

HDSA Workshop on Economic Transformation in the Petroleum Sector
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Impediments and opportunities for meaningful transformation
of the retail petroleum industry and possible solutions

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Message from SAPRA



“Don't judge each day by the harvest you reap, but rather by the seeds that you plant.”

Context



- SAPRA is a member of the Petroleum & Liquid Fuels Sector Code Alignment Steering Committee.
- The Petroleum & Liquid Fuels Sector Code Alignment Steering Committee is committed to ensure that
 - Meaningful radical economic transformation is realised in the sector;
 - The Petroleum and Liquid Fuels Charter (LFC) promulgated under Schedule 1 of the Petroleum Product Act, 1977 (Act No. 120 of 1977 as amended by the Petroleum Products Amendment Act 58 of 2003 as the strategic tool adopted to date to effect transformation in the petroleum sector is the aligned to B-BBEE policy framework; and
 - That the LFC as a Sector Charter applies to all stakeholders in the sector.
- Key stakeholder alignment is required as a pre-cursor to gazetting the Petroleum & Liquid Fuels Sector Code in terms of the B-BBEE Act.
- The objectives of this Scope of Work is to summarise and collate the key issues to be addressed in the Petroleum & Liquid Fuels Sector Code
- The targeted timeline is for the Petroleum & Liquid Fuels Sector Code to be gazetted is September 2017
- SAPRA's strategic intent regarding transformation is to contribute to the growth and profitability of fuel retailers by influencing all the role-players in the fuel industry value-chain in such a way that we contribute to a viable and sustainable downstream fuel industry for **ALL** petroleum retailers

SAPRA Strategic Intent



To influence the role-players in the Fuel Industry Value Chain in such a way, that we contribute to a sustainable Downstream Fuel Industry for all Fuel Retailers

What does SAPRA do



- Contribute to the growth and profitability of all petroleum retailers;
- Support the principle of BBBEE and encourage meeting the objectives thereof;
- Make fuel retailing a business of choice for investors and business people;
- Ensure ongoing liaison with government, oil companies, financial institutions and other stakeholders for better trading conditions;
- Promote, protect and encourage the interests of petroleum retailers by setting proper standards of service and ethical trading conditions;
- Improve the security and safety of petroleum retailers;
- Regulate relations between petroleum retailers and their employees and/or trade unions and protect and further the interests of members in that regard;
- Promote, support or oppose any proposal or action affecting the interest of members;
- Affiliate with and participate in the affairs of other bodies sharing common interests with all the members and constituent associations of the Organisation;
- Access and participate in other business partners' industry specific product offerings if necessary by means of separate service level agreements and performance standards;
- Provide for and administrate training courses pertinent to the petroleum industry through the W&R Seta funded SMME training programmes;
- Actively promote one petroleum retailers' forum with one voice in all dealings with retailers and other stakeholders;
- Disseminate relevant information to members

Short Overview of the Retail Petroleum Industry and some dynamics

Ownership and relationship models



- For Oil Companies, security of tenure is the name of the game
- This is primarily to protect the fuel production supply from their refineries
- Full site ownership is the first option
- Long term registered leases and servitudes are prevalent
- Other securities such as bonds, etc.
- Sites are typically:
 - CORO – Oil Company owned Retailer operated
 - CLRO – Oil Company leased Retailer operated with variations
 - RORO – Retailer owned Retailer operated
 - RLRO – Retailer leased Retailer operated with variations

Regulation and legislation



- Retail Petroleum Industry is heavily regulated
- Petroleum Products Act of 1977
 - Price maintenance of petrol and pump prices fixed by government
 - No self service
 - No vertical integration
- Licensing regime
 - Site license
 - Retail license
- Competitions Act
- B-BBEE Act
- National Environmental Management Act
- Consumer Protection Act
- Local laws and regulations

Uniqueness



- Barriers to Entry
 - Scarcity of suitable land for site development – proper evaluation and feasibility is essential
 - Multiple approvals required – Zoning; Access/Egress approval; Environmental Impact Assessment (EIA)
 - Site and Retail License
 - Development costs for new site
 - Goodwill values in the sale of existing site
 - From land acquisition to site commissioning can take up to four years
- Combination of business
 - Fuels forecourt
 - Convenience store with bakery
 - Car wash
 - Quick Service Restaurants

Typical Capital requirements

Development of a new site

Item	Value Rm
Land	5.0
Holding and maturing	1.0
Civils and Buildings	5.0
Forecourt equipment	4.0
C-store equipment	3.0
Signage and other	2.0
Total	20.0

Operations for a new site

Item	Value Rm
Upfront Franchise fee (CORO sites only)	5.0
Fuel stock plus guarantee	2.0
C-store dry stock	1.5
Other	0.5
Total	9.0

Margins



- Petrol is a regulated product (Petroleum Products Act of 1977)
- Diesel not regulated – discounting is allowed
- Petrol pump prices are fixed by legislation – retail price maintenance
- Margins are therefore also fixed
- Recently introduced Regulatory Accounting System (RAS) based on Benchmark Service Station determine the Retail Margin where:
 - Return rewards Investment in assets
 - Operational costs are reimbursed
- WACC, CPI and other economic indicators are used to determine annual adjustment
- Developed primarily for a RORO site
- Margin split between Investor and Operator
- Provision for Wholesale Margin, Storage and Secondary Distribution Differentials

Current Petrol Margins in the RAS



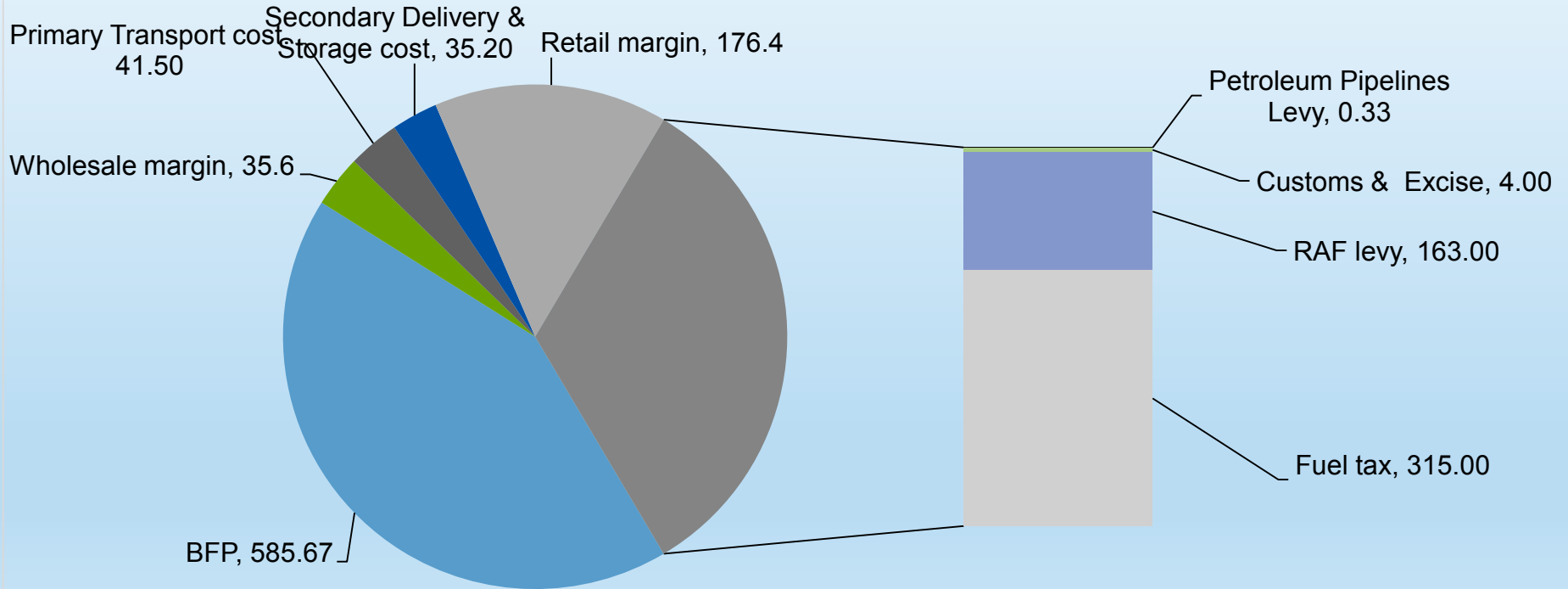
- **Oil Company**

- Wholesale Margin - 35.6cpl
- RAS Retail Margin - between 0cpl and 64cpl depending on deal type
- Service Differential (Storage and Secondary Distribution) - 35.2cpl
- Primary Distribution (Zone Differential) – between 2.5cpl and 100.0cpl depending on inland site location relative to coast

- **Retailer**

- Franchised (CORO) sites typically 115cpl to 120cpl depending on Oil Company and deal type
- RORO sites up to 176.4 depending on the deal type
- C-store – Gross margin of 30% of turnover. Net of between 10% and 20%
- Car wash – Gross margin of 10% of turnover. Most sites operating at a loss
- QSR – Gross margin of up to 60% of turnover. Net of between 15% and 25%

Petrol pricing in the RSA – ULP93 in Gauteng Zone 9c – R13.57



Challenges facing petroleum retailers

Challenges facing Petroleum Retailers



- Volumes are not growing
- Costs are ever increasing
- Margins are flat
- Compliance to numerous bits of legislation
- The normal product supply challenges
- Labour issues
- Oil Company relationships
- Diesel discounting and new sites

Challenges facing Petroleum Retailers



- Future of carbon based fuels
- Alternative fuels
- Impact of world macro environment
- Changes in technology
- Safety, health, environment, risk and quality issues
- Changes in legislative environment
- Oil company strategy and business models
- New entrants

Industry Transformation Challenges: Retailers

Industry Transformation Challenges: Retailers



Codes of Good Practice Barriers

1. Turnover-based size definition – results in classification of independents as Large Entities instead of QSE's.
2. Fuel retailers are forced into Large Entity thresholds
3. EME and QSE Service Station's B-BBEE levels are determined by the signing of an affidavit and not by a score card.
4. Signing of affidavits will encourage fuel retailers **NOT** to participate in Skills development, Employment equity, Enterprise development and Supplier Development
5. Discounting is a negative principle – positive reinforcement will make a bigger impact on economic transformation

Codes of Good Practice Barriers (Continue)

1. EAP Targets for Service Stations as large entities are not realistic.
2. The measurement compliance criteria based on the relevant EAP statistics is unfair for Service Stations as it discriminates on the basis of size of an entity and does not allow all entities "equal protection and benefit of the law".
3. Ownership measurement criteria not conducive for radical economic transformation
4. Wholesaler's and Retailer's lack of understanding on the benefits of B-BBEE Transformation.

Procurement Barriers

1. Suppliers not meeting procurement requirements.
2. Retailers have very little discretion when determining where and whom to procure from and are prejudiced where they have no control over the outcome.
3. No industry focussed effort to develop suppliers

Skills Development Barriers

1. No standard Retailer Ownership Development and Leadership Development Program in place.
2. No standard Service Station Employee Career Development Program in place
3. Wholesaler Business Advisors not properly trained to provide in depth support to fuel retailers
4. General resistance by fuel retailers to provide adequate training to employees at own cost
5. No standard e-learning utilised to train NTI retailers and service station employees

Industry Transformation Challenges: Retailers



Barriers to Entry

1. Lack of mentoring and coaching of New To Industry (NTI) sites during 1st six months of operations.
2. NTI lack of financial management, financial controls and cash flow management skills.
3. NTI not understanding the complexities and intensity of the petroleum industry as a regulated environment.
4. No standard ownership change program for NTI in place.
5. Focus on quantity vs quality of NTI fuel retailers.
6. Not utilising a Standard Service Station Business model.
7. Complex non-integrated computerised systems utilised

Barriers to Entry (Continue)

1. No standard Service Station Value Creation methodology in place, including the acknowledgement of Goodwill .
2. NTI not qualified to be appointed as a fuel retailer
3. Access to funding limited
4. Cost of capital & bank guarantees excessive as a result of higher levies in the retail fuel price
5. Allow NTI retailers to take over a site without extensive training prior to the handover
6. No proper due diligence done on a service station sales transaction

RAS Pricing System

1. Implementation of RAS pricing mechanism has negatively impacted the entrepreneurial compensation.
2. Perception that Oil Companies dictate the % of the margin in pricing negotiations.
3. Vertical integration & cost subsidising as a result of Diesel Cards continues
4. RAS not consistently applied across different brands
5. Huge lag and inconsistencies in margin increases
6. Fuel retailers lack of understanding of RAS

RAS Pricing System (Continues)

1. Challenges in terms of the correct implementation of the RAS pricing mechanism seem to have resulted in retailers being undercompensated in terms of the stipulated margins relative to their costs of doing business

Industry Transformation Challenges: Retailers



Regulatory

1. Cumbersome Regulatory Framework EIA, Rezoning, site and retail license applications

Policy & Regulation

1. Retailer transformation resistance as a result of forced transformation practices.
2. Narrow focus on B-BBEE transformation
3. Retailers in financial difficulty sell their property to wholesaler
4. Uncertainty in tenure period
5. The negative impact of uncontrolled proliferation of service stations on the transformation of current service stations

Policy & Regulation (Continue)

1. Conditional selling not allowed by wholesalers & retailers, however 3rd parties through loyalty programmes may sell on condition
2. No industry consensus on transformation targets
3. No Management Information System to monitor progress on Radical Economic Transformation

Proposed Solutions

Proposed Solutions



- Ensure that the majority of Service Stations are QSEs because this will motivate Fuel Retailers to participate in the B-BBEE Transformation process. Service Stations classified as Large Entities will in most cases be non-compliant – therefore, no motivation to embrace Transformation at all
- Ensure that all Fuel Retailers participate in Skills Development, Enterprise Development and Supplier Development – all QSE Service Station B-BBEE levels to be determined by a score card and not by the signing of an affidavit
- QSE Service Stations will all qualify as Empowering Suppliers because they only have to meet 1 criteria out of the five criteria
- NTI and current Fuel Retailers to utilise a standard Service Station Ownership development program in conjunction with the W&R Seta -the RSM NQF6 qualification program is currently available

Proposed Solutions



- Implement a career development program for Service Station employees who would prefer to follow a career in the corporate world
- Utilise latest technology to train NTI on site as a result of time constraints
- Provide longer term contracts to Fuel Retailers who 1) are prepared to utilise their sites as training sites for NTI owners 2) spend their 12 hours per month with the development/support of EMEs 3) adopt a school
- Develop Information Systems to monitor the status of B-BBEE Transformation on a regular basis – 1) support planning and reporting programs 2) reduce the need for major audit programs 3) monitor the success rate of all facets of Transformation
- Complete overhaul of RAS
- Develop Information Systems to maintain accurate information on the implementation of RAS

Future Prospects

Future prospects



- B-BBEE transformation of the Retail Petroleum Industry is not negotiable
- Carbon based fuels will still be around for some time
- Other fuels will however have to be catered for
- Clusters of sites will become a reality
- Deregulation some time in the future is a distinct possibility
- Network rationalisation is also going to have to happen
- New entrants – sale of Chevron South Africa to Sinopec

Thank you and be well

Credentials

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An informed Retailer is an Empowered Businessman