

FARSTAD SHIPPING

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1 Introduction

1.1 About Farstad Shipping

Farstad Shipping ASA is a major international supplier of large, modern offshore support vessels. It has a fleet of 57 vessels and currently has one vessel under construction. It is headquartered in Aalesund on the North West coast of Norway. It has offices in all major ports of the world including Aberdeen in Scotland, Melbourne in Australia, Singapore and in Macaé in Brazil. Through a joint venture it also has presence in Angola. In 2008 the freight income was earned in the following markets: 16.0% in Norway, 14.0% in the UK, 45.0% in the Far East/ Australia, 19.0% in Brazil, 6.0% in West Africa and Mexico. Farstad Shipping has been listed on Oslo Stock Exchange since 1988 and has over the years given the shareholders a competitive return on their investment. The number of outstanding shares is 39 million out of which approximately 46% is owned by the Farstad family (Farstad Shipping, 2009).

1.2 Brief History

The shipping company Sverre A. Farstad & Co was established in 1956 by Consul Sverre A. Farstad and the ship-owners Ole Schrøder and Sverre Farstad jr. The first vessel, an ore carrier of 10 500 DWT, was ordered the same year from Haugesund Mek. Verksted. In early 1988 Farstad bought the "empty" company Hemes with the purpose of being quoted on the Oslo Stock Exchange. Soon after the acquisition of Hemes, parts of the Farstad ship owning interests went public through the introduction of Far Shipping A/S to the Oslo Stock Exchange. Far Shipping A/S later changed name to Farstad Shipping ASA. The company became an integrated shipping company in the year 1993 and in 1997 it established a JV with P&O, which was followed by a

JV with Petroserve in 1999. In subsequent years the company has expanded its operations in the Indian Ocean and set up offices in Singapore and West Africa.

1.3 Core Values

In order to understand the strategy of Farstad shipping it is important to note the values which are imbibed in the employees of the corporation. They are the following

Safety Minded: The company believes that all its employees should be trained in basic safety measures and drills. It wants to be a responsible employer where the services rendered to the client are done with compromising the safety of the employees

Value Creative: The Company wants to create value for all its stakeholders including employees, shareholders, customers and the society in general.

Reliable The Company believes in owning up to the decision it has taken and believes in exercising a high sense of integrity

Inclusive The Company wishes to be individual focused taking into account their different needs through sharing knowledge and experience.

Visible and Transparent: The Company wishes to stand with its customers and clients in their endeavors. It also wishes to support the local community.

1.4 MISSION AND OBJECTIVES

Farstad Shipping's wishes to be a long-term, major supplier of large, modern offshore supply vessels to the oil industry worldwide. It also endeavors to achieve the following

1.4.1 Core Focus

- Anchor handling tug supply vessels (AHTS) larger than 10000 BHP and platform supply vessels (PSV) larger than 2000 DWT.

1.4.2 New Areas:

- Focus on the supply vessel market which is most complex in terms of advance and large amount of tonnage
- Target subsea and construction activities leveraging the experience gained. This would allow the company to support its clients forays into this area

1.5 Financial Overview

The company achieved in 2008 operating revenues of NOK 3,019.7 million, which is the highest in the company's history. The result after tax amounted to a profit of NOK 1,225.6 million (NOK 89.3 million deficit) after the recognition of NOK 316.3 million in tax income, of which NOK 317.8 million came from the reversal of the environmental portion associated with the new tax regime in 2007.

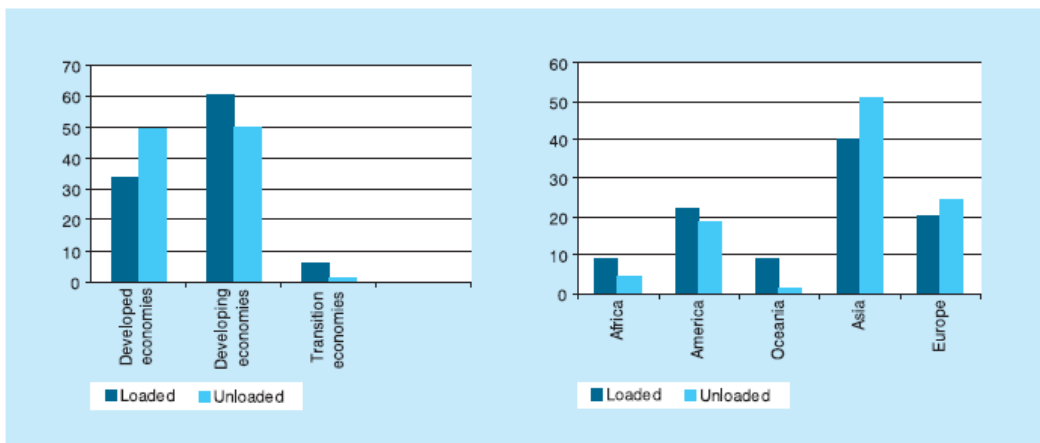
In Q-2 2009 the company had a had an operating income of NOK 839 mn as compared to an income of NOK 662 mn. The profitability as measured by EBIDTA also improved considerably to NOK 451 mn as compared to NOK 346 mn in the previous year. The PAT for the quarter was

NOK 366 mn as compared to NOK 225 mn in the same quarter previous year (Fastard Shipping, 2009).

2 Industry Analysis

Due to the global economic slowdown the seaborne trade grew at just 3.5% in 2008 as compared to 4.5% in 2009. However the past trends continue where the developing regions offered the maximum loading accounting for 60% of the tonnage and developed countries had 33.6% of the tonnage. The overwhelming dominance of Asia was quite start with it controlling almost 40% of the trade.

World seaborne trade, by country group and region, 2008
(percentage share in tonnage)



Source: Compiled by the UNCTAD secretariat, on the basis of data supplied by reporting countries, ports and specialized sources.

Development of international seaborne trade, selected years
(millions of tons loaded)

Year	Oil	Main bulks ^a	Other dry cargo	Total (all cargoes)
1970	1 442	448	676	2 566
1980	1 871	796	1 037	3 704
1990	1 755	968	1 285	4 008
2000	2 163	1 288	2 533	5 984
2006	2 648	1 888	3 009	7 545
2007	2 705	2 013	3 164	7 882
2008 ^b	2 749	2 097	3 322	8 168

Source: Estimated by the UNCTAD secretariat, on the basis of data supplied by reporting countries, ports and specialized sources. Data have been updated to the most recent available.

^a Iron ore, grain, coal, bauxite/alumina and phosphate.

^b Preliminary.

2.1 PEST Analysis

2.2 Economics

2.2.1 GDP Growth

The global GDP growth in 2008 has slowed down to just 2.0 percent as compared to 3.7% last year and below the annual average of 3.5% recorded during the period 1994-2008. World output has contracted by 2.7% in 2009, first time ever since 1930. Since the demand for maritime

transport is dependent on global growth in production, the maritime industry is also expected to suffer the fall out of this fall in demand.

Developed countries are the ones which have suffered the most in terms of GDP growth with a decrease in GDP by 4.1 % in 2009. Developing countries however continued to expand output by 5.3% in 2008 down from 7.3% in 2007. China continued to lead, with its GDP growing by 9.0 per cent. Other major countries such as India and South Africa continued on the growth trajectory although at a slower rate of growth (UNCTAD Report 2009).

2.2.2 Impact on Merchandise Trade

The decrease in the global output worldwide has had a material impact on the growth in world merchandise trade. Although the volume in 2008 grew by 2% this was 4% points lower than that in 2007. In most of the previous years the growth in global trade outpaces the growth in GDP, however this year the same was not noticed.

In 2008, the American export volumes grew by a meager 1.5% while the European Union registered the slowest growth ever. There was a rapid decline in imports as well, with US hitting -2.5% and the EU a negative 1% (UNCTAD Report 2009).

Growth in the volume ^a of merchandise trade, by geographical region, 2006–2008
(percentages)

Exports			Countries/Regions	Imports		
2006	2007	2008		2006	2007	2008
8.5	6.0	2.0	WORLD	8.0	6.0	2.0
8.5	5.0	1.5	North America	6.0	2.0	-2.5
7.5	3.5	0.0	European Union (27)	7.0	3.5	-1.0
1.5	4.5	3.0	Africa	10.0	14.0	13.0
3.0	4.0	3.0	Middle East	5.5	14.0	10.0
4.0	3.0	1.5	South and Central America ^b	15.0	17.5	15.5
13.5	11.5	4.5	Asia	8.5	8.0	4.0
22.0	19.5	8.5	China	16.5	13.5	4.0
6.0	7.5	6.0	Commonwealth of Independent States (CIS)	20.5	20.0	15.0

Source: WTO press release: World trade 2008, prospects for 2009. March 2009.

2.2.3 Trade Finance

Trade finance is a key influencing factor when it comes to the maritime industry. In fact experts believe that this unmet need of trade finance is the key reasons for a rapid decline in maritime activity with the advent of the financial crisis. Banks have become conservative in issuing letters of credit and other instruments which facilitate trade. This has had a considerable impact on the trade particularly amongst developing countries. The unmet need for trade finance is estimated to be USD 100 bn to USD 300 bn annually (UNCTAD Report 2009).

2.3 Political

2.3.1 Efforts by Government to Stimulate Economy

A global economic recovery and by extension, a recovery in merchandise trade and demand for maritime transport services will depend on actions by world governments to stimulate investment and consumption and thus promote trade. (Scott and Jefferrey 2007)

Governments individually and as part of the G-20 have taken action to revitalize the economy. In the G-20 meet in April 2009, they agreed on a \$1.1 trillion support effort with \$250 bn out of this attributed only to trade finance. Countries such as India and China have lowered interest rates to stabilize financial sectors and stimulate the economy (Harrigon and Deng 2008).

2.3.2 Security at Sea

A key challenge facing the maritime industry has also been the safety of the maritime vessels at sea. This has been challenged by a surge in piracy incidents in key strategic transit points such as Gulf of Aden. These incidents of piracy have a considerable impact on ships, crew and cargoes and on the maritime industry. It threatens global seaborne trade (over 80% of trade moving through the Gulf of Aden is In addition to the direct impact on ships, crews and cargoes, and on the maritime industry and governments, piracy threatens global seaborne trade (over 80 per cent of seaborne trading moving through Gulf of Aden goes to Europe). This spurt in piracy has led to high insurance costs for the ships passing through the Gulf of Aden with the war insurance premium climbing to USD 20000 per ship from USD 500 bn year ago. (Clark 2007)

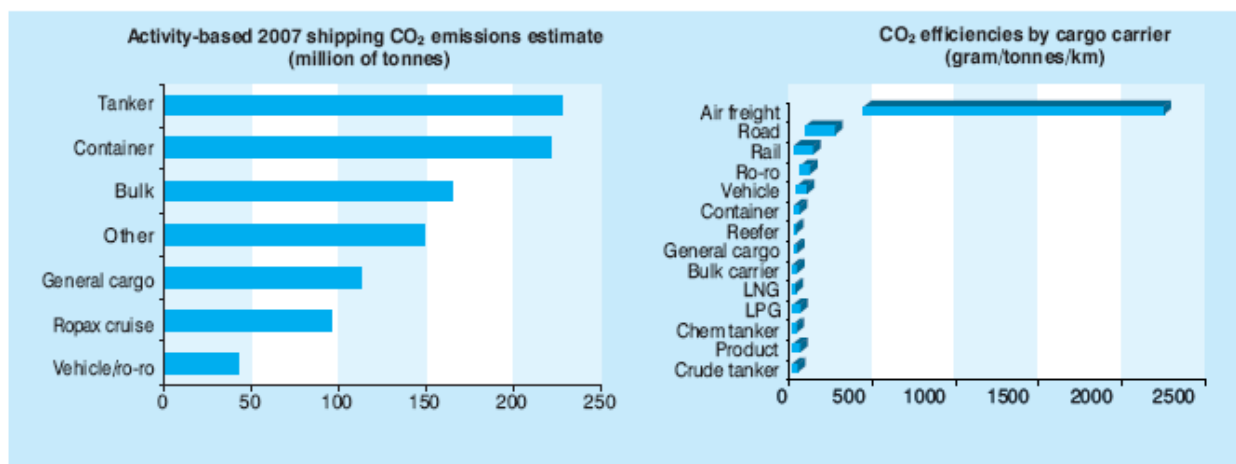
2.3.3 Climate Change

The issue of climate change has been becoming increasingly important. There has been compelling scientific evidence about the seriousness of the threat which has moved the issue to the forefront of the international agenda. The impact has been more significant in the more vulnerable countries. Maritime transport as a major transportation industry also has a role to play given the fact that by volume it carries over 80 per cent of global trade, has a role to play in addressing this formidable challenge.

International maritime transport faces a dual challenge. As a transportation sector it's a contributor to the greenhouse gas emissions and thus faces ire of environmentalists. It is also

directly impacted by the climate change factors such as rising sea levels, extreme weather events and rising temperature. The wide ranging impact climate change is likely to have on maritime transport and the implication for trade growth and development need to be addressed by integrating this in the strategy planning process for a maritime transport company (UNCTAD 2009).

Shipping sector CO₂ emission and CO₂ efficiencies by cargo carrier (gram/ton/km)



Source : UNCTAD, based on IMO 2000 Updated On Greenhouse Gas Emission from Ships, 2008. Includes international and domestic shipping and excludes fishing and military vessels.

2.4 Technology

2.4.1 Dependence on Oil

Maritime transport industry relies on oil, in particular on heavy grade fuel oil for propulsion. Although there is a possibility of using alternative energy sources such as wind and solar power for giving additional power to the ship. LNG may be used as an alternative fuel in shipping; however it also faces the challenge of being stored aboard.

2.4.2 Emergence of Green Ships

Evergreen Line a company which runs shipping operations worldwide has introduced green ships which are much more fuel efficient and technology advanced to meet the challenges posed by climate change. These include following distinct features

1. Alternative Maritime Power: Connects to alternative power from shore to reduce air pollution during loading/unloading
2. Superior Hull Design: This improves speed and reduces fuel consumption to make the ship more efficient.
3. Waste Storage Chambers: Treats garbage to maintain excellent sanitary condition.
4. Low Sulfur Fuel System: Reduces emission of SO_x gasses to prevent air pollution

(Clark et al 2005)

2.5 Social and Cultural Factors

2.5.1 Demographic Change:

It is to be noted that the consumption driven economies of Europe and North America have shown sign of slowing down. Although the issue in North America is primarily due to the after effects of the financial crisis, the situation in Europe maybe even more complex. This is primarily due to the rapidly ageing population. A rapidly ageing population usually points towards a shift away from a consumption driven economy and a stable or declining population growth rate. This is in contrast to the population composition in China and India which is mainly young, with almost 50% being under the age of 30 years. This demographic shift in population is bound to influence maritime trade which is likely to get a boost in these countries.

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3 Analysis of Farstad Shipping

3.1 Strengths

3.1.1 Strong Order Book

1. The company has been awarded a four year contract with Petrobras in Brazil. Startup of the contract was end of January
2. The company has been hired to provide charter services for a period of 12-15 months to support drilling operations in New Zealand and Australia.
3. Shell Australia has also contracted the company to support the operations in western Australia for oil drilling and exploration
4. Shell has awarded a contract to the company for exploration around the Irish shelf.

(Farstad Shipping 2009)

3.1.2 Induction of New Technology Ships

The company has started employing platform supply vessel which is designed for transportation of supplies/equipment to and from offshore installations. Transporting individual items mainly in containers on deck, in addition to a variety of different products (dry and wet) in separate tanks.

3.1.3 Strong Financial Condition

The company is strong in terms of its financial condition. The following financial parameters point out that the company is under leveraged, has fund raising ability and has been steadily cash positive in the last few years

1. **Debt/Equity Ratio:** The company has a debt equity ratio of ~0.8 i.e. <1. This implies that the company is considerably under leveraged as compared to its peers. The company

has considerable debt raising capacity which when done in Norway and other developed countries would be available cheaply. This can be used to fund the opportunities which exist for the company in emerging market and new areas of interest.

2. **EBIDTA:** The cash generation ability of the company as measured by the Earnings Before Interest Depreciation and Taxes is quite strong. The EBIDTA for year 2009 was 1736 NOK mn as compared to 1729 NOK mn in 2008 and much higher than 1376 NOK mn in 2007. Thus in spite of the global financial crisis the cash generating ability of the company has not been impacted.
3. **Cash and Cash Equivalents:** The cash and cash equivalents of the company were 1544 mn NOK in the year 2009 as compared to 1189 NOK mn in the previous financial year. Thus the company's cash reserves have increased substantially in the last year owing to superior profitability

(Fastard Shipping 2009)

3.2 Weakness

3.2.1 Cost of Human Capital

Since the company is mainly based out of Norway, the strength of its human capital comes from the developed countries. Thus given the wage differential between developed countries and developing countries the company operates at a high cost of human capital. It is likely to face challenge from carriers operating from developing countries such as India and China.

3.3 Threats

3.3.1 Foreign Exchange Risks

Due to the company's global operations it carries a foreign exchange risks on its revenues, profits as well as sources of funds. The company has a negative impact of 273 mn NOK due to the unrealized foreign currency loss. Thus it is important for the company to hedge against the foreign currency risks (Fastard Shipping 2009)

3.3.2 European Crisis

By the end of year 2009, the financial crisis was looking to be over with the fall in jobless claims in the United States. However the impact of a free wheeling monetary policy unleashed in the wake of the financial crisis has started telling on European nations. Countries such as Greece and Italy which were always struggling with the fiscal deficit seem to be struggling with their burgeoning fiscal deficit. If the trend continues and the crisis spreads to the powerhouses of European economy i.e. France and Germany, we might be in for a rough ride out of the recession. This would mean a period of stagnated growth for another year and a half. This combined with an ageing population is likely to result in fall in demand in the European mainland and thus a fall in trade (UNCTAD Report 2009).

3.3.3 Climate Change

The issue of climate change has been highlighted above and is a growing and gathering threat to the company in the long run. Since the company has been operating its fleet for a long time it has many aged vehicles in the fleet. There is always a fear that given the fact that the climate change

has taken international centre stage, a legislation imposing more stringent emission norms on the maritime industry is not far away.

4 Opportunities

4.1 Asia

The economies of China and India even in the worst times of the financial crisis have shown resilience, although haven't been completely untouched by it.

4.1.1 High Growth Rate

The countries continue to grow above a growth rate of 7-7.5%. This is mainly on account of the strong domestic demand supported by a favorable demographic profile. Given the fact that a majority of the population is under the age of 30 yrs, the working population in these countries is very strong

4.1.2 Rise in Imports:

The growing demand in developing countries for white goods, luxury goods and commodities is all set to increase in the coming years given the increasing proportion of the middle class. In India alone the population of the middle class is likely to be 250 mn in another five years, this is roughly equal to the entire population of the United States. Hence the increase in trade to and from these geographies is all set to increase exponentially.

4.1.3 Better infrastructure

Developing countries such as Brazil, China and India have considerably increased their expenditure on infrastructure projects such as development of ports etc. This is likely to reduce

the turnaround time for the ships which use these ports often thus decreasing the overall cost of trip. This would be a positive development for Farstad Shipping.

(Harrigon and Deng 2008)

4.2 Increase in Oil Prices

The oil prices which were on a downward spiral in the year 2009 have stabilized and are all set to rise as the Chinese growth engine gets into the fast gear. An increase in all prices is likely to rejuvenate the oil exploration market and thus provide opportunities for maritime support. A higher oil price means that the oil companies are ready to explore areas where the probability of finding oil may not be very high, since the opportunity cost of not exploring the area is very high. This translates into better and higher amount of business for the maritime industry (Berthelon and Freund 2008).

5 Competitor Analysis

The Norwegian shipping industry is composed of almost 85 shipping companies which operate in one or other niche. However there are only four other bigger players which challenge Farstad in its domain of AHTS and PSV. They are as follows:

1. Deep Sea Supply: The Group's principal activities are ship owning and operating of several Anchor Handling Tug Supply vessels (AHTS vessels) and Platform Supply Vessel (PSV). The Group operates in two segments AHTS and PSV. The Group operates in the following geographical areas: North Sea, Mediterranean, Africa, Australia/Far East and North & South America. It does not have presence in the sub-sea category in which Farstad now operates giving Farstad a definitive edge in the market.

2. DOF ASA: The group operates around 67 vehicles out of which 23 are owned by the group and the rest are leased. These include 23 PSV's, 21 AHTS and around 23 Multi Purpose Vehicles. This group has an extensive presence in the sub sea segment and thus poses a direct challenge to Farstad's domination in this arena. The group is the largest Norwegian player, next only to Farstad.

3. Havila Shipping: The company operates 10 supply vessels and another 12 new buildings. These include a total of eight PSV's, 9 AHTSV and three subsea construction vessels. The company's expanding operations in the lucrative sub sea market threatens Farstad's revenues from the same.

(Fastard Shipping 2009)

6 Analysis of Farstad's Strategy

Farstad's strategy can be summarized as three pronged. The first two deal with its conventional strengths in supporting the needs of the oil industry and carrying advanced tonnage while the third one is the new area of focus i.e. subsea activities.

- a. **Oil Focused:** Farstad's main focus has been to be a long term supplier of large, modern offshore supply vessels to the oil industry worldwide. However this strategy comes with risks as it would make the company dependent on the fortunes of the oil industry. In case of a dip in the oil prices it would put pressure on the company's revenues and margins.
- b. **Supply Vessel Market:** The company also endeavours to focus on the supply vessel market which demands the most advanced tonnage. Thus it also believes that it can cater to merchandise trade. In this category the company is amongst the top 5 service providers with a global market share of 5%.
- c. **Subsea Activities:** The company's new area of focus is leveraging the experience gained from the conventional offshore activities to strengthen its presence in the sub sea activities to support client needs.

Farstad's Fleet

- a. **AHTS (Anchor Handling Tug Supply Vehicle) Anchor Handling Tug Supply Vessel** – They are offshore supply vessels specially designed to provide anchor handling and towage services for semi submersibles, platform jackets, barges and production modules/vessels. Certain AHTS in the fleet are equipped for fire fighting, rescue operations and oil recovery

- b. **PSV (Platform Supply Vehicles):** These vessels are designed for transportation of supplies and equipment to and from offshore installations.
- c. **Subsea:** These are customize for operations and construction work on the seabed, and support for subsea operations.
- d. **CSV (Construction Support Vessel).** Vessel especially designed for operations and installations at great ocean depths. MPSV (Multipurpose Supply Vessel) large supply vessels equipped for support, maintenance and installation of equipment on the seabed.

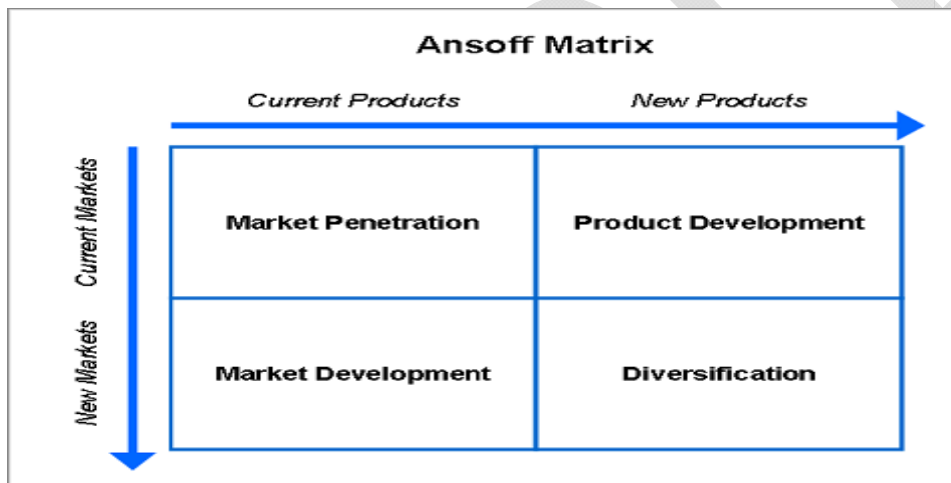
7 Critical Success Factors

Critical success factors for the company will be determined by the company's internal strengths as well as the opportunities which exist in the market. The critical success factors for the company based on the above are as follows:

1. **Meet the Challenge of Climate Change:** Climate change issue as discussed earlier is likely to have a major impact on the maritime transport industry. Hence it is important to tackle this issue through a combination of efficient ships and smarter loads. Thus Farstad shipping needs to achieve this to stay competitive and be a leader in the industry.
2. **Exploit Emerging Markets:** Emerging markets such as India and China are likely to be key to the success of Farstad. As they are the growth markets for any new company, so further addition to the company's top line would be dependent on its efforts to exploit the trade routes emanating from these countries.
3. **Target Oil Operations:** Oil is a critical resource and given the recent trends, the price of oil is likely to rise as the world recovers from the financial crisis. Thus given the high margins on oil it is likely that deep sea oil exploration is likely to be a major growth area.

8 Developing Strategic Options and Recommended Strategy

The way forward for Fastard is dependent on the company's internal strengths and weakness which need to be leveraged so as to exploit the opportunities and counter the strengths. Thus it is important to focus on strengthening the current area of operations of the company and exploiting the opportunities available. Let us try and develop the strategy for the organization taking cue from Ansoff's matrix



Now based on Ansoff's matrix above the organization needs to focus on the following strategies.

Assessment of Strategic Options

1. **Market Penetration:** It needs to focus on penetrating the existing market, by capturing a larger market share. However given the tough competition in terms of shipping rates it may not be wise to decrease rates to attract more customers as it would result in loss in the long run. Thus this strategic option is not recommended.

2. **Product Development:** Given the changing dynamics of the shipping industry, there is a need to develop new products which are faster and more fuel efficient. This would differentiate the service offering in the market and thus attract more customers.
3. **Market Development:** In this case the company can leverage its existing strengths in shipping and expand its markets to the two major untapped areas i.e. North America and South Asia.
4. **Diversification:** The company should continue to focus on its core areas of operations and not venture into unrelated diversification given the volatility of the external environment.

To enable this the following should be the key pillars of company's strategy going forward:

Market Development

1. **Target Emerging Economies:** The Company has not as yet exploited the rapid growth in the emerging economies of China and India. It is critical going forward that it is able to capture some of the demand emanating from these countries. The countries are dependent on imported oil and are facing severe resource constraints in finding vessels for the import of such oil. China is entering into long term strategic partnerships with Africa to get oil.
 - i. Farstad should exploit its presence in Angola to cater to the business which this strategic partnership is likely to generate.
 - ii. Farstad should also establish a presence in the major ports in the region especially Shanghai and Mumbai which are the new financial hubs of the

east. The company's business development efforts in these cities can exponentially grow its revenues.

- 2. Shipping Operations to North America:** It is essential that the company takes advantage of the reviving U.S. economy and expands its business to the U.S. and beyond. As the company expands its presence in U.S. and China it can capitalize on the huge amount of trade which happens between these two countries and thus increase revenues as well as profitability

Product/Service Development

- 1. Deep Sea Oil Exploration:** Given the highs touched by Crude oil prices it is obvious that once the world economy recovers the oil prices are likely to head north with a demand supply mismatch given the production cuts by OPEC. In an era of high oil prices deep sea oil blocks which were earlier not very profitable to explore are likely to become profitable targets for exploration. Thus if the company is able to take a step forward from its strengths in sub sea construction and provide vessels for Deep sea oil exploration it will be capitalize on a new source of revenue.
- 2. Ship Procurement and Development:** It is important to realize that the challenge of climate change is only going to get bigger with time and there is going to be considerable pressure on the maritime industry to cut down on emissions. Thus this needs to be reflected in the ship building and development effort of the company so that more fuel efficient vehicles can be built. It might be prudent to analyze the development efforts of the Greenline shipping company to understand how these efforts can be made more fruitful.

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