South Africa can also try to attract pension fund money into low-risk port activities, starting on a small scale. However one major problem with proposals for private investment in South Africa is TNPA's insistence that container terminals be transferred back to the public sector at the end of the concession period, with no compensation to the private investor. This is a major rigidity in the contracts that is preventing more private investment.

LOGISTICS

Another focus area for private investment in ports relates to their role in industrial development. Ports are key nodes in the supply chain, and the possibility exists of them taking charge of the supply chain by becoming more involved in logistics management. Some shipping lines have been successful in logistics management, for example. However, most port authorities that have looked into logistics have backed off due to lack of global outreach, conflicts of interest with freight forwarder customers, high levels of competition, government policies which favour rail transport, and lack of precedents.

Back of port logistics parks are now common, and are good for small private investors because they require relatively small investments that can be rolled over on a revolving fund basis. They are also attractive for pension funds because they have low risks, although returns are not that high, and because joint ventures with property developers can be set up. However, land needs to be reserved for further expansion, and port authorities are often reluctant to leave land idle for long periods of time.

FREE TRADE ZONES

Ports are often used as focal points for Free Trade Zone (FTZ) developments, but are FTZs useful as economic development tools and are ports the right organisations to develop FTZs?

Over the past 60 years, FTZs have evolved from being trade-oriented tax havens in the pre-1960s, to using low-cost labour for manufacturing in the 1960/1970s, before becoming distribution and logistics centres in the 1980/1990s, with strategic location becoming more important than cheap labour as a success factor. Currently FTZs are developing into high-tech service centres, attracted by an enabling business environment.

FTZs have become a standard part of a port, but their tax advantages have decreased following global trade liberalisation. In terms of employment, every FTZ is different in its ability to create jobs.

South Africa is strategically positioned to perform as a distribution centre for Sub-Saharan Africa. It is surprising that a FTZ attached to a port has not been developed yet, particularly given the availability of land in the Saldanha and Richards Bay areas. According to Transnet, discussions are in progress concerning the developing of the Richards Bay area.

South Africa can benefit from an FTZ because it has a large market on its doorsteps compared to other African countries, a crucial success factor in becoming a gateway to regional markets. However complexities and inefficiencies in customs procedures may make it difficult to have a world-class FTZ in South Africa.

SOUTH AFRICA'S POSITION IN LOGISTICS AND FREE TRADE ZONES

The existing integration of ports and railways provides opportunities but not incentives for the development of world-class logistics in South Africa. The physical and institutional structures already exist. However, Durban and Cape Town ports are not spacious enough to develop conventional back-ports logistics zones, although Asian-style high-rise warehousing could be developed. The land reserved for Distripark-type development behind the container terminal at Ngqura is reasonable in scale, but there may not be enough industrial land overall if Ngqura is successful in attracting port related industry.

According to Farrell, there are opportunities for developing FTZs at Saldanha and Richards Bay, but the major issue is who is going to develop and pay for them, and drive the marketing. A dynamic and dedicated team is required to head these developments. Non-transport agencies such as South African Revenue Services, the Department of Home Affairs and provincial and city government also have an important role to play in developing FTZs.

CAPITAL AND SERVICES EXPORTS

In terms of exporting capital/investment and services, Transnet could consider going into other African countries to sell its services. One of South Africa's big selling points is the integration of rail and port system in Transnet. South Africa has a unique experience of developing and managing railway infrastructure in association with ports, which is lacking in most private investors, while many of the big port projects coming up in other African countries are linked to the development of multi-modal transport corridors from the coast to land-locked countries in the interior.

An issue that is hindering the export of port investment and services is the political acceptability of state-owned enterprises in other countries. South Africa's relationship with other African countries is also a sensitive issue, so Transnet's marketing drive needs to be selective, and able to distinguish between countries which would welcome its expertise and ones which are not so keen.

South Africa also has a mixed reputation for port performance, with world-class ports in Saldanha and Richards Bay, which have an excellent reputation worldwide. However, it also receives bad publicity because of labour issues and strikes at Durban. Transnet is currently getting advice from the Dutch government about labour issues and how to improve South Africa's image in the rest of the world. Its limited experience of working in competitive commercial environment also places Transnet at a disadvantage.

There might be opportunities for private South African companies to invest in other African countries if Transnet does not want to do so. Companies such as Grindrod are already investing in nearby countries such as Namibia and Mozambique.

CONCLUSIONS

South Africa is strategically positioned to experience significant success in the restructuring of ports for improved investment. If the focus is placed on broader economic objectives and not only the physical handling of cargo at ports, there will be an increase in private port investment. Attention should also be paid to strengthening the level of trust between government and the private sector, particularly international investors. There will be opportunities for investing in container terminals, as well as FTZs in the Saldanha and Richards Bay areas, which will help develop South Africa as the gateway to other African markets.

REFERENCES

Farrell, S. 2013. *Restructuring of Ports for Improved Investment.* Powerpoint Presentation, Sheila Farrell Associates Ltd

Juhel, M. H. 2001. *Globalisation Privatisation and Restructuring of Ports.* International Journal of Maritime Economics, 3,139-174

Van Niekerk, H. *Ports Restructuring, Policy and Regulation: The South African Case.* Department of Logistics University of Stenllenbosch

**TIPS is a non-profit company (NPC) based in Pretoria, South Africa.
The organisation facilitates policy development and dialogue in pursuit of sustainable and inclusive growth.**

info@tips.org.za +27 12 431 7900 www.tips.org.za