CHAPTER IX

CONCLUSIONS

In the fast developing economy of Malaysia, the future is very promising for all investors. To realise the potentials fully is, however, not easy. Any investment, if it is to be productive, necessitates a sound approach. The positive efforts of the Government to industrialise the nation's economy, and its untiring efforts to uplift the standard of living of its people have certainly made the future very bright, particularly so for the petroleum industry. However, a little reflection will bring the consciousness back to those who are always inclined to hold this optimistic view. This particular industry has been characterised by very keen competition, and perhaps over-saturation of participants. There are 5 rival companies, Esso, Shell, Caltex, Mobil and B.P., for a relatively small country like Malaysia. With the present policy of the Government, there is no guarantee that new competitors will not enter the industry at all. As such, a sound marketing philosophy and a realistic approach towards the industry are two of the basic essentials for successful investments. An appraisal of the method adopted by Esso in its retail trade development is, therefore, appropriate.

In the course of reviewing this exercise, one would certainly notice the adoption of a special retail function. The company does not actually sell to the final consumers directly, but through an intermediary - the retail outlet dealers. Perhaps the question may be raised: Is not the retail sales function of the company redundant or unnecessary? The Retail Sales Department does not perform the retailing function one would expect it to; neither do the retail salesmen of the company perform the usual task of selling directly to the final consumers. In retrospection, one would realise that the unusual type of retailing in the petroleum business necessitates this unique nature of retail sales function, having regard to the very keen competition in this particular industry and to the fact that direct selling by the company to the final consumers is simply impractical, as this would make the sales function so enormously heavy that effective execution of the retail sales development programme may be curtailed. Thus, the function of direct selling to the final consumers is delegated to the retail outlet operators. The Retail Sales Department, therefore, concentrates on the function of retail sales development to a very large extent, and the retail salesmen assume the peculiar role of business advisers as well as assist the Retail Sales

Department in the development of the retail market. The retail outlets are also made highly competitive so as to be in accordance with the concept of "merchandisable" outlet and the operators or dealers are very well trained to perform the retailing job through the dealer training programme. Such a thorough planning with well-coordinated functions has greatly enabled the company to achieve successful operations in the retail business of the petroleum industry.

Turning to the company's policy of investing, as far as possible, in the assured type of retail outlets, the writer has but this to comment. It is, in relation to the marketing concept of the company and its retail sales function, most consistent and well chosen course of action. Through ownership of land or building or both, or through lease or other contractual agreements, the company is assured of the desired channel of distribution through which its products can be exposed and sold to the final consumers at all time. Assuming that such line of action has not been adopted and that the company has to rely mainly on the dealer-built outlets or non-assured outlets to distribute its products to the consumers, a situation may arise where all such outlets, through some unified action, turn against the company and refuse to sell its products

or adopt a general boycott against the company due to some transactions not acceptable to the dealers in general. Then the position of the company in the industry would certainly be greatly jeopardised.[42] An even worse situation may arise if the dealers decide to turn to the company's rivals and market their products. A complete collapse of the company is not unimaginable. The farsightedness of the company in its investments in the assured type of outlets has certainly placed it in a soundly protected position against such an eventuality.

Since 1962, not a single retail outlet built by the company has been closed down for business. Such a phenomenal feat alone is enough to reflect the soundness of the approach towards the making of investments in retail trade. This may be attributable to the excellent programming of site selection and evaluation. All the factors relevant to such selection and evaluation - economic characteristics of the trading area, traffic arteries and traffic exposure, economic environments of the trading area, as well as the station's layout

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[42] Although such a situation is highly impossible, it cannot be ruled out entirely. Already in a certain area, retail outlets' dealers have contemplated the formation of petroleum dealers' association. To the writer's knowledge, a protem committee had already been formed.

and design, accessibility and visibility, etc. - are taken into consideration. Nevertheless, the analysis is not without its shortcomings. Can all the necessary information be obtained? It is apparent that some information is hard to come by, and some is simply non-existent. Can the person engaged in site selection and evaluation find out the age level of the consumers, their income level, or the number of vehicles per household? Statistics pertaining to a particular area are definitely scarce, or even not available. What he obtains are essentially guesses or approximate data only. There is thus a lack of objective data for assessing the desirability of an area for development into a retail outlet. The true picture of the area is liable to be distorted.

The primary instrument for justifying any proposal is the Retail Outlet Proposal Analysis (or commonly known as BUD-12), with a supplementary Discounted Cash Flow Analysis. Obviously the validity of these analyses hinges heavily on the estimated volume of sales of the proposed retail outlet. Unless the estimation of the volume potential is realistic and genuine, these analyses cannot be relied upon. The importance of having reliable estimate of volume potential cannot be over-emphasised. In the BUD - 12, the main criterion of justification is the simple rate of return on investment

based on the second-year performance. Surely, the returns for the subsequent years will differ from the second year's return. Although the returns on investment for the subsequent years can, in a way, be said to have been taken care of by the growth rates of these years, it is doubtful as to the validity and applicability of the growth rates. The growth rates may have general applicability, but certainly they cannot be used with absolute accuracy and reliability in every specific situation.

A slight anomaly in the DCF analysis has also been observed. The usual procedure for determining the residual value at the end of the twentieth year is to double the original value of investment.[43] The reason for doubling the original value of investment is that after twenty years, the station will still be there - a too optimistic view perhaps. Moreover, if the station has not been built, the same amount of investment will have to be made if the company decides to invest in the area after twenty years' time. Thus the value of the station will amount to twice the original amount of investment if the investment is made now. The

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[43] The writer was taught by the company to double the original amount of investment in order to arrive at the residual value at the end of the twentieth year. The writer regrets that the explanation cannot be accurately quoted here.

explanation is entirely unacceptable to the writer.

In determining the residual value of the investment at the end of twenty years, what should be found is the net realisable value of the assets at the end of the twentieth year. Land may not wear out after twenty years, and in accordance with the generally accepted accounting principle, land may not be charged off as depreciation expense.[44] The more acceptable value of land, however, should be its market value at the end of the twentieth year, which may be higher due to appreciation brought about by the improved surrounding economic conditions of the locality with the passage of time. As for items under improvements and equipment, the residual value should be their net realisable value. Thus, for the DCF analysis, the residual value of the investment after twenty years should be the net realisable value of the assets, consisting of land and the physical facilities.

Also, in order to be in consistence with the concept of "merchandisable" outlet which takes into consideration such factors as pleasing appearance of station, attractive facilities for satisfactory services, and so forth, the writer wishes to suggest that future

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[44] Finney, H.A. and Miller, H.E. Principles of Accounting, Introductory, Prentice-Hall, 5th. edition, Ch. 18.

investments such as modernization of building and ancilliary investment on the proposed outlet should be roughly estimated and integrated in the analysis. After all, a station cannot always remain in competitive position for twenty years without modernization and improvement such as building rennovation and equipment replacement, so that the station is in line with the concept of "merchandisable" outlet of the company as well as the concept of retail location as advocated by other authorities.[45]

In the calculation of the DCF Analysis the "average gross profit margin after average marketing expenses" is determined by reducing the gross profit by the wholesale and station expenses; the difference is then divided by the number of barrels, (refer to the section on DCF analysis Ch.VI). Depreciation, which is a non-cash expense is also included. However, if the actual discounted rate of return is to be obtained, then the average gross profit margin should be $2.4US per barrel, obtained by excluding the non-cash depreciation expense.[46] In this case, the

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[45] Refer to Baker, Anderson and Butterworth, Principles of Retailing, McGraw-Hill, 3rd. Edition, Ch.5

[46] Average gross profit margin after average marketing expense (excluding depreciation) = $\frac{20288 - 4432 - 863}{6164}$ = $2.4U.S. per barrel. For figures, see BUD-12.

series of annual cash inflows would be more accurate, and consequently, the actual discounted rate of return on investment would be 31.55% instead of the 27.5% as obtained previously.[47] Perhaps, the understated rate of return is deliberated in order to provide a safety margin for erroneous estimation of volume potential of the proposed outlet.

As already pointed out there are many possibilities for the actual performances of retail outlets to deviate from the expected performances. The re-evaluation of retail outlets that have completed two full years of operation is an instrument for detecting such deviations. It is very essential in the sense that such stations are held in constant check, and for those stations that have failed to achieve at least 90% of the target, corrective actions can be timely effected before it becomes too late. Perhaps, this positive step of making a re-evaluation of such stations having completed two full years of operation augurs well for the fact that no station since 1962 has been put out of business at all.

In conclusion, it should be pointed out that the approach towards site selection and evaluation

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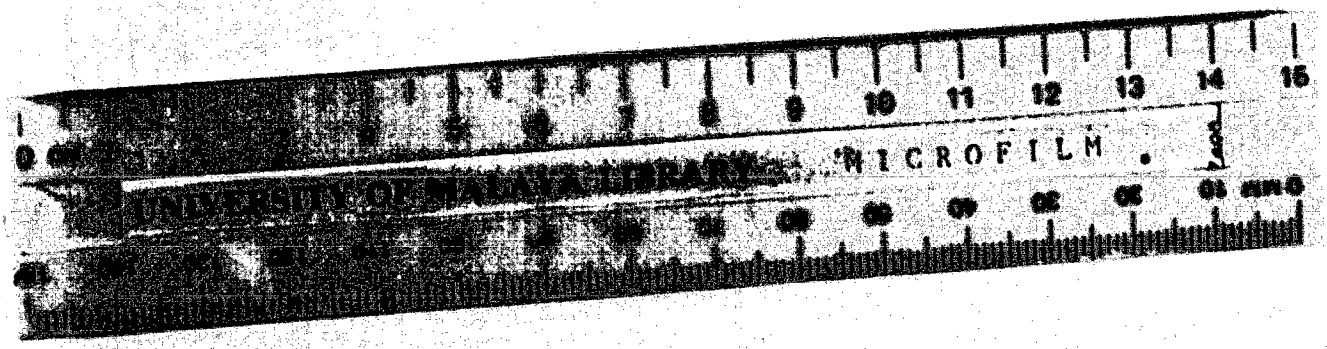
[47] See Appendix 6.

and the various evaluation processes are certainly very well-planned, thorough and realistic except for a few shortcomings which are inevitable.



APPENDIX I

TRAFFIC COUNTS CONDUCTED AT THE FOUR SITES A, B, C AND D.

(Figures are cumulative.)

Time	Site A	Site B	Site C	Site D
10.00 - 11.00 a.m.	548	735	472	659
11.00 - 12.00 noon	1,144	1,443	901	1,282
12.00 - 1.00 p.m.	1,778	2,222	1,354	2,057

Notes:

(1) Due to lack of time, the writer could only take the traffic count in 3 sampling hours, as indicated in the table above.

(2) The reason for selecting these sampling hours is that the traffic flow at this time is normal.

(3) In taking the count, a vehicle is counted as many times as it passes the site. E.g., a car which passes Site A thrice will be counted 3 times in the count taken at Site A.

(4) The count includes all motor vehicles passing the sites but excludes scooters and motor-bikes.

RANDOM SAMPLINGS OF 25 SALES MADE AT SERVICE STATIONS IN KUALA LUMPUR, PENANG AND IPOH.

Kuala Lumpur Esso Jalan Selangor Service Station	Penang Esso Kelawai Road Service Station	Ipoh Esso Kampar Road Service Station
M$ 8.64	M$ 8.20	M$ 15.12
5.60	1.00	14.07
14.65	2.00	6.80
2.20	7.50	1.50
10.00	6.85	2.60
10.30	17.82	3.45
6.08	2.60	8.04
14.07	9. 48	4.10
8.00	15.05	4.87
4.45	4.10	15.12
25.40	6.70	10.85
10.12	9.80	5.09
9.60	15.00	2.16
10.80	8.00	10.00
5.80	10.80	20.05
4.60	7.30	4.45
4.00	10.80	15.00
11.10	4.00	4.75
10.80	6.00	11.45
5.00	8.38	2.60
10.00	15.72	4.00
4.02	10.60	6.00
5.00	3.00	10.80
15.80	4.80	2.80
10.60	7.30	15.80
Total: M$239.23	M$192.90	M$201.18
Averages: M$ 9.57	M$ 7.76	M$ 8.05
Price of Esso Extra Gasoline Per Gallon: M$ 2.16	M$ 2.16	M$ 2.17
Average Purchase in Gallons: 4.4	3.6	3.7

Notes:
(1) These locations are located in residential areas.
(2) In estimating the sales potential of the selected site at Jalan Tambun, Ipoh, the writer has assumed the average purchase of customers to be approximately 3.7 gallons.

COMPARATIVE SITE EVALUATION WORKSHEET

Address of Site Being Evaluated_____ Street ____ City

	Brand	Brand	Brand
1. Address of Competing Outlet			
2. Market Share (City or Town)			
3. Age of Stations (Years)			
4. Average Monthly Motor Fuel Volume			
5. Market Share Ratio = Esso's Market Share Factor / This Brand's Mkt. Share Factor			
6. Maturity Ratio = Esso's Maturity Factor / This Brand's Maturity Factor			
7. Comparable Esso Site Volume = (4) X $\sqrt{(5) X (6)}$			
8. Average Comparable Esso Site Volume = Sum of The Comparable Esso Site Volume / The number of Comparable Sites Above			

9. Factors Comparison (Esso versus Above Competitors)

Check (✓) the appropriate column.

	Better	Same	Not As Good	Better	Same	Not As Good	Better	Same	Not As Good
Traffic: Exposure									
Control									
Speed									
Site: Dimensions									
Location									
Visibility									
Accessibility									
Neighbourhood:									
Competition									
Proximity to Shopping Area									
Population Density & Growth									

Total Column Checks:

Under Better =

Same =

Not As Good =

Minimum 1st. Year Volume For Site Development = _____ gallons

Notes:

When a new site is being considered and the average Esso site volume is less than the minimum 1st. year volume and most column checks are under "same" or "not as good", reject the site.

For all other conditions, complete the Inherent Site Evaluation Worksheet.

APPENDIX A

INHERENT SITE EVALUATION WORKSHEET

Estimating Base Volume:

1. Traffic Count _____ passing cars
2. Multiplier (Trading hours per week divided by sampling hours.) _____
3. Estimated Weekly Exposure.i.e. (1)X(2) _____ cars
4. Percentage of Weekly Traffic Exposed Making Purchases _____ %
5. Estimated Number Of Cars Exposed To Site Making Gasoline Purchases Weekly _____ cars
6. Gallons Per Gasoline Purchase _____ gallons
7. Estimated Gallons Sold Per Week: i.e. (5)X(6) _____ gallons
8. Estimated Gallons Sold Per Month: i.e. (7)X4.3 weeks _____ gallons
9. Estimated Gallons Sold Per Year _____ gallons (Base Volume)

Adjustment To Base Volume: **% Adjustment** (Plus Or Minus)

Dimensions
Type
Location
Signals
Speed
Curb Cuts
Visibility
Income
Age
Competition _____
Net % Adjustment: _____

Therefore, Adjusted Base Volume = Base Volume X (1.0 ± Net % Adjustment) ____ gallons

Add: Population Density Factor, If Any ____ gallons

Net Estimated Volume Potential _____ gallons

ADJUSTMENT FACTOR SHEET

Site Factors:

1. Dimensions:

Over 15,000 sq. ft. and over 150 ft. frontage	+10%
10,000 - 15,000 sq. ft. and 120 - 150 ft. frontage	-0-
Under 10,000 sq. ft. and/or under 120 ft. frontage	- 5%

2. Type:

Residential only	-0-
Residential - shopping (Located at or within one block of a planned shopping plaza)	+10%

3. Locations:

Inside lot	+ 5%
Inbound	-0-
Corner lot: Best site	+10%
Far corner site	+ 5%
Other site	-0-
Worst site	-10%
Triangular lot: Best site	+ 5%
Other sites	-0-

4. Signals:

If none	- 10%
If stop signs or traffic lights	
Near corner site	- 5%
Far corner site	+ 5%

5. Average Traffic Speed:

Residential only:	Under 20 m.p.h.	+ 5%
	20 - 30 m.p.h.	-0-
	Over 30 m.p.h.	- 5%
Residential - shopping:	Under 20 m.p.h.	-0-
	Over 20 m.p.h.	- 5%

6. Possible Curb Cuts:

	Main St.	Side Sts.	
Corner lot full cut or	3 cuts	2 cuts	+ 10%
	2 cuts	2 cuts	+ 5%
	2 cuts	1 cut	-0-
	1 cut	1 cut	- 5%
Inside lot full cut or	3 cuts		+ 5%
	2 cuts		-0-
	1 cut		- 5%

7. Visibility: (Oval Visible From Left-Hand Lane, Main Street)

Over 500 ft. away	+ 5%
Under 300 ft. away	- 5%

8. Average Annual Family Income In Area:

Low Income	- 5%
Middle Income	0
High Income	+ 5%

9. Age In Area:

Under 30 years	- 5%
30 - 40 years	0
Over 40 years	+ 5%

10. Competition:

6 or less competitors in 2 block radius	0
Over 6 competitors in 2 block radius	- 10%

11. Population Density:

For each 100 households with more than 1,500 persons in a half-mile radius, ADD 500 gallons to the adjusted base volume.