Modal Shift to Rail- Prospects and Challenges

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Dedicated freight corridor boosts modal shift from road to rail

Container cargo transported through railways (Rail volumes) grew by a healthy year-over-year rate of 17.63% to 74.38 million metric tonne (MMT) during FY22 as compared to 12.51% growth in overall container cargo volumes. The rail co-efficient also expanded by 115 bps to 26.70% during FY22, mainly supported by partial connectivity of the dedicated freight corridor (DFC) with Mundra and Pipavav ports on the western coast. This marks the beginning of the modal shift from roads to rail.

Slated completion of the prestigious DFC project by June 2023, growing movement of cost-effective double-stack container trains and incremental volumes of cement cargo through railways are prominent factors for the switch from roads to rail.

CareEdge Ratings believes that transit assurance under DFC with a reduction in transit period by 40-50% for some of the routes shall accelerate this transition. Based on estimates, inventory carrying cost constitutes 43% of the overall cost of logistics. Thus, a significant reduction in transit duration is expected to help in achieving Just-In-Time based inventory management thereby boosting the cost competitiveness of domestic goods. Nevertheless, establishing first-mile last-mile connectivity through electrification of feeder routes, container freight terminal and warehousing capacities are crucial for achieving the envisaged modal shift.

Modal shift expected in some of the bulk cargo categories

Indian railway's freight is dominated by a few bulk commodities like Coal, Fertilizer, Iron-ore and raw materials for steel. The government of India allowed transportation of bulk cement in containers in FY22, which is beginning to aid rail volume growth for containers and could add incremental annual volumes of 10-12 MMT by FY25. Rail volumes are expected to be buoyant due to DFC benefits and cargo diversification in container volumes.

Care Edge Ratings expects container rail volumes to grow at a healthy compounded annual growth rate (CAGR) of 15.60% for FY2022 to FY2025 with steady improvement of the rail-coefficient to 31% and incremental volumes from cement.

Growth in rail container volume Vs overall container volume and Rail-Coefficient

Land lease policy to improve privatization prospects and aid multimodal logistics

Higher land lease payment to Railways is one of the hurdles for the rail logistics segment. However, in September 2022, the Union cabinet approved a reduction in the railway land lease fee from 6% of the market rate of land per acre to 1.5%. The lease period has also been extended from the prevailing period of five years to 35 years. The new railways land lease policy is also a positive catalyst for the privatisation of the rail logistics sector and the development of 300 cargo terminals (in line with PM Gati Shakti framework).

National Logistics Policy to integrate data exchange among stakeholders

National Logistics Policy (NLP) aims to bring down the logistics cost of India to less than 10% of Gross Domestic Product (GDP), in line with other developed countries from the existing level of 14%.

Development of the Unified Logistics Interface Platform (ULIP) allows data exchange among stakeholders, which will improve work efficiency in the logistics sector by providing real-time information to all stakeholders and thus strengthen India's international competitiveness.

Higher haulage rates and need for regulator for railways continue to be a challenge

The haulage rates are periodically notified by the Indian Railways and the charges paid by container train operators form 65-75% of their total operating expenses. As per a World Bank report, while ~60% of the capacity of the rail network is deployed for passenger transport, the segment contributes only ~30% to Indian Railway's freight revenue. This translates into extensive cross-subsidisation of passenger fares with freight fares reducing the competitiveness of rail freight over roads.

CareEdge Ratings opines the need for an independent regulator in railways from three key perspectives: (i) rationalising the freight tariff by determining the optimum level of cross-subsidisation of the passenger segment with the freight segment (ii) facilitating private participation by ensuring the protection of their interests, and (iii) transparent dispute resolution mechanism.

Conclusion

The rail co-efficient expanded by 115 bps to 26.70% during FY22, mainly supported by partial connectivity of the dedicated freight corridor (DFC) with Mundra and Pipavav ports on the western coast. CareEdge Ratings expects container rail volumes to grow at a healthy CAGR of 15.60% for FY2022 to FY2025 with a steady improvement of the rail-coefficient by 430 bps to 31% and incremental volumes from cement.

CareEdge Ratings believes that transit assurance under DFC with a reduction in transit period by 40-50% for some of the routes and over 3 x growth in the movement of cost-effective double stacker container trains by FY25 shall accelerate this transition. The new railways land lease policy is also a positive catalyst for the privatization of the rail logistics sector and the development of 300 cargo terminals.

Nevertheless, prevailing high haulage rates for operating container trains due to extensive cross-subsidization with passenger freight, challenges in establishing first-mile last-mile connectivity and the absence of regulators in Railways unlike roads and airports are the major bottlenecks for the modal shift of cargo from roads to rails.