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The Future of Fuel Retailing in India

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Automobiles sales, which today number just over a million vehicles a year, could reach 20 million a year by 2030

In 2002, however, the government made a U-turn, allowing multinationals and other private players to re-enter the market. The policy shift sparked a rush of service station openings as both private and public companies positioned themselves to sell to the nation's growing, increasingly mobile middle class. While the private sector welcomed the liberalized market, in practice it came with several strings attached. Private players were required to invest at least 20 billion rupees (around $500 million) in refineries, pipelines or other energy-related assets in the country, limiting the number of new entrants. And although the government abolished formal controls on fuel prices, it continued to dictate them indirectly through the pricing policy of India's national oil companies (NOCs). These factors have slowed the evolution of the sector – at least for the moment.

Prompted liberalization to Indian fuel companies

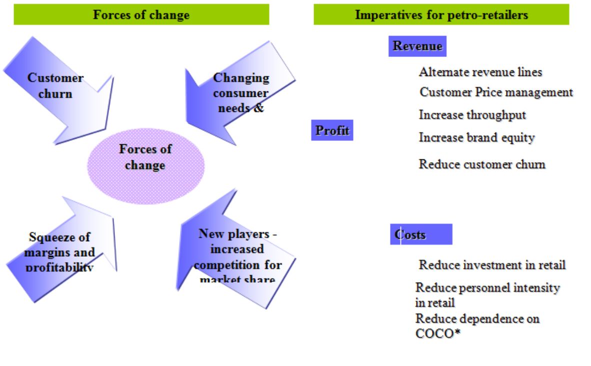
Many of India's service stations are poorly designed and congested leaves a natural opening for newcomers who offer a better alternative. Typical old-fashioned Indian service stations feature long queues, cars jockeying for position, oily forecourts and hand-operated petrol pumps that may not accurately measure the volume of each sale. They also lack convenience stores or other facilities. Liberalization prompted Indian companies such as Reliance and Essar to aggressively enter the fuel retail market. Reliance, for instance, expanded its network rapidly, building more than 1,200 service stations, with plans for up to 6,000. However, Reliance stopped at around 1,300 stations when it started to lose money, due to the government's policy of influencing prices. Shell is so far the only international oil company to enter the Indian retail market. The company's development of a liquefied natural gas terminal and regasification facility at Hazira allowed it to meet the government's call for investment.

In 2005, after an absence of nearly three decades, Shell opened a new petrol station in India. Run by a former Pizza Hut manager with a track record of good customer service, the station - on Dr. Rajkumar Road in Bangalore - quickly became a landmark thanks to its team of efficient attendants directing traffic, cleaning windshields and pumping petrol. Today Shell operates 35 stations in southern India. "We did not come here simply to lead in the market," says Surinderdeep Singh, Managing Director of Shell India Marketing Pvt. Ltd. "Rather, we would like to create a brand known for its quality fuels, accurate quantities and superior services." India's NOCs dominate the market that the newcomers have entered. Bharat Petroleum, Indian Oil and Hindustan Petroleum have vast networks of petrol stations across India - approximately 30,000 in all. Many of these petrol stations were State-owned oil companies command some 80% market share inherited from the old multinationals or established when land prices were much lower than they are today.

For almost 30 years the government strictly controlled public-sector companies, dictating prices, and directing the expansion of their dealer networks. While these companies had retained the infrastructure of the nationalized multinationals, their reason for being changed dramatically. Objectives such as job creation had taken precedence over purely commercial goals, including profitability when running the business.

The move toward liberalization brought a sudden shift in priorities as the public-sector companies prepared to face the new competition. "We've actually grown more in the last four years than we had in the last 30," says Tejbir Singh Sanghvi, Deputy General Manager of Highway Retailing at Hindustan Petroleum. "The government has given us more flexibility in terms of expanding our dealer network. We've also had to develop a lot in order to compete. There are new initiatives, new physical standards and new technologies. Fuel retail used to be a seller's market. Now the focus has shifted to the consumer." The following chart depicts the emerging competitive force-

Emerging competitive forces will force retailers to review their business models…



Source: * COCO – Company Owned Company Operated

As the semi-urban, rural and highway market grow, franchising would offer a lower risk option for entrepreneurs in the petro-retail space

- Currently, entrepreneurs have limited exposure to petro-

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retail

- Franchising increases attractiveness for entry of independent entrepreneurs by offering comparatively lower risk option as compared to independent retailers in other sectors
- Management training and support
- Brand name appeal
- Standardized quality of goods and services
- National advertising program
- Financial assistance
- Proven products and business formats
- Centralized buying power

There are two types of franchising that are prevalent today that facilitate distribution1 - Product/ Trade name and Business Format franchising

Challenges for new comers

Newcomers to the Indian market face several challenges. For one, the government has an indirect hand in pricing policy through its national oil companies. The policy takes into account factors such as inflation and the proximity of upcoming elections. For example, between 2003 and 2007 the price of petrol in the international market increased one and a half times. During the same period the retail price of petrol in India only rose by about 50%. The government subsidises India's NOCs to compensate for below-market prices. Between April, 2007 and March, 2007subsidies totalled approximately $3.6 billion, according to a government advisory committee report. Since state-owned oil companies command some 80% market share, private-sector competitors must match their artificially-low prices to stay in business. "It was assumed that after the APM (Administered Pricing Mechanism) was dismantled in 2003, there would be a genuine free market in India for transportation fuels," says Vivek Srivastava of Reliance. "But the APM never really faded away in practice, thanks to political reality."

Retail site headache

Securing prime retail sites is also a headache. Real estate prices remain high and the process of acquiring real estate is mired in red tape. Moreover, land titles in India tend not to be clear, leading to delays. And construction can be challenging – schedules aren't adhered to, quality needs to be closely monitored, and safety consciousness has a long way to go. However, the outlook for newcomers is starting to improve. Government policies are becoming increasingly liberal and market-driven, and there is an overall cultural shift towards greater professionalism in Indian business. While there does not appear to be any imminent movement on the government's approach to fuel pricing, the economy in general is moving towards greater deregulation. Tax reform promised in 2010 could significantly improve the outlook for private players in the oil sector through a simplified indirect tax structure. This could allow the government greater room to introduce free pricing. Meanwhile, fuel retailers in India are gradually adopting the practices already used in international markets, which plays to the strength of newcomers who are building their networks from scratch. Fuel retailing in other parts of Asia, such as Singapore, has moved towards providing convenience stops for customers, following the model that prevails in Europe and North America. India is likely to follow in the same direction, especially in cities. However, the pace of change and the speed with which newcomers gain a foothold in the Indian market still depend largely on government policy.

Leading private company in the Indian lubricant market

Castrol India is the second largest by market share in the In-

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dian lubricant market. In the retail automotive segment, the company is the market leader with a share of 30 per cent in the retail segment. Many of its brands are market leaders in the segments in which they operate e.g. Castrol CRB (in the multi grade diesel engine), Castrol Active (4 stroke motorcycle engine oils) and Castrol GTX (multi grade passenger car engine oils).

Factors for success

Castrol India has consistently increased its market share in a price-sensitive market despite the advantages enjoyed by its public sector competitors in retail infrastructure. Over the years, the company has increased its market share from around 6 per cent in 1991 to the current 26.7 per cent in the automotive market. BP has succeeded by building strong brands catering to different segments, robust distribution networks and strategic partnerships furthering its brands and reach.

The Great Indian Retail Sector

India has close to 13 million retail outlets — the highest in the world while the retail industry is close to Rs 9 lakh crore, growing at 20 per cent but organised retail is only 2.5 per cent of the pie, though growing at a healthy clip of 35 per cent. The Indian retail industry can be segmented in different segments viz. cosmetics, footwear, sanitary products, entertainment etc. However, with a contribution of Rs. 100,000 crore, the downstream petroleum retailing can be termed as one of the largest segments of the Indian retail industry.

The petro-retail sector can be termed as one of the most organized sector of the retail industry. Now, it is not all about offering fuel only at the petrol stations. The new look petrol pumps, apart from dispensing fuels, now offer the best of retail chains providing a value added service to busy consumers. This trend is in circulation in the international markets and the big petrol station convenience stores earn more than 30 to 40 per cent of their profits from the non-fuel activities. The range of value added services is all beneath one roof. The new-look petrol pumps are now the more advanced multi-purpose dispenser petrol-pumps. The petrol pumps are computerized, thus reducing waiting time which not only ensures accuracy, but also saves a lot of time for customers and avoids misconception and arguments.

The Indian Petro-Retail Sector: Pre-APM Era

The development of petrol-retail sector in India has witnessed three distinct phases:

Period of dominance of multinational companies

At the time of independence, the marketing & retailing of petroleum products was in the hands of private companies like Caltex, Esso, Shell etc. Later the government gradually exercised control through public sector companies.

Advent of public sector, its growth in co-existence with these transnational companies

The second phase started with actions taken in pursuance of the Industrial Policy Resolution, 1956 to promote growth of the vital petroleum sector under the state control. Eventually, IOC was formed in 1959, IBP was acquired in 1970, HPC came into existence in 1974 and BPC in 1976.

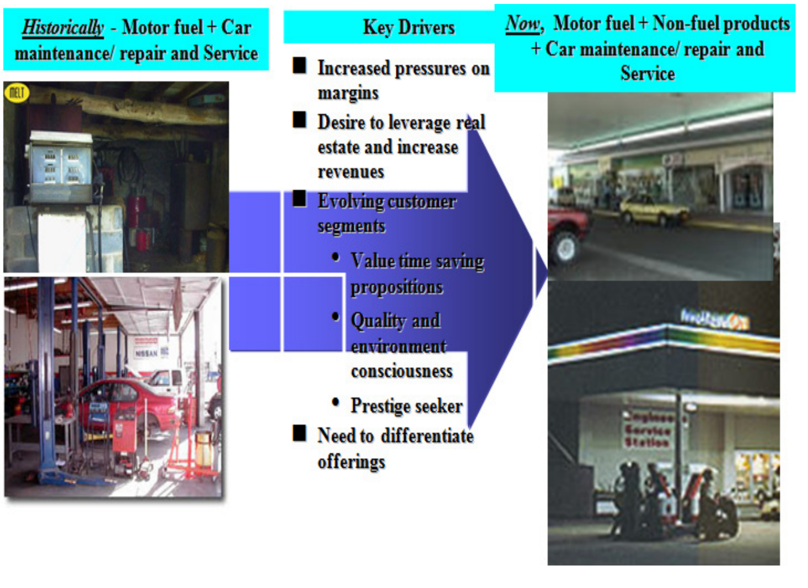
Marketing by the wholly government-owned companies and the fulfillment of socio-economic objectives.

In the third phase, the experience gained by the government during the second phase and the socio-economic factors encouraged it to go ahead for acquiring the assets of all multinational companies operating in the country. In 1981, the entire oil industry was truly in the government fold.

Liberalization in the Marketing Sector

Keeping its promise of decontrolling pricing and control over marketing structures, the Govt. of India on April 1, 2003, opened up retail marketing of automotive transportation fuels (petrol, diesel) to private and foreign companies with 100% FDI allowed. This marked the end of an era in which only state owned HPCL, BPCL, IOC and IBP were allowed to undertake retail marketing in automotive fuels. Based on the recommendation of the Naresh Narad Committee on regulation of marketing of controlled products, players who satisfy the entry criterion (i.e. investment of at least Rs. 20 billion in oil exploration and production, refining, pipelines or terminals) were allowed to set up retail network for marketing petrol and diesel with immediate effect. Also, new players can set up a number of outlets as long as they commit to set up certain 11% of total number of outlets in remote and low service areas.

Globally, the petroleum retailing landscape has transformed from only petro-products to Multi-product and services



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New Players in Petro-Retail Sector

The deregulation of the marketing sector has led to the grant of marketing rights to Reliance Industries (5,849), Essar Oil (1,700), ONGC (1,110), and Shell (2,000). Anticipating the immense competition ahead in the petro-retailing, the existing oil marketing companies has geared up and the following are the changes that have occurred in recent past since the deregulation of downstream oil industry.

- Shifting focus from the urban to highways and sub-urban areas.
- More communication with the customers in the media and onsite
- Building PFS, Club HP, Q&Q as a brand
- From fuel dispensing to multi product selling
- From commodity selling to brand marketing
- From executive level sales management to intermediary supervisory cadres
- From direct controls to third party audits – these certifying agencies require their own infrastructure
- From dealer proprietor to reputed companies from other sectors making forays into petro-retail management

Given today's open & competitive environment, oil-marketing companies, both existing and new entrants, are going full steam ahead to capture the largest share of the pie. While the PSUs have added more than 3000 retail outlets to their network in last three years since deregulation, the private players have added only a little over 450 retail outlets. However, we can say that with 30,000 petrol retail outlets expected in the next 5 years, up by 30% from today, there is going to be a downward pressure on profit margins and revenues per outlet which will push the industry to reinvent itself.

Challenges Ahead in Petro-Retail Sector

1. No real Market Determined Pricing
2. Consultation with the oil companies.
3. Cut-throat Competitive environment
4. Consumer's increasing expectations
5. Need to provide alternate sources for revenue

Future Vision

1. Shift from retail outlet branding to corporate branding
2. Offer of range of premium branded fuels
3. Emergence of non-fuel services as a major activity at retail outlets
4. Loyalty programs an integral part
5. Attempt by all players to drive volumes to retail sites
6. Leveraging automation and communication for enhanced offerings
7. Competition on price

Strategies in the Changed Environment

1. Marketing & Distribution Infrastructure: nature of access
2. Superior Network Architecture
3. Understand Industry Structure and Conduct
4. Adoption of New Retail Skills
5. Alternate sources of revenues

CONCLUSION

Summing up the study, we reach the conclusion that opportunities are still waiting to get unfold in petro-retail sector. With the expected growth in number of vehicles from 1.1 million in 2004 to 1.7 million in 2010, the sector is going to be the next battleground after IT and Telecom industry. However, to emerge as winner, the whole lot of concentration is to be driven towards the customer, but of course, keeping profitability in minds and Govt of India has to take necessary steps to have regular supply of fuel with out creating artificial demand.

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