Oil and Gas

New Retail Fuels Channel Strategies for the Next Round of Downstream Growth and Competition

To improve returns on capital, many of the world's largest oil companies are actively reducing their direct investment in retail and focusing on their more profitable upstream operations. Over the past decade, global oil firms have reduced investment in their networks of company-owned retail sites and increased dependence on channel partners—retailers, dealers, and branded wholesalers—to own and manage sites, deliver fuel to customers, strengthen the oil companies' brands, and provide a market to off-take product from refineries.

This restructuring of the industry's distribution channel has generated valuable business results. Oliver Wyman's experience suggests that there is considerable value at stake in restructuring the retail channel and refocusing retail support efforts to align to retailer preferences while taking out capital and reallocating operational spend. This includes a dramatic (often over 20%) increase in fuels volume that can occur after this refocusing of channel support strategies.

Yet these changes have also raised significant new challenges for downstream fuels executives as their strategies, marketing tactics, and mindsets need to fully shift from managing direct retail to competing in channel-partner-dependent markets. To surmount these challenges—and boost their companies' bottom lines—managers must reexamine how they do business with retail channel partners.

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Across the globe, the oil industry's channel structure is changing shape. Oil companies, seeking to improve their capital returns, are moving away from company-owned retail sites and looking increasingly to channel partners, including retailers/dealers (a.k.a. independent dealers with ownership for sites) and branded wholesalers (a.k.a. jobbers, marketers, or distributors) to own and manage sites and serve as their operational face to consumers. Over the past several years, many of the major fuel brands have announced an exit from company owned and operated businesses. We expect this trend (Exhibit 1) to continue.

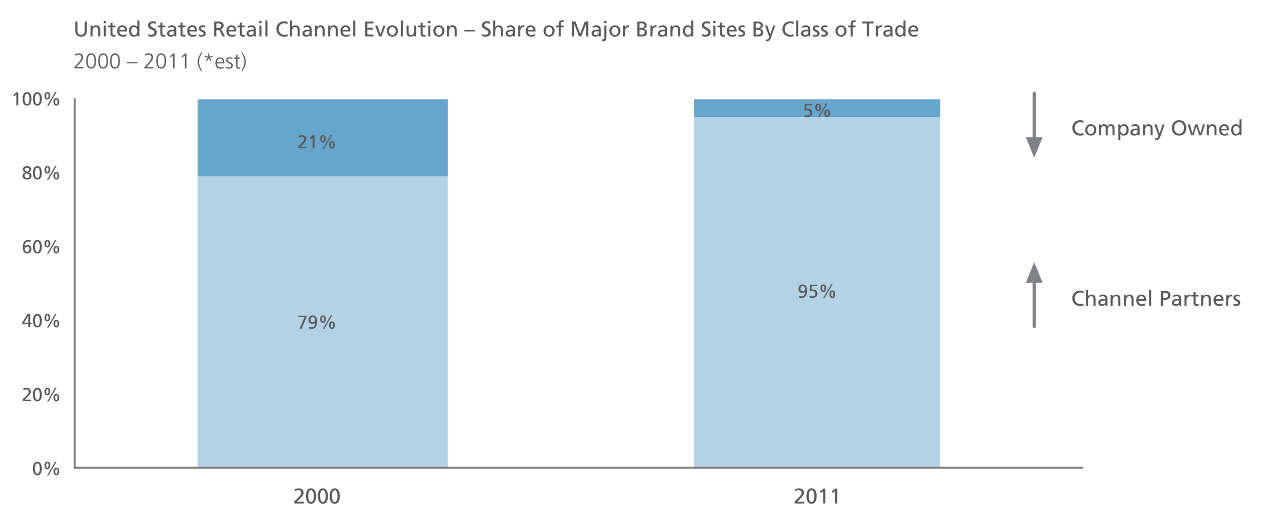
Several forces are driving this shift. First, oil companies have recognized that they generate far less profit from retail operations than they do from their upstream operations. Indeed, company-owned retail contributes just single-digit percentages to overall shareholder value. Moreover, oil companies have proven less effective as retail-site operators than as fuel suppliers, and their overhead costs are typically not competitive with those of stand-alone, non-oil company retailers. In addition, there is growing pressure for oil companies to improve returns on invested capital—which have proved more attractive in upstream. Thus companies are deploying their capital dollars outside retail.

Beyond the shift to the channel partners, particularly in the United States, wholesale is now the primary channel for branded fuel suppliers increasing as a percentage of both sites and volume. Branded wholesale is playing a larger role in major metropolitan markets. As branded fuel suppliers divest markets, wholesalers are the buyers of choice as they enable the fuel suppliers to figuratively keep sites "in the family." As a result, in most areas of the U.S., wholesalers have become the brand. While this move to the wholesaler class of trade has not yet become a global phenomenon, in the years ahead we can expect that wholesaler channels will develop in new markets around the world. Already today, globally, retailers and multi-site dealers have become larger, more sophisticated operators making the step to the wholesale channel a faster transition than in the past.

New challenges and requirements for channel management

The industry's changing distribution-channel picture has presented challenging new realities for oil executives. As the channel has shifted shape, channel partners have become more sophisticated at owning and operating sites as well as gaining access to needed capital. In the United States alone, there are nearly one thousand branded wholesalers. Branded-wholesaler class of trade is emerg-

Exhibit 1 **Class of Trade Shifts**



*Estimate based on announced exits from company operations.
Source: Oliver Wyman analysis.

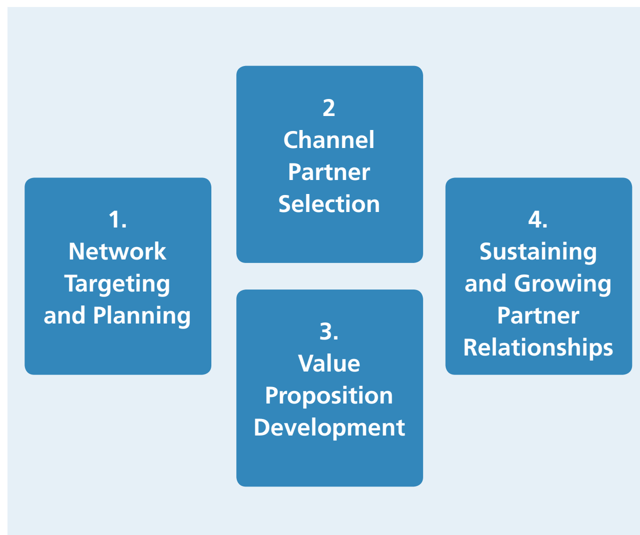
ing in other parts of the world as well, such as in Malaysia and the United Kingdom.

Oil companies have begun shifting their strategies accordingly. Executives are now focusing their attention on geographies where their branded retail networks can provide ratable volumes for company-owned refineries. Margin and cost pressure is prompting oil companies to provide leaner support programs to dealers and branded wholesalers. Lastly, oil companies are concentrating on strengthening the skills needed specifically for supplying fuel rather than those required for managing gas stations and their employees.

All this raises some burning questions for heads of oil companies' downstream operations, strategy, and fuels marketing. Taken together, the questions now center on how to ensure that the company's relationships with channel partners ultimately benefit all parties involved. Specifically, managers must now ask themselves:

- How will we secure a sustainable and ratable stream of fuel volume to support utilization and expansion of our refineries?
- How will we protect and strengthen our brand with end consumers in a world of independent dealers and wholesalers—many of whom do business with multiple brands?
- How will we remain competitive in the markets in which we operate and continue to achieve higher levels of site effectiveness?
- What can we offer channel partners to make a relationship with us attractive to them and to drive loyalty and growth in our products' volume?
- How will our program offers differ between channel partners, or between single-site and multi-site operators?
- How do we cultivate a network of cooperative and loyal retailers, dealers, and wholesalers in markets that currently have few such potential channel partners?
- How should our organizational structure and culture change to support a successful move from retailer and asset owner to fuel supplier?

These are difficult questions, but executives must answer them to evolve their companies' business strategies and align their organizations to the strategies. Oliver Wyman's extensive experience with energy clients worldwide suggests that there are four "levers" executives can pull to achieve the above objectives:



In the sections that follow, we take a closer look at each of these levers.

1. Network Targeting and Planning

The initial point for planning must start with an understanding of the market dynamics as a backdrop to decision making. Understanding how a given market and competitors' marketing strategies will evolve is foundational for selecting target markets and retail partners.

Oil companies need to ask a series of questions to understand how the market and competitors in their geographies are evolving:

- How will my markets evolve given competitor, regulatory, and consumer behavior trends?
- How will competitors and unbranded retailers (e.g., high-volume retailers (HVRs) and super C-retailers) grow, evolve, and impact markets?
- How might margins and value available in the market be impacted?
- How will consumers' fuel purchasing behavior and price/value equation change?
- How do various competitors' supply positions impact market dynamics?
- How attractive does this make a market over the long term and what relative position should my network hold?

Oil-industry retail markets can differ across geographies in numerous respects, including: site productivity, as measured by average throughput per site; intensity of competition; fuel-brand presence and strength; and maturity, as measured by metrics like HVR or hypermarket penetration. To get the most from their new channel strategy, company executives must weigh several crucial considerations related to global/regional strategy—such as:

- In which retail markets do we already have a strong presence that should be maintained?
  - How will our core markets be impacted?
  - Which become more attractive (relatively)?
  - Which become less attractive?
  - How could our competitive position change?
- Which current markets are most attractive and/or important for future volume placement?
  - Which markets require a push for growth?
  - Which require pre-emptive action now?
- What additional/newer markets should we target for growth?
  - Where could we establish a viable competitive position?
  - Where might additional supply logistics assets (pipes/terminal capacity) strengthen our position?
- What are the businesses volume growth requirements?
- Which markets should no longer be priorities for us?
  - Which should we exit?

Challenges to running a profitable channel are increasing...

With branded wholesaler becoming the dominant retail channel in the U.S., several challenges to ensuring channel profitability are emerging:

- Jobbers continue to consolidate—in five years there will be fewer, much more powerful entities
  - Regional super-jobbers are beginning to emerge with as many sites as key regional oil companies
  - Many of these will consider creating their own brands
- Pressure continues from "newer" offers—big box with gas and high-volume C-stores
- Industry economics will force jobbers to rapidly close sites
  - The number of closures could reach 20%+ of existing sites
- Competition for jobber business continues to intensify
  - Power is shifting from the suppliers to the buyers—projecting lower margins and more support
- Jobber/distributor business models are evolving, with value-capture mechanisms becoming more varied and more complex
  - Many are making significant returns buying and then selling the majors' old networks. Once this is complete, what's next?

Increasingly, these questions about fuels marketing strategy need to be tied to the overall integrated value-chain strategy (a discussion topic in and of itself). This antecedent includes the view that companies should locate their downstream operations in those markets where refinery volume needs to be anchored and secured.

Undertaking a market and network review is an important first step in ensuring that the channel partner strategy is focused in winnable and profitable growth markets. Such a review must be strategic and differs from traditional asset-based analysis. The focus is not on specific sites/assets. Instead, decisions must be made at the market level and should include expectations of future dynamics and compare attractiveness across markets.

2. Channel Partner Selection – Selecting the right partners for the long term

As all world-class retailers know, site managers and frontline employees can make or break the performance of any retail operation. Given that the same holds true for oil-industry retail sites, it is crucial to find the right channel partners. These partners will ensure their managers and workers share the oil company's values and can execute the actions needed to support and enhance the fuel brand in the minds of consumers.

When evaluating potential partners, company executives need to consider whether the channel partner:

- Is growing in terms of volumes, sales, and number of sites
- Has a current network of sites that boasts higher-than-average fuel volumes
- Is competitive within its market in terms of market share
- Considers customer service and our fuel brand important, as evidenced by their image, reputation, and performance during mystery-shopping tests
- Shares oil company's values regarding operations and execution—including the importance of brand image, consistency in customer experience, site safety and security, environmental responsibility, and ethical labor practices
- Spends sufficient time at its sites or has designated a manager for each owned site
- Has sufficient capital to support its cash-flow needs

While historically the fuel marketing space has always witnessed competition for end customers (drivers), C-store wallet share, and even site employees, competition for channel partners is the emerging competitive landscape. Developing a structured channel partner selection and evaluation program is crucial to identifying the retailers and branded wholesalers that will support the brand, culture, and business performance desired.

3. Value Proposition Development

The value proposition is the most significant lever available to oil companies and requires consideration at two levels:

A. The broader offer (fuel, brand, non-fuel services)

B. Commercial terms

A. The Broader Offer—Fuel, brand, and non-fuel services

Fuel-product offerings, price, and supply priorities

In the low cost and capital approach, the fuel offering is the primary product of concern to an oil company. In deciding what range of fuel products to offer at each retail site, executives need to consider premium fuels, diesel and premium diesel, alternative fuels, biofuels, and ethanol. To ensure fuel quality, they must make choices about fuel additives, technical support, and fuel-product testing. Testing becomes particularly important in markets where unbranded products can illegally enter the supply chain. The offering will differ across markets—in some markets there is limited fuel product differentiation while in other markets premium alternatives may be a requirement to compete (e.g., premium diesel in European markets).

Fuel price and supply remain the most critical aspects of the retailer value proposition. In studies conducted by Oliver Wyman, there is clear agreement that price and supply are the top two considerations when choosing a supplier.

Fuel suppliers need to get pricing strategy, pricing structure, and consistency right while being sensitive to local market conditions. Channel partners are increasingly concerned about non-fuel branded competition, especially competition by hypermarkets and convenience retailers. The perception among retailers is that non-branded competitors employ aggressive pricing which is supported by lower fuel supply cost. While these perceptions may or may not be true, the industry is shifting to new pricing structures and levels. In the U.S. wholesalers are demanding more attention to the unbranded price differential at the rack, contract-based pricing, and Platts pricing. Oil companies need to be thinking ahead to revisit their pricing strategy and processes—sustaining brand premium and ensuring that the price supports their strategic brand position.

As executives consider their fuel offering, it is important to ensure that supply reliability is aligned, including decisions regarding fleet management and terminal siting. Oliver Wyman's studies have shown that channel partners will switch to new brands if supplies prove unreliable. Oil companies must therefore master the skills needed to ensure reliability—such as wet-stock management and logistics support within a particular market (including stock monitoring, automatic replenishment, and outsourced delivery).

Brand support

All major branded suppliers face serious pressures relative to perceived brand value. Oil companies' channel partners—dealers and branded wholesalers alike—prize extensive brand support from companies. And these partners become quite vocal when they believe an oil company is offering insufficient support. The right level of brand investment can strengthen partner relationships as well as drive overall market awareness and top-of-mind consideration among consumers—which in turn drive more consumers to sites. But such support is expensive; thus it warrants careful planning to ensure maximum return on oil companies' marketing investments.

Clearly, some brand spend mediums (e.g., advertising, site promotions) are more effective than others. Advertising, for instance, is viewed as the most critical marketing services element of a value proposition. Partners are looking for a mix of advertising content, with particular interest in fuel quality/retail brand base advertising. Ensuring that advertising dollars are effectively invested is a crucial area for marketing program management.

Channel partners also show significant interest in loyalty and credit card programs. Both are viewed as major sources of value resulting from the oil company's network scale and national presence.

Non-fuel services

Oil companies need to decide to which degree they will support non-fuel products at retail sites—choices that must be made at the market network level. A simple understanding of site economics and resilience can help executives make a clear case for broader site offerings (such as convenience stores, car washes, and lube services).

But such services are costly to support. Oil companies should therefore conduct analyses to determine what level of support they can provide profitably. In Oliver Wyman's experience, consistency on the backcourt is important, and companies should consider a range of store concept options—from franchise models, alliances, and cross-promotion arrangements to selective support for merchandising and supply chain.

B. Commercial Terms—Creating a compelling business case for potential partners

With non-company-owned retail sites, an oil company must persuade dealers and branded wholesalers to sell its fuel and not that of its rivals. To make a relationship with a particular company attractive to potential channel partners, executives must craft a compelling business case for partnering. That means strengthening existing partnerships by offering services that support the success of retailers currently in their site network and that attract new channel partners away from competing companies.

The overall objective is to present a compelling retail-channel offering that provides the requisite value though dollars and incentives, and supported with standards, processes, and tools to the channel partner. The ideal partnership deal will:

- Offer services that meet existing retailers' needs
- Offer services and incentives that convert new retailers
- Sufficiently support the brand and increase the competitive ante
- Reduce complexity of delivery and enhance cost efficiency for retailers and the oil company
- Offer varying levels of support across a range of support elements

Our research has consistently shown that channel partners most value a strong fuel brand backed by advertising and local marketing, business-consultant support and relationships, and fuel quality and assortment (for which many are willing to pay a premium). A retailer pointed out in one survey that "if I see a price that is much lower, instead of feeling good that I'm getting cheaper gas, I doubt the quality of the gas. Brand gives it a sense of quality." Another survey respondent wrote, "Fuel quality and delivery are well worth the premium we pay for it." Still another explained, "Without advertising, you can't stay top of mind for consumers."

Clearly, oil companies can bring numerous forms of value to the table that will appeal to their channel partners. These include:

- Upfront monies to support site development and advertising
- Discounts for selling significant volumes of fuel
- Financing services
- Leasing of signage and other equipment
- Help with site-network planning, facilities design, construction, maintenance, and conversion
- Co-op marketing funding
- Assistance with selection and implementation of convenience-store merchandise
- Training programs, manuals, and tools to educate novice site managers and owners on operating procedures and site standards
- While not a critical element of the value proposition, technology, can impact the supplier/retail relationship. POS and web portal are the most critical technology issues, and suppliers need to support technologies that allow their distributors flexibility (loyalty programs, promotions).

Each form of value has several potential levels. For example, training services may range from the provision of simple site-operations manuals to retailer training sessions to on-site workforce training.

With such an extensive menu of options, how can executives put together the most compelling offer for potential channel partners? Oliver Wyman's surveys have revealed distinctive segments within dealer and branded-wholesaler groups. The dimensions along which channel-partner segments can differ include single- and multi-site, single- and multi-brand, operating/business model, tenure of supplier relationships, regional regulatory requirements, and competitiveness within market.

Oil companies can sweeten the odds of sustaining and growing their channel-partner networks by tailoring their partnership deals carefully to each segment. But to do so, executives must take stock of their own and their competitors' existing retail-support offerings as well as deepen their understanding of channel partners' most pressing concerns. All this calls for extensive analysis of market data and fact gathering through site visits, focus groups, and retailer interviews and discussion groups.

Oliver Wyman's Strategic Choice Analysis® methodology has helped companies customize their partnership offers for particular retailer segments in ways that benefit all parties (see "About Strategic Choice Analysis®").

While designing a partnership offer tailored to a specific retailer segment, executives should keep in mind that the right offer will also need to support the company's strategy for a particular market. The best offers will not only maximize the oil company's return on its investments in the partnership but also enable the company or the retailer to manage costs. Most important, executives should recognize that developing a mutually attractive partnership offer is just the beginning of a longer journey.

4. Sustaining and Growing Partner Relationships

How can oil companies best safeguard their fuel brand with channel partners? These partners tend not to like change, and clearly believe that this is a relationship business. The components of a relationship keep channel partners satisfied and loyal to the brand. The most potent approach is to provide advisory- and coaching-based support for these partners—especially in markets where channel partners have less experience or need help growing.

Many channel partners find field support particularly valuable. In essence, a field-support representative is the face of the oil company: part advisor, coach, negotiator, and relationship manager. Thus he/she needs the right skills and tools, such as experience in retail operations or business development, to provide the desired counsel and to maximize the mutual value of the partnership. But all too often, field-support personnel find themselves taking care of low-value administrative tasks (such as resolving supply issues or invoicing) when they should be focusing on value-added activities (including coaching the retailer on growth and operations).

To correct the situation, companies can use inbound service call-centers to ease field reps' administrative burden. Channel partners with questions or concerns about supply, invoicing, and other matters can call the centers at any time for assistance. However, call-centers should not replace field personnel, as face-to-face interaction is vital to cultivating positive partner relationships. As one dealer explained in a client survey, "My rep does everything to help improve my station—from suggesting improvements on the site to educating me about recent regulations and trends." Companies can further keep channel partners engaged by establishing retailer councils and committees, where participants can share best practices and experiences, and by organizing major events for retailers such as annual conferences.

Being a trusted advisor also means helping channel partners monitor their performance and address any shortfalls. Monitoring tools include customer-satisfaction surveys, mystery-shopper programs to assess the quality of the customer experience, and measurement of brand consistency and compliance with image standards established by the oil company. Use of such tools generates performance data that oil companies can then use to launch improvement programs for their partners or to provide coaching.

Finally, to navigate the transition from being in the company-owned retail business to partnering with dealers and branded wholesalers, oil companies must reinvent themselves at the local, regional, and headquarter levels. These changes include redesigning organizational structures, bringing in new types of talent, establishing new processes in the area of channel partner support, and developing new capabilities and skills needed to support mutually beneficial partnerships.

In short, whereas they used to rely on command-and-control to operate their company-owned retail sites, they now must draw on their powers of influence, deal making, contracting, and relationship management to protect and enhance their brand with channel partners.

The four levers discussed in this paper—Network Targeting and Planning, Channel Partner Selection, Value Proposition Development, and Sustaining and Growing Partner Relationships—can help executives craft channel strategies with the best chances of success. ❖

About Strategic Choice Analysis®

Oliver Wyman's proprietary Strategic Choice Analysis® (SCA) approach helps oil company executives understand dealers' and branded wholesalers' preferences and priorities, enabling them to identify value tradeoffs and design programs that focus dollars on what matters most. Through a combination of conjoint and discrete-choice modeling, we uncover the importance that partners assign to specific offer elements. Companies can use these findings to segment channel partners and to tailor their partnership offers accordingly. Exhibit 2 depicts five potential oil-company offerings differing along five elements (upfront imaging, rebate level & term, co-op/business development rebate, site program commitment, and penalty provision). Marketers and wholesalers considered the five offerings and then selected the one they found most appealing for an unencumbered site (one not committed to a contractual term).

Exhibit 2 **Sample SCA Choice Set**

Please review the five hypothetical competitive offerings in addition to your current agreement today.
After you understand each offer set, please answer the question that follows:

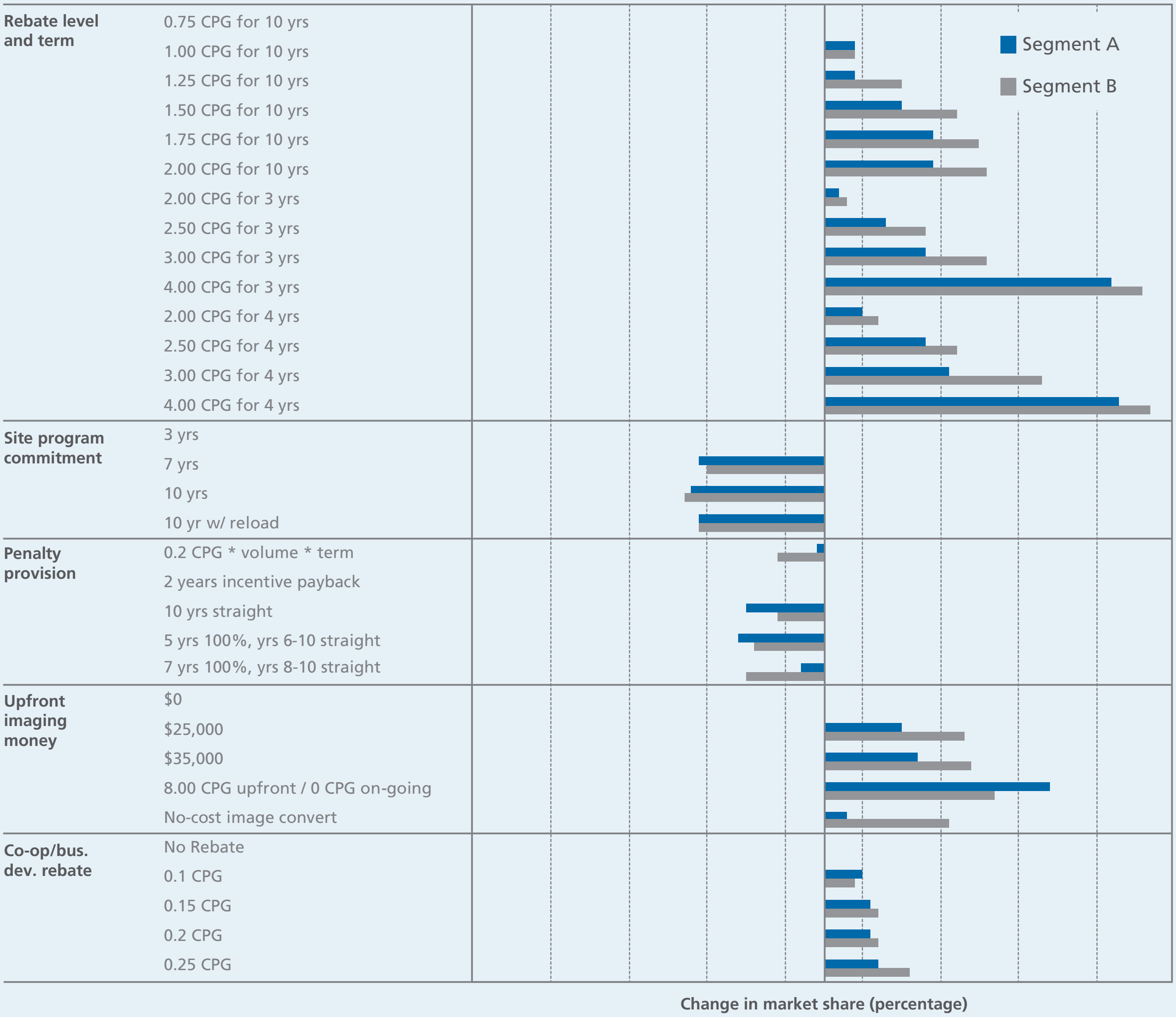
	Co A	Co B	Co C	Co D	Co E
Upfront imaging	No-Cost Convert	$25,000	$0	$100,000	$25,000
Rebate level and term	2CPG for 10 years	1CPG for 10 years	2CPG for 4 years	3CPG for 4 years	4CPG for 3 years
Co-op/bus dev rebate	0.25CPG	0.00CPG	0.05CPG	0.05CPG	0.10CPG
Site program commitment	10 years	10 years	7 years	3 years	5 years
Penalty provision	2 years of payments	2 years of payments	0.2CPG*volume*term	10 year straight	Upfront 5 & 5

Now that you've considered these potential offerings, please select the most appealing offer from this group for an *unencumbered* site:

Unencumbered site:	○	○	◉	○	○

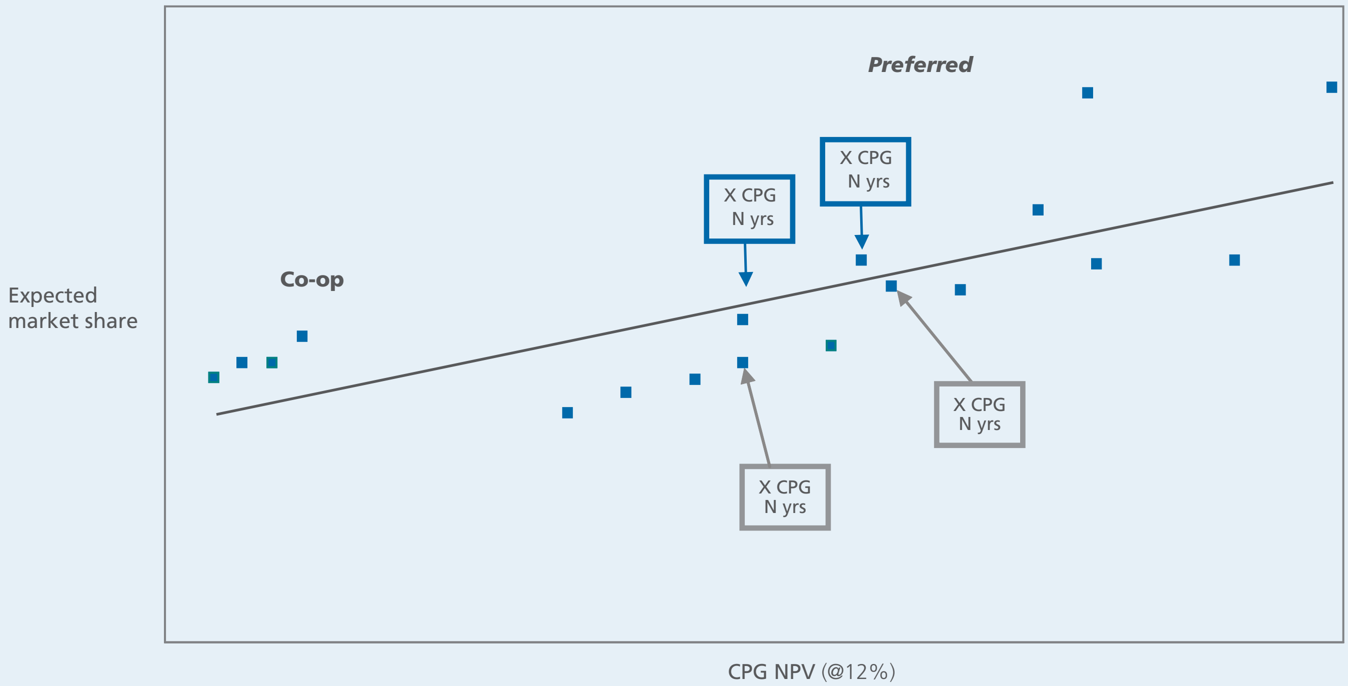
Analysis of the survey results produced the tornado chart shown in Exhibit 3, which depicts the channel partners' utilities for particular incentive attributes, how the utilities differ across channel partner segments, and the resulting potential change in fuel volume share.

Exhibit 3 **Channel Partners' Utilities for Incentive Attributes**



Finally, the company used the survey results to compare the expected volume market share to be gained from the preferred offer to the cost of providing the offer. The graph in Exhibit 4 shows these calculations.

Exhibit 4 **Expected Market Share vs. Cost of Program Attribute**



In developing a strategy for their retail channel, oil companies must take into account a wide range of variables. Decisions about which geographies to focus on and how best to partner with retailers, dealers, or branded wholesalers in those markets depend on several matters: the oil company's value proposition, its performance targets (revenue, site throughput, margin, cost, and capital hurdles), the nature of competition, and certainly both channel partners' and end consumers' needs.

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With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC]

Oliver Wyman's Oil and Gas Practice

Oliver Wyman's Oil and Gas practice defines itself by the value it creates for clients. Our state-of-the-art problem-solving tools combine with our "client-first" culture and relevant industry knowledge to ensure that the right opportunities are pursued with the best tools in a cost-effective way.

This white paper was prepared by Robin Sahota, a Toronto-based Associate Partner, Eric Nelsen, a Chicago-based Partner, and Bob Orr, a Houston-based Partner of Oliver Wyman's Oil and Gas Practice. If you are interested in discussing Oliver Wyman's perspectives on channel strategies, please contact your Oliver Wyman account partner or one of the authors at:

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