CHAPTER 1: INTRODUCTION

1.0 Introduction

Is a product or a customer the central of importance to a business entity in a competitive environment? Do we start a business with a product or the customer as end in mind? These are valid questions that warrant debates and further research.

The complexity in competitive business environment requires businesses to make shift managerial decisions or to suffer from opportunity loss. This includes deciding what type of customers to pursue, retain or to forego. In the current business environment, the only way for sustainability is to ensure continuous profitability. As maximizing firm value is always the undisputable objective of any business entities, it is essential for a business to continue servicing profitable customers and to forego those who do not give or give lower profitability to the firm. This is especially more important for oil companies operating in Malaysia with limited promotion opportunity, fixed margin and escalating costs.

In view of the current business scenario, coupled with the impending introduction of Anti Competition Law in Malaysia that expected to be implemented by end of 2011 with the objective to protect consumers against monopoly market abuse (Mazwin, 2010), it is suggested the oil company to shift attention on understanding its customers. Specifically, the focus is on the revenue earned from a business relationship with its customers over a period of time and the cost of maintaining that business relationship.

Hence, in achieving above mentioned goals, Customer Lifetime Value (CLV) is the key to understand the transaction behavior of an individual customer (Venkatesan & Kumar, 2004) in order for the company to serve its customer base more effectively. CLV basically uses finance concept of Net Present Value (NPV) that dwells into the revenue and cost structure of a customer in details, which leads to the justification of various customer relationship management investment. While various industries have started to put more focus in CLV as a means of increasing their competitiveness, a retail oil and gas company was chosen for the study.

SPCSB, a retail oil and gas company, is chosen in this case study for several reasons. It operates in an oligopoly market, the main products sold, petrol and diesel, are commodity products with hardly any differentiation. The situation is worsened by the fact that they are controlled items; the selling prices are regulated in Malaysia. Regulated fuel price means the selling price is fixed by the government and the margin of oil companies are also fixed. Hence, no sales promotion activities are allowed in terms of discount and other incentives which imply cheaper fuel prices. The retail price of petrol and diesel in Malaysia is determined using Automatic Pricing Mechanism (APM) since 1983 (Ismail, 2009). Any fluctuation in oil prices is managed by means of government subsidy and sales tax. In this context, the government subsidy will increase when crude oil price increases and vice versa. Also, the government may collect sales tax from the oil companies. The APM components are summarized in Table 1.

Table 1: APM Components

Components	Description
Product Cost	The product costs of petrol and diesel are determined using daily average price of Mean of Platts Singapore (MOPS).
Alpha	Alpha is the difference between actual price purchased by oil companies and Platts published price. An oil company will bear the extra cost if the actual price is higher than Platts price, and vice versa. The Malaysian Government set Alpha to five cents per liter for petrol and four cents per liter for diesel.
Operational Cost	Main components of operational costs are marketing and transportation. The operational cost is 9.54 cents per liter for Peninsular 8.98 cents for Sabah and 8.13 for Sarawak. However, these rates may be revised by the government from time to time.
Oil Company Margin	The margin is fixed at 5 cents per liter for petrol and 2.25 cents for diesel. However, these rates may be revised by the government from time to time.
Station Dealer Margin	The margin is fixed at 12.19 cents per liter for petrol and 7 cents for diesel. However, these rates may be revised by the government from time to time.
Sales Tax	According to Sales Tax Act 1972, the Malaysian Government may collect a maximum sales tax of 58.62 cents per liter for petrol and 19.64 cent for diesel. This component is used to adjust the retail pump prices.
Subsidies	This component is used to adjust the retail pump prices when the actual price is higher than the fixed retail pump price.

The same situation is also being observed for SPCSB other's products such as the fuel cards. It is noticed that oil companies do not advertise their fuel cards publicly. The public come to know the product information via SPCSB's sales force, through its official websites or word-of-mouth. The sales and marketing is basically done through their personal selling and telemarketing

Apart from that, the introduction of Diesel Subsidy Scheme in 2006 has made the customer switching cost even higher as the customers could not change fuel supplier freely. In this context, a company which has already registered with an oil company and uses its fleet card must obtain a letter of release from that particular oil company should it decide to change to another oil company[6].

For simplicity, the term CLV which represents Customer Lifetime Value will be used throughout the report.

1.1 SPCSB SWOT Analysis

SWOT assesses the overall company's strengths, weaknesses, opportunities, and threats where it provides on an organization's internal and external environments with an objective of ascertaining its internal strengths as well as leveraging on its external opportunities and avoiding its external threats, while addressing its weaknesses.

SWOT is the conventional way, according to Valentin (2001), in searching for insights into methods of realizing the desired alignment. Without doubt, SWOT analysis is a crucial mean in the field of business strategy as it stirs decision makers to critically consider aspects of their organization's surrounding and assist in organizing their thoughts. It is aimed to spark distill fragmentary facts and figures and strategic insight into coherent backdrops for strategic planning (Mintzberg, 1994). Useful strategic insights are a source of limited intellectual assets that enhance chances of securing competitive advantages, while ignorance and strategic misconceptions, on the other hand,

[6] http://www.mymesra.com.my/index.php?ch=mmc_pns_misc&pg=mmc_pns_misc_misc&ac=39&tpt=mmc.v.

Accessed on Dec 6 2010.

often yield costly deficits top firms (Barney, 2002; Glazer, 1991; Srivastava, Shervani & Fahey, 1998).

Ultimately, any SWOT analysis aims to identify the critical internal and external factors that are the determinant in achieving a firm's objectives. Overall, it categorizes important information into two main categories, i.e.

1. Internal factors: it consists of the internal 'strengths' and 'weaknesses' of the organization.

2. External factors: it consists of the 'opportunities' and 'threats' reflected by the external environment.

By using the SWOT matrix, a series of choices for a firm or business unit based on particular combinations of the four sets of strategic factors can be obtained.

The matrix also is capable of illustrating how the external opportunities and threats facing a firm can be accommodated with its internal strengths and weaknesses on order to yield the best solution for the company in a particular situation.

In essence, the SWOT matrix includes:

1. SO strategies: efforts are channelled in order to use the strengths of a business to take advantage of the opportunities more effectively.

2. ST strategies: emphasize on the attempt to use the strengths of a company to avoid external threats to the company at any particular time.

3. WO strategies: effort is given directly in aiming to cut any weaknesses in order to open new opportunities to the firms.

4. WT strategies: Basically defensive in nature and serve as to reduce weaknesses and to avoid threats.

SWOT analysis is widely adopted in the context of companies as well as classrooms where it serves as the centerpiece of situation assessment (Day, 1984).

The sections below detail the Strength, Weakness, Opportunity and Threat (SWOT) analysis of the company.

Strength

- Strong Human Capital

Armed with an estimated workforce of 1300 staff at over several regional offices nationwide, employees are seen as a great asset. One of the key strategies of the group is to enhance employee capability to meet human resources needs in petroleum sector through its education and human resources training and development initiative which begins since 1978.

- Strong Financial Performance

SPCSB is financially stable with strong cash flow. It posted net profit of RM752.9mil on revenue of RM20.7billion for Financial Year 2010. The net profit is an increase of 30 percent from Financial Year 2009. The company's net profit margin of 3.06 percent is far healthy than its close competitor's 2.47 percent (SPCSB, 2010). With the strong and stable company financial performance, it is believed that the company is able to allocate resources to meet business needs.

- Extensive Service Station Network

The company has an extensive service station network along the highway and in the rural area. This has served as an arm for the company in reaching customer all over Malaysia more effectively.

Weakness

- Inflexible Operation

The ultimate holding company is a state owned where it operates under highly regulated market environment. State owned companies normally have limited operational flexibility. This implies that the company may not operate as a business entity as the decisions it made may not always be a business decision. Having substantial amount of service stations in rural area is the best testament. When a business entity does not have the free hand to make sound business decision, it is unable to act independently and unleash its full potential, resulting in a less competitive business player.

- High Dependency on ICT Vendor

Highly dependent on Information & Communication Technology (ICT) vendors is another weakness of the company. Unlike its close competitor who maintains their own ICT Department which is also providing IT services to other regions, the group has outsourced its ICT support services to a new and less established IT company 7 years ago. Until today, the company is struggling with its unstable legacy card system at service station which affects the customer total encounter experience.

Opportunity

- Deregulated Market

Statistics shows that in year 2007, the Malaysian Government had paid a total of RM16.2billion fuel subsidy (Jabatan Penerangan Malaysia, 2008). As a proportion to GDP, Malaysia is one of the world's highest subsidised countries, i.e. at 4.7 percent of GDP, when its GDP grew at 3 percent per annum on average. This is far higher as compared to neighbouring countries Indonesia's 2.7 percent, Philippines's 0.2 percent, Organisation for Economic Co-operation and Development (OECD) countries at 1.5 percent ("After the subsidy", 2010).

If the fuel subsidies continue for the next 10 years, Malaysia would probably go bankrupt by 2019, revealed by the Subsidy Rationalisation Lab Open Day, Performance Management and Delivery Unit (Pemandu). In view of the future scenario, Malaysian Government is mulling to withdraw subsidy gradually and eventually deregulate the market.

Should this happen, it is a great opportunity for the company is forced to compete in the same level playing field with other oil companies. Also, this is seen as good opportunity where all the companies currently entitled for Diesel Subsidy are freed and free to choose any oil companies of their choice.

Threat

- Crude Oil Price Volatility

Unpredictable crude oil price volatility is the main threat. Retail oil and gas industry in Malaysia is regulated, the margin is fixed. Besides, the company is also experiencing rising operating costs.

- Depleting Resources

At the current production rate, it is expected that Malaysia will run out of oil in 18 years and gas in 35 years. Depleting crude oil reserves has forced all companies to start finding alternative fuel such as NGV, bio fuel, hydrogen etc. Meanwhile, car manufacturers have spent extensively on R & D which led to car engine breakthrough. Car manufacturers worldwide such as GM, Toyota, and Honda are selling hybrid cars which are very fuel economic. All these affect the selling and consumption of fuel.

- Stringent Environmental Regulation

Exploration and selling of petroleum products is one of the most destructive activities. Hence, oil companies are required to comply with the stringent environmental regulations to curb green house gas emissions, resulting in additional capital and operation expenditure.

1.2 Problem Statement

SPCSB operates in a regulated market where fuel prices are regulated by the Government. The margin is also directly determined by the Government. Meanwhile, its products are hardly differentiated; in addition, no promotion activities are allowed in terms of discount or other sales incentives. Retail business, despite being stated as the main focus and revenue driver to the company, continues facing stiff competition. The inconsistency in reporting its retail business market share in annual reports implies unstable market share and challenging times ahead. At the same time, operating cost is escalating. Hence, there is an urgent need to assess its business strategies in order to increase the company performance via sustained profitability. Being a marketing company, the customers are the main stakeholders directly contribute to the profitability of the company. Profitability study is not complete without investigating the revenues and costs, especially those involving the direct customers, the main profit contributor. This seem contradicts with SPCSB's current practice of just relying on the total purchase volume as an indicator of customer profitability without looking into the cost associated with servicing the customers. CLV, with the forward looking capability is used in this case to better predict the customer profitability for justifying marketing investment. In this context, fleet card business customers are chosen for reason no other than it is a retail business and the company has direct influence in term of acquiring strategy, business decision and customer information.

Case study is deemed appropriate and chosen to assess the above profitability study. It provides the avenue to review the overall business environment so that the most dwelling problem faced by the company can be identified and given priority, in real life context. Once the specific problem area is identified, case study warrants an in-depth investigation of the phenomenon which often leads to practical recommendations in solving real business problem. Due to case study involves specific study on particular phenomena, it often results in a specific and in-depth understanding of the issues at hand that is applicable and can be generalized in similar business setting. This also leads to the discovery of specific important aspects for future research.

1.3 Purpose of the Study

The purpose of this study is to evaluate the CLV of fuel card customers of an oil company. Fuel card is a plastic payment card similar to a credit card. It could be issued either by a bank or an oil company, used to perform electronic purchases especially fuel products. Meanwhile, CLV has been given many names by different researchers (Dwyer, 1997; Berger & Nasr, 1998; Dipak & Siddhartha, 2002; Hogan et al., 2002; Gupta et al., 2004; Pfeifer, Haskins & Conroy, 2005). Among others, it is also known as Customer Equity or Customer Profitability. They define a customer's CLV as sum of the revenues gained over the lifetime of transactions, after deducting the cost of acquiring, selling and servicing the customers, taking time value of money into consideration.

The study aims to analyse the revenue and cost structures of a fleet card business. It explores the existing literatures and models describing the customer profitability and brings it into the specific context of evaluating fleet card customers. The case study analysis will further try to answer the following research questions:

Question 1: How to evaluate the CLV of fleet customers?

Question 2: How to segment fleet customers using CLV?

Question 3: Which segments of the prepaid and post-paid customers are more profitable?

Question 4: What are the appropriate marketing programs for customer retention of fleet card customers?

Question 5: Which are the areas of improvement to better service the customers in the future?

1.4 Significance of the Study

A research remains an academic piece of work if it does not try to solve real life business problems. This study aims at utilizing class room knowledge to assist organizations answering the questions pertaining to the business transactions with their customers. Among others, the study has identified three main contributions, i.e. Contribution to SPCSB Practice, Contribution to the Practice and Contribution to the Theory and Methodology. The following sections detail the three contributions.

1.4.1 Contribution to SPCSB Practice

Besides credit worthiness assessment, the company under study currently does not have any systematic way of evaluating and assessing its fleet card customers, in term of profitability brought in by a particular customer or a segment of customers. This study is the first step towards developing an organized and step-by-step way of gaining valuable insights into its individual customer by inspecting the revenue earned from a business relationship. In addition, this information further serves as a good input in customer segmentation decision making. Instead of treating every customer the same and differentiate it merely with the monthly transaction volume contributed, the company can now improvise its standard customer retention program to reward customers based on different levels of the profit brought by different segments of customers. A conscious decision can be taken in forgoing unprofitable customers.

CLV study, besides investigating the revenue drivers, it also permits an insight into its cost structure and to identify cost drivers. Measures can then be taken to maximize revenues, apart from re-examining into the business processes to cut down the operating costs. With this valuable information, it will contribute to strategic planning in achieving the overall goal of the company.

1.4.2 Contribution to the Practice

This study benefits directly the companies in the same or similar industry. Other retail companies can make use of these research findings to understand the customer transaction pattern and profitability of their customers, hence to formulate business strategies and to optimise the overall company profitability.

1.4.3 Contribution to the Theory and Methodology

The findings of this study serve as a source of material for future reference. Research shows that CLV studies have been carried out in the insurance, credit card, telecommunication and online catalogue businesses (Donkers, Peter, Martinj & Jong, 2007; Li & Chang, 2010; Hwang et. al., 2004). The details pertaining to the said research are elaborated in Chapter 2. Nonetheless, research that attempts to calculate CLV on fleet card business is not known to be available. Hence, this study serves as the base for future research to improve the CLV model for fleet card business.

Besides, the recommendations from this study can be used as inputs for the strategic planning of fleet card business as well as for future research in this area.

1.5 Scope of the Study

The scope of the study is the section details the areas covered under this study. It serves as guide directing the research towards achieving the stated research objectives. Areas not covered would become the study limitations.

The study is using an existing company as a case study where fleet card business is one of its many businesses. Also the study will be focusing into two main segments, which are post-paid and pre-paid customer base.

1.6 Organization of the Study

This research write-up is organized into five chapters. Chapter One involves the introduction of CLV concept and its definitions. It summaries the whole research by highlighting the purpose of the study, the significant contribution of this study as well as the objectives and expectations from this study.

Chapter Two starts with the introduction of fleet card itself as well as the business. The challenges faced by the business prompt the needs of assessing the customer lifetime value of fleet customers. Subsequently, a great length of explanations on the first birth of CLV concept, the different interpretation of CLV definitions and various component/value drivers by many researches involving CLV are given. The literature review also discuss on the importance and usage of CLV in justifying marketing investment, the first attempt to link finance and marketing via CLV . It goes further to demonstrate the applications of CLV in various industries, including credit cards and telecommunication.

Chapter Two also includes literature reviews on business concepts such as customer segmentation technique.

Chapter Three focuses on the methodology used in this study. It details the data collection technique and quantitative analysis used in deriving customer lifetime value of fleet card customers. Technique used to segment the customer according to CLV is also being discussed. On top of that, qualitative analysis which involves focus group interview of selected customers from each segment is put forward for discussion.

Chapter Four discusses the detailed step-by-step CLV calculation. It also presents the analysis and research findings.

Chapter Five sets to conclude the findings of the study, the contributions and proposal for future research. Besides, it also highlights the limitation of the study.