

Is Sri Lanka's logistics hub steaming ahead?

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Sri Lanka has the potential to become a South Asian logistics hub. In fact, it's an opportunity that is hers to lose. She commands a strategic location adjacent to one of the world's busiest shipping-lanes (which by some estimates accounts for over half of global container traffic) and at the mouth of the vast Indian market. Already many of the ships sailing between East and West offload their Indian cargo in Colombo, rather than spending time sailing and offloading at Viskhapatnam or Chennai. So much so that Indian cargo accounts for 75 percent of Colombo port's trans-shipment.

The 2010 Mahinda Chinthana – Vision for the Future policy and the Central Bank's recently released roadmap rightly recognized these tremendous opportunities. They envision making Sri Lanka the region's maritime and aviation transport hub. Over the past years, some of these ideas were implemented and key steps were taken in that direction. Chief among them are efforts to triple Colombo port's capacity, which has already increased by over half since the Colombo South harbour opened last July. In addition, enabling Colombo to berth container ships that most other South Asian ports can't handle was also a timely move.

The vision was sound and some important progress was made. But upgrading physical infrastructure alone is not enough. Building capacity is easy, making sure that there are buyers for it is not. Sri Lanka becoming a logistics hub will not depend on it increasing capacity faster than its competitors; rather, it will depend on increasing demand for its capacity faster than competitors. So the important question to ask is whether Sri Lanka's competitiveness has increased?



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The UAE, Singapore and Malaysia are all key trans-shipment hubs for Indian cargo. If Colombo doesn't improve faster than these alternatives, the chances are that it won't succeed in becoming a logistics hub. Indian ports are competitors too; if their efficiency increases dramatically some of Colombo's cargo could be routed directly to India.

Sri Lanka competitiveness isn't increasing

One way in which competitiveness can be assessed is using the World Bank's International Logistics Performance Index. This index, which covers 160 economies, is a worldwide survey of multinational freight forwarders and the main express carriers. It is useful for two reasons. First, it tracks perceptions of the main clients and potential clients of Sri Lanka's hub. Second, the index assesses logistics competitiveness holistically – not just looking at infrastructure.

The good news for Sri Lanka is that its rank on the index hasn't declined in the last seven years, the bad news is that hasn't improved much either. A cause for greater worry, especially considering the significant expenditure on infrastructure, is Sri Lanka's decline in the last two years – from 81st in the world to 89th. This does not bode well for its logistics hub plans. If Sri Lanka is serious about becoming a logistics hub, it should aspire to becoming more competitive than its regional competitors. One way in which it can demonstrate that commitment is by ranking higher than India and Malaysia or at the very least rising to the top 50 countries on the index.

This is far from impossible or even difficult. Sri Lanka jumped 56 places in only two years between 2010 and 2012. Beating India requires an improvement of only 35 places.

Physical infrastructure isn't enough

Looking at the index's sub-indicators gives us some insight into how that can be achieved. Sri Lanka's fall is largely explained by declines in its international shipments rank – from 50th in 2012 to 115th in 2014 – and its infrastructure rank. The international shipments rank is based on the “ease of arranging competitively priced shipments”. Sri Lanka's prices are not greater than its competitors and according to the Domestic Logistics Performance Index (distinct from the international index) have not changed much over the last two years.

Therefore, the problem lies with the ease of arranging shipments. Here again the

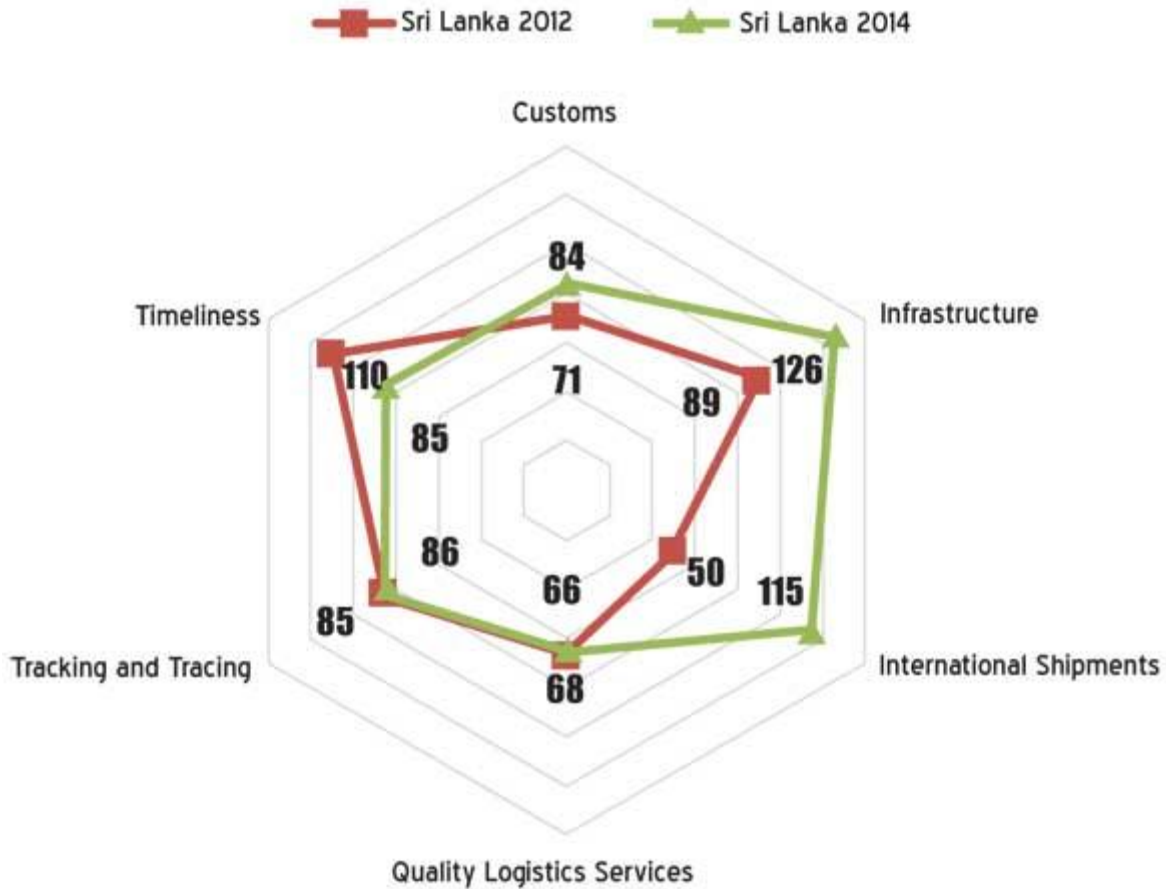
Domestic Logistics Index is instructive. One factor that might help explain the decline is the increase in the number of physical inspections (rather than scanner inspections). In 2012, 33 percent of shipments were physically inspected. This figure increased to 49 percent in 2014. Singapore, a world logistics leader, by contrast only physically inspects 5 percent of shipments.

Another driver of Sri Lanka's decline was its falling infrastructure rank. Considering the considerable investment in physical infrastructure this is puzzling. Two factors could explain this decline. One is that Sri Lanka's infrastructure is perceived relatively less well compared to its competitors – this perception could partly be a result of poor marketing.

For example, Sri Lanka is not home to any major third party logistics providers but 20 of the top 25 have their regional or global headquarters in Singapore. Second, infrastructure cannot be limited to physical infrastructure. Technology and IT infrastructure needs to improve too. For example, unlike Singapore, which has enough scanners to scan all its cargo, the Colombo port doesn't have the capacity to scan much of its cargo (which may also explain the rise in physical inspection). Similarly, despite promises for over a decade now, customs and clearing procedures are still not fully automated. Therefore, focusing on soft infrastructure may be as important or more important than hard infrastructure.

While the above can help stave the decline, if Sri Lanka is to become a hub and get ranked in the top 50, it needs to improve its rank on other sub-indicators too. One important observation is that Sri Lanka's quality logistics service rank, which is the domain of the private sector is ranked highest compared to other sub-indicators, which are largely controlled by the government.

EXHIBIT II: INTERNATIONAL SHIPMENTS, INFRASTRUCTURE RANK DECLINES



The way forward

Sri Lanka clearly has the potential to become a logistics hub. Expanding supply through capacity expansion is an important necessary step. But it is not enough. To be poised for success Sri Lanka needs to generate demand. Demand cannot be created by capacity alone; it requires making Sri Lanka competitive on factors that matter to global logistics players. Investment in soft infrastructure, including IT and process reform must be as much of a priority as buying new berths and gantry cranes. Sri Lanka's future in logistics will depend on it.

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