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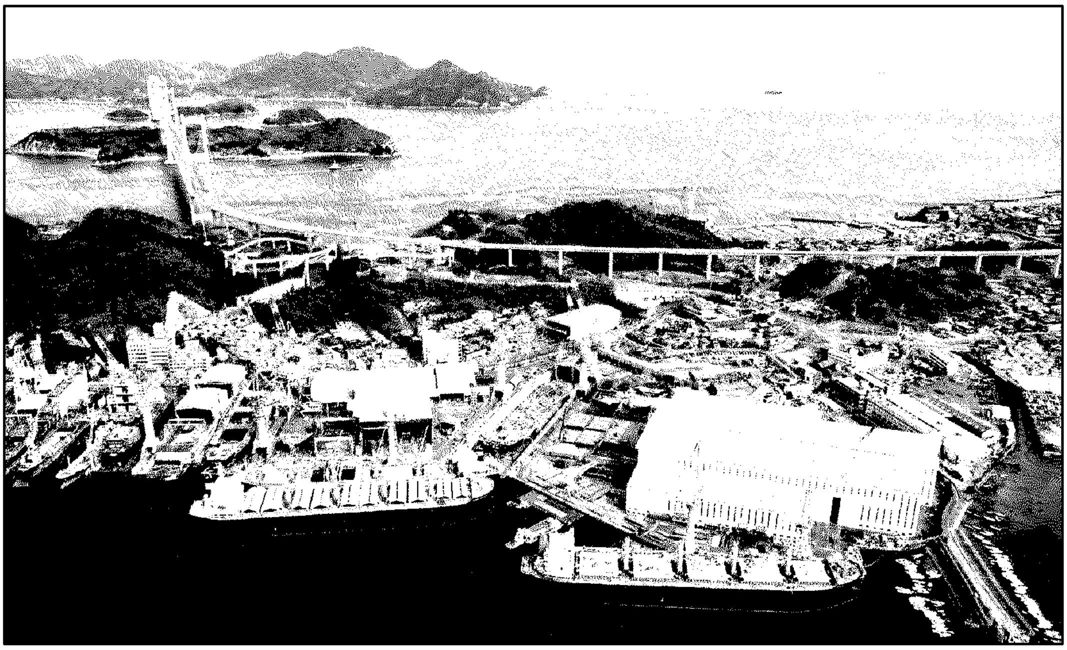
Is this the end of the line for Japan's maritime cluster?



Imabari Shipping's shipyard and headquarters in Imabari city, Ehime prefecture, Japan. Bloomberg

Building a successful shipping cluster can take decades — just ask Singapore. But unravelling one is much faster, as Imabari may be about to find out

COLUM MURPHY – HONG KONG

KATSUYA Abe pours me a beer almost by reflex. It is a gesture of hospitality by the president of shipping company Nissen Kaiun, engrained, no doubt, by years of fostering close ningen kankei, or human relations, on which Japan's self-proclaimed maritime heartland, Imabari, is formed.

For generations, shipowners, shipbuilders, ship parts manufacturers and their financiers have coexisted in a cosy symbiotic relationship that propelled Japan into the highest ranks of the global maritime industry.

Imabari is home to 60 Japanese shipping companies that are involved in international seaborne trade.

Together they own 830 ships, or roughly one third of the nation's 2,535 vessels involved in international shipping. Another 217 companies are engaged in domestic shipping, owning 5%, or 279 ships, from the 5,609 vessels engaged in domestic trade.

Yards located in the city or with headquarters in the city account for 30% of the Japan-produced ships.

It is an impressive position and one that makes Imabari one of a handful of true maritime hubs in the world. But all that could change. Several forces are combining that could see the intricate ties between the industry players weaken and fall apart as they feel compelled to venture overseas in an attempt to secure long-term survival.

Leading the charge is Capt Abe himself. He is among a number of so-called Imabari owners that are giving serious consideration to moving their businesses offshore from Japan, to Singapore, Hong Kong or other locations. "About one third or one quarter of Imabari shipowners needs to go out [leave Japan]," he said.

Prominent ship financier Hajime Tsuji, president of Anchor Ship Investment, said the theme of moving offshore has been debated for quite a while. "Some visionaries have already made the move. Now a bigger number of people are coming to a similar conclusion," he said, and agreed the current situation was a kind of "tipping point".

Typically, owners list several reasons why they feel the urge to move offshore, but underlying nearly all of their neat rationales is one issue: tax. A desire to reduce tax, however, is just one manifestation of the need to cut costs in the face of the ongoing crippling effect of the yen's appreciation and other cost pressures.

As operating costs increase and profitability comes under threat, Imabari's shipowners face an increasingly severe environment.

Japan's renewed concerns of economic downturn following the March 11 earthquake and tsunami only serve to compound this.

That said, the country's taxation system remains a "handicap" in Capt Abe's eyes, and could be catalyst that spurs a group of Imabari owners to move abroad.

Corporate taxes in Japan of around 40% were reduced by five percentage points in the fiscal year that began April 1, but in the wake of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the March 11 earthquake, it remains to be seen how sustainable the cuts are. Even so, the rates are still relatively high and will continue to be the key concern for Japanese shipowners.

While the Japanese government introduced a tonnage tax recently, critics say it does not go far enough because it only covers Japanese-flagged vessels and owners continue to lobby for the tonnage tax to be extended to foreign-flagged vessels.

Because Imabari shipping companies tend to be family-run, inheritance tax is also a consideration, especially as many long-time industry players prepare to pass the helm to their heirs.

It is not surprising, then, that Japanese shipowners are looking at Singapore in amazement. There, not only is the corporate tax rate much lower, at around 17%, but also companies in the maritime sector can qualify for further incentives under the Maritime and Port Authority of Singapore's Approved International Shipping Enterprise scheme.

Companies approved under the AIS scheme are tax exempt on qualifying shipping income for 10 years, and the status is renewable subject to terms and conditions, according to MPA.

Moreover, in its latest budget in February 2010, the Singapore government extended its incentives for the maritime community by introducing tax exemption for interest payments on loans to build or buy ships as well as expanding the scope of Goods and Services Tax zero-rating for repair and maintenance services performed on ship parts and components.

But, if high tax rates are pushing Imabari shipowners out of Japan, fear of the unknown is holding them back.

In order to avoid paying Japanese tax, any new entity set up by Japanese shipowners overseas needs to be completely divorced from its Japanese operations or run the risk of being targeted for audit by the Japan tax bureau. But there is much ambiguity as to what exactly will and will not satisfy the Japanese authorities in this regard.

Hiroshi Sato, general manager of Japanese trading company Itochu's marine department, said that while the requirement is that the overseas entity be a "substantial, independent body" that is removed from any Japanese organisation, there still was no assurance that a company would not be charged by Japan's tax office. "No one is 100% sure," he said.

Setting up companies that are not linked legally to Japan brings another critical challenge to the fore — finance.

One Singapore-based banker with a Japanese institution, who said he considered Imabari shipowners more as financial investors than actual shipowners, explained the typical process for moving offshore would probably entail the sale of ships at market price to the newly-established foreign entity or a special purpose vehicle. Since, strictly speaking, this new entity is an entirely new organisation it has no track record, making it difficult at times to secure finance and almost impossible to do so at the same rates and conditions that the Imabari owners have become accustomed to over the years.

Despite these concerns, Cap Abe considers such a move overseas as a "must" for his company. He said his company is in talks with Singapore's MPA, but has also not ruled out Hong Kong or "somewhere in Europe". Capt Abe said he expected to be able to take first steps towards a move overseas within a year. "We are now discussing with the banks," he said.

Japanese trading company Mitsui Bussan is also thought to be part of the talks.

Other owners, while in agreement that a move overseas is needed, are not convinced that the timing is right. Yoichiro Seno, president of Imabari-based Seno Kisen, believes the next generation of Imabari shipowners should be the ones to take that move.

He said tax reasons were the main incentive but raised another financing concern frequently voiced by Imabari owners, namely how to survive in the financial environment where owners must come up with 30%, sometimes even more, of the ship's price themselves.

For years, Imabari owners have been sheltered from such loan arrangements, considered typical in most other countries. Instead, buffered by long-term charters from Japan's big three operators, and courted by the country's large trading houses as well as by the yards, owners enjoyed a privileged relationship with local banks in which 100% financing was not uncommon.

Now Imabari owners who decide to set up abroad will need to face new realities, including how to come up with large portions of equity.

"If you go international you will have to compete. You will not be as insulated as before," said Christoph de Buys Roessingh, principal with Roland Capital, a provider of financial services to the maritime industry.

The source at the Japanese financial institution in Singapore said he was worried that Japanese banks in overseas markets might be tempted to step in and help out Imabari owners by giving them terms and pricing similar to those in Japan.

That would be regrettable, the banker warned, as margins should be based strictly on risk.

He added that there was a limit to how accommodating the loans to Imabari could be, as local financial supervisory bodies would be keeping a close watch. ■

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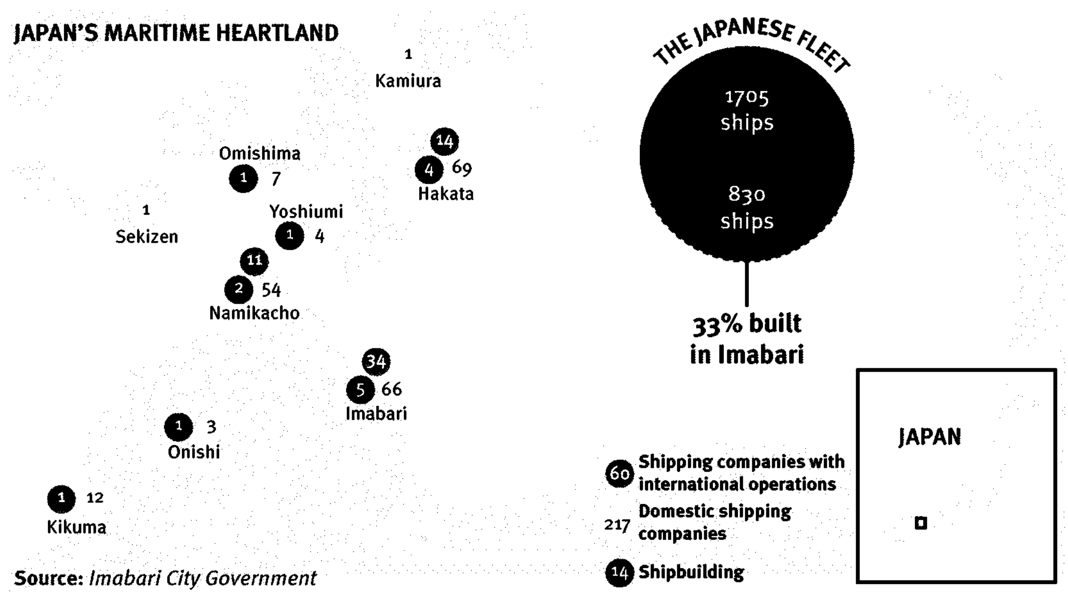
Hajime Tsuji, Anchor Ship Investment

Stay or go? Imabari builders' dilemma



IMABARI shipowners are not alone in their pursuit of survival by moving overseas, their friends in the shipbuilding industry are also grappling with that option, *writes Colum Murphy*.

In fact, the move offshore has already begun to take place, with Tsuenishi Shipbuilding leading the way. Strictly speaking, Tsuenishi is not from Imabari. Instead, its head office and Tsuneishi yard is located in Hiroshima on the main island of Honshu, while its Tadotsu yard is located nearer to Imabari in neighbouring Kagawa prefecture, on the island of Shikoku.

Tsuneishi was the first major Japanese shipbuilder to establish a yard in the Philippines. Established in 1994, Tsuneishi Heavy Industries (Cebu) is on a site of 1.5m sq m and employs around 550 staff in shipbuilding and ship repair.

The company also has facilities in China, where Tsuneishi (Zhousan) is engaged in shipbuilding, manufacturing of accommodation and large outfitting components, and manufacturing of ship blocks. Located on a 1.3m sq m site, the facility employs around 610 staff.

Katsushige Kambara, president and chief executive of parent Tsuneishi Holdings said the combination of yards located in Japan and overseas yards allowed Tsuneishi to be cost competitive while at the same time delivering 'Made in Japan' quality. He said the company had a long history of overseas expansion, including failures in Papua New Guinea and Uruguay. "Making large overseas investment entails a lot of risk," he said. "That could be why there is a reluctance among Japanese shipbuilders to venture abroad."

That will change he said, as the yen's appreciation forces more and more Japanese yards to explore overseas production options.

However, not all agree that moving offshore is the way to go.

Shipowner Cesare d'Amico, chief executive of Italy's d'Amico Societa di Navagazione, said if shipbuilders move too much of their activities overseas, they risked losing focus.

He cited the case of an unnamed South Korean yard that had set up a shipbuilding facility from scratch in China. "It has not been so successful," he said.

The biggest builder in Imabari is Imabari Shipyard headed by president Yukito Higaki.

Hiroshi Sato, general manager of Japanese trading company Itochu's marine department said Imabari appeared to have "no intention" of moving substantial components of its shipbuilding processes overseas.

Mr Sato said Imabari Shipbuilding recognised that one of its core differentials was its network of excellent subcontractors at home in Japan.

"Once Imabari Shipyard goes out of Imabari they would lose that competitive advantage," he said. ■

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