The Dynamics of Related Diversification

The Retail Initiatives in Petroleum Limited

Case study
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This case was written by Professor Ashok K Sar, IBAT School of Management. It is intended to be used as the basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation. The case was compiled from generalised experience.

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The Dynamics of Related Diversification: The Retail Initiatives in Petroleum Limited

It's the beginning of the financial year in India, and year of test for Vardharajan P.K (VPK), head of allied retail business in Petroleum Limited. He has been at the helm of affairs of the **"CoolOne"** *brand, and has seen the retail initiatives budding, flowering and fruiting. But this year is expected to be different with emerging changes in the economic environment of business and competing petrol stations trying to catch up fast. Besides, a host competing retail stores have come up in a large number of strategic markets. In the words of VPK, the retail venture is no more a tree, which is expected to bear stable fruits, but is a seasonal plant-bed on a kitchen garden. Every year, the saplings have to be planted, nurtured and nourished to be able to get that wonderful product in the shape of fresh vegetables. Can VPK make it happen this year?*

The Indian petroleum retailing industry is today poised to make giant strides both in terms of new forecourt retailing opportunities and superior customer offerings at the retail outlet. With the onset of the post administered pricing mechanism (APM) deregulated scenario, the spirit of competitiveness amongst the petroleum companies augurs well for the consumers, with each of the companies adopting innovative ways to capture a larger part of the consumers' mind share. Diversifying into organised retailing with opening of retail stores at petrol stations, has been natural diversification for the major downstream oil companies. Despite convergence of strategic orientations on the part of these oil companies, there appears to be a stronger focus in Petroleum Limited (PL) towards creating focussed differentiation. This attracts significant attention owing to its strategic orientation of cost leadership in its core fuel and oil business.

Prof. Ashok K. Sar prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The case is based on a successful operating organisation whose name is disguised.

Entry:

In 2001, PL had healthy margins, based on the assured 12% post tax return on net-worth under the APM. However, growth in the fuel and oil business (retail business in particular) was limited by the retail network expansion norm of the government. In other words PL had very limited avenues for investment of its surplus cash. During the late 1990's when the government was getting ready to deregulate the Indian oil sector, PL was getting prepared to face the post-deregulation competition. It upgraded a large number of petrol stations in strategic markets to match the customer service standards (CSS) of best in class retail outlets. In these petrol stations, it created additional floor space for possible expansion of conventional lubricants and after market products. It also took the petrol station owners, (known as dealers) through a series of training and development experiences, thereby creating a pool of smart and professional dealers who understood the external environment, the resource requirements for success and the required processes. However there were not enough business opportunities from the natural growth in fuel and lubricants business to exploit these strengths, viz., financial resources, physical facilities at the retail outlets and the dealership abilities. Diversifying into the organised retailing was a natural option, taking cue from the international oil majors, who had significant earnings from the allied retail businesses. The early entry into organised retailing was also expected to pre-empt rivals. Thus realising the importance of a greater understanding of consumers' needs and consistent with its core objective of continuously adding value to its customers through innovative means, PL has launched its convenience retailing initiative under the **"CoolOne"** brand in 2001. It offers a convenience proposition where a number of typical household errands are aggregated under one roof for the benefit of the customers. As at beginning of 2007-08, there were 370 CoolOne stores across India, which bring in unmatched convenience at the petrol stations. Strategic alliances have been formed with major brand owners and retailers in the country to further strengthen the convenience proposition. PL is the 2nd largest oil marketing company in the country with over 6000 retail outlets (RO) spread across the length and breadth of the country. The CoolOne chain of convenience stores has been set up in the urban, sub-urban and highway markets at strategically located RO sites with high customer footfalls.

Industry

The new Indian consumer is now richer, younger and more aspairational in his/ her needs than ever before. Consumer now value convenience and choice at par with getting value for their hard earned money. A range of modern retailers are attempting to serve the needs of the new Indian consumer. The last few years have witnessed an explosion of organised retail formats like super markets and hyper markets in an otherwise fragmented Indian retail market.

The retail industry is now estimated at $200 billion. Out of this, organised retailing is just 3%, i.e., $6.4 billion, which is expected to grow to $23 billion by 2010.

The industry is associated with favourable demographics, characterised by the following:

- 60% of the population is below 30 years of age.
- Increase in spending power – 50% of cell phone purchases were by under 30 age group.
- AC Neilson Online Survey 2005 rates India in the highest category of Aspairational Index in Asia along with China, Indonesia and Thailand.
- Increase in working women population.

Food and grocery account for the maximum percentage share of organised retailing. It also has the highest growth rates.

The industry is also associated with favourable macro environmental factors such as 7-8% growth in GDP and associated growth in disposable income.

The operations in India are however at a nascent stage and the key success factors are going to be the following:

- Excelling in internal processes, viz., supply chain management; private label management and loss prevention.
- Real estate availability and costs.
- Finance availability and costs
- Availability of quality human resource and costs thereof.

With the emergence of organised retailing in the country and a growing demand from consumers for a superior shopping experience, convenience retailing has emerged as a key business area for petroleum companies given their wide retail presence, existing customer base and strategically located sites. Convenience need gaps have been felt in various fields and research has shown that the urban consumer today seeks convenience in shopping for their basic requirements so that their precious time is reserved for more fruitful pursuits. Petrol retail outlets provide the right framework for setting up convenience retail chains where the consumer has the opportunity of combining shopping with the fuelling occasion.

Petrol stations are widely recognised to be one of the highest traffic aggregators and retail majors like hypermarkets such as Sainsbury, Tesco and Carrefour have added motor fuels in their basket of services for the convenience of their customers. Hence along with strategic locations, the availability of footfall in the petrol retail outlets gives petroleum retail companies the competitive advantage. Worldwide, petrol station convenience stores have developed into a serious business in itself with companies like Shell, Caltex, BP, Exon-Mobil running their convenience store chains very profitably. All of them have deployed best retail practices in their stores and offer a wide range of services including laundry, postal services, courier services, fast food etc.

Synergy

The early mover advantage and exploitation of the three key assets, viz., cash, physical facilities at the ROs and the entrepreneurial assets of the dealers helped PL to reap quick benefits. Bulk of the stores started to operate with 50-75% of the capacity in 3-4 month's time. However, the competitors caught up fast and in a years time the other two national oil companies came up with their retail formats at the petrol stations.

The retail strategy team at PL were getting ready with a set of initiatives to create strategic assets which would be difficult on the part of the competitors to imitate, trade or substitute, with a view to earn superior long term profits.

The 1st of the initiatives was the creation of the brand CoolOne. In the beginning, it appeared a gross miss-number to a majority of the members of the team itself. However, the core competence of 'team learning' which was created over a period of ten plus years and got refined in 1996-97 during the organisational restructuring came very handy in the process of co-creating a vision for the retail initiative, and the initiatives on the branding in particular. PL already had a loyal customer base for the fuel and oil products, which was getting managed through the Customer Relationship Management (CRM) route and reinforced with the introduction of 'FASTCARD' (smart card based transaction processing product). The branding was associated with limited above the line promotion, but extensive below the line promotion. With the branding, a substantial portion from the pool of loyal customer was expected to be attracted to the stores. Although the CoolOne brand has been with reference to the stores, it also enhanced the customer enrolment for fuel and oil products. The FASTCARD became an effective tool to keep track of customer enrolments both for the fuel and oil products and stores.

For obvious reasons, the dealer community focussed their attention on initiatives which were most rewarding to them. Although PL had created a pool of professional dealers, their enrolment for the retail initiatives came with question marks, as the returns in the 1st year was not very encouraging, as large number of competitors' petrol stations came up with similar stores. Thus it was not easy and straight forward to have this loyal dealer base to work for the stores. As a part of the allied retail business (ARB) strategy, dealers were involved in designing in-store promotions, incentives and a host of other below the line promotional activities. This helped to enrol dealers and seek their long term commitment. The core competence - skills associated with understanding complexity and change gained over a period of time and refined during the organisational restructuring process during 1995-97, helped to create this strategic asset, i.e., dealer loyalty.

For the fuel and oil business, effective management of inbound and outbound logistics has been a key competency which has driven PL to success. The same is also associated with the key success factors of the organised retailing. The challenge was to share the associated assets with the retail business unit. On examination of the physical logistics infrastructure, it was found that, except for the IT network, SAP (the ERP application) in particular, not much interrelationship can be exploited. However, some of the key people behind the successful management of logistics were enrolled to design a logistics system for the retail business unit. In about four months, an effective interrelationship in the areas of IT and logistics was established. The core competency of shared vision and team learning helped to create the associated strategic assets.

The Indian retail industry was notoriously unpopular for its dubious credibility on quality and quantity of the products and services. There is no dearth of news reports in the print as well as electronic media of cheating by ROs on quality and quantity. PL however, had the distinction of having quality and quantity at the top of its marketing priority. It successfully got to a Quality and Quantity assurance initiative under the banner Q&Q. This initiative was formalised through an ISO Certification like process, where individual retail outlets have to get Q&Q certified. For the retail strategists, the challenge was to share the associate assets with the retail store. Baring a few standards laid down for Q&Q certification, the remaining ones, was found to be equally applicable to organised retailing. While no Q&Q certification was proposed, bulks of the associated processes were used for the retail stores. These processes were further made a part of the store promotions activities.

Something related to the Quality and Quantity initiatives was the pool of suppliers. On a 1st cut analysis of the suppliers, it was found that nearly 75% of the suppliers were common to all petrol station stores and neighbourhood stores. It was felt that, unless PL has a pool of loyal suppliers, it would not be able to sustain the competitive advantage. Over a period of time, PL had created a pool of loyal fleet operators for distribution of its fuel and lubricant products. It had also created a pool of loyal civil, mechanical and electrical contractors for development and maintenance of its retail network. These two key supply inputs have been critical to success in fuel and oil retailing, and PL was considered the number one in these, i.e., most preferred principal for transporters and contractors. For instance, new PL petrol stations took the least time to come up, and had the least break-down related closure/ suspension of sales and least cost of development and maintenance. Similarly, it had least transportation cost and product dry-outs at petrol stations. The dealer and contractor loyalty was further captured in the large number of application received for empanellement. The key to creating this loyal base of contractors and fleet operators was standardised and transparent operating procedures and assistance for vendor development. Taking cues from these keys, seeds were shown for creating a base of loyal suppliers for the retail business. Half of the existing common vendors were more than willing to have formalised long term associations with PL. And a few more common suppliers followed shoot. But this exercise took a little longer than expected, and in six moths time, 65% of the suppliers were associated in the vendor loyalty programme. The most excited suppliers were the local grocery suppliers who had nearly 30% value addition in this process.

In about a year's time, PL's retail strategy team was able to put in place resources and capabilities which remained unique, and hard to copy on the part of either other stores based at competitor petrol stations or neighbourhood stores. At the end of 2006-07, PL had 370 stores running across India. 75% of the stores are termed as small stores with around 500 square feed of space and remaining 25% as medium to large stores with space in the range of 600 – 1200 square feet. Very few stores had space above 1200 square feet. The growth in customer enrolment and healthy margins has been indicators of the overall stores' performance. The gross margins were in the range of 11-14% and net margins in the range of 2.5 – 4%. **"CoolOne"** stores have become the largest organized convenience store retailing chain in the country with a standardised layout across the country, with a high level of aesthetics and an ambience aimed at deriving maximum value for alliance partners and offering consumers a revolutionary solution for attending to their daily chores. They are the first to open and last to shut in the neighbourhood.

The Offerings:

- It offers a wide range of services viz., ATMs of leading Banks, Music stores from Planet M and Music World, Beverages from Pepsi, Coffee and snacks from Cafe Coffee Day and Coffee Day Xpress and a variety of impulse buys including confectionery, snacks, convenience foods, toiletries and select range of branded groceries and other FMCG products through exclusive tie-ups with such FMCG majors like ITC, Cadbury and Frito-Lay.

Implementation:

Initiatives in the retail strategy were mapped in balanced scorecard format as a strategy map. This captured the interrelationships with reference to the strategic assets and the core competencies which underpinned the improvement, creation and fission of the strategic assets. The implementation mechanism was like "front-end separation and back-end integration". The strategy map captured the objectives, measures and initiatives for all key operating personnel. There was a departure from the conventional coordination by direct supervision through elaborate hierarchy and standardisation of work processes to coordination by mutual adjustment. Limited standardisation was still maintained at the operating core with a view to implement the standardised offering across stores country wide. Liaison roles were created at the back-end to take care of the coordination arising out of the "front-end separation and back-end integration".

Ownership:

Bulk of the investments in the stores was specific to the stores and had very limited productivity outside the stores. It was therefore difficult to seek investment from outside, more particularly owing to perceived hold up problems. Further, it was also difficult to seek market for the stores in general, at the target rate of return. In other words, it was rewarding for a dealer to run the store than a third party, as the dealer had substantial cost advantage over third parties. Besides cost advantage, the dealer had supporting strategic assets, viz., key manpower, reputation and knowledge about customers and competitors. Considering these factors, a hybrid structure was considered to be appropriate to gain cost advantage by chaining and differentiation advantage by franchising. Under this structure, all fixed facilities, viz., land and building; furniture and fixtures; air-conditioning and IT equipment were owned by the company, i.e., PL. The stores pay a license fee, partly fixed (based on the stores size) and partly variable (based on the throughput) to PL. It was the responsibility of the dealer to arrange for the working capital for the merchandise, add-ons and other revenue expenses. The manpower of the stores were on the payroll of the dealers, but selected by a team comprising of the dealer (or his/ her representative); representative from PL and an external HR resource person. This structure was also expected to help in developing organising retailing at the petrol stations in general, and help to address the intense coordination requirements arising out of the "front-end separation and back-end integration" in particular.

The Emerging Challenge:

Global retail big wigs like Walmart, Tesco and Coiffeur, and domestic players like Reliance and Bharati group, are already fancying India's super hot retail sector. This is expected to intensify rivalry in major market segments. A basic question arises – what impact all these entry decisions will have on the competitive position of "CoolOne"?

Issues for discussions:

1. What is the rationale behind diversification to organised retailing by Petroleum Limited? From Fuel and Oil to convenience goods?
2. What can be said about the success of the organised retailing venture in the emerging economic environment of business with world's top retailing heavy weights being in the market in the coming 2-3 years?