

# Supply chains and store operations of oil companies



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## Introduction

Recently, the Iraq War and the War on Terror have caused some surges for the energy industry; oil prices have been heavily fluctuated. Ironically, the solid performance in overall oil industry suggests that oil companies are heading with decent momentum.

*' The surge in oil prices, from \$10 a barrel in 1998 to above \$50 in early 2005, has prompted talk of a new era of sustained higher prices. Even so, an unusually loud chorus is now joining Messrs O'Reilly and Chavez, pointing to intriguing evidence of a new " price floor" of \$30 or perhaps even \$40. To see which camp is right, two questions need answering: why did the oil price soar? And what could keep it high?' [1]*

The energy industry has experienced the tumultuous era domestically and internationally. This paper will apply STEEP and Porter's five forces to determine competitive strategies in order to respond to two questions: why did the oil price soar, and what could keep it high?

## Porter's Five Forces

### 1. Bargaining power of suppliers

The oil companies have exposed to price fluctuation risk. Additionally, currency exchange risks have increased the cost of capital and worsen the debt ratio in the oil industry. As a result, oil companies might enter into long-term sales contracts for the oil and gas suppliers and establish long-term hedging agreements to protect against currency volatility. [2] However, the

question is whether the industry has succeeded in finding its way to organize alliances between oil suppliers and oil producers. Although bringing down the costs of developments through common practices has already been established, the achievement breaks down some barriers which have existed between oil companies and their contractors for such a long time.

Additionally, the profits from oil reservoirs have caused political turmoil in Venezuela and the Middle East region. OPEC (the Organization of Petroleum of Exporting Countries) is confident to defend its stated high price policy at any costs. Furthermore, high-sky oil prices have been helped by the strong demand from China. Coupling with these events is the sharp downturn of the U. S. dollars. Thus, the global downstream market has undergone pressure; the oil industry has high power of suppliers.

## 2. Threat of Substitute Products

High gasoline prices drive efforts to increase ethanol consumption and ethanol related products. Additionally, propane, methanol, natural gas and especially ethanol are most widely uses gasoline-alternatives. Besides, electricity, hydrogen and palm oil become among substitute fuels which car producers and chemical companies are developing.

Europeans cut their dependence on oil suppliers by switching to substitutes, such as coal, nuclear power, and natural gas. Nevertheless, the Euro currency now appreciates against U. S. Dollars. Since Europeans usually purchase oil in U. S. currency, their profit margins become narrowed. The fuel prices are so high that it would take a quick drop to make ethanol unprofitable and stunt the growth of its use.

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On the other hand, gasoline prices at high record can help biotech companies achieve a breakthrough in reducing cost of ethanol. It might take a few years before reasonable prices for ethanol could be commercially available, and cheaper ethanol might not take much of a dent in gas price. Thus at this time the threat of substitutes is low for the industry.

### 3. Bargaining power of buyers

As mentioned, gasoline at this time does not have many alternatives although many nations have tried to reduce dependences on oil suppliers. However, these substitutes also require suitably designed devices, which might cause higher cost of finished goods. As a result, in the mean time, the cost incentives will discourage the purchasing power.

The oil industry is defined as a basic commodity. The outlook for the energy industry is given high commodity prices, high growing demand, and lack of alternatives to oil as the primary transportation fuels. The oil industry has efficiently squeezed from operating assets, such as untapped resources and refineries. The growth of oil price will lead to increase transportation and energy in price, driven by market forces inflamed by infrastructure shortage.

Despite of many impacts, oil industry has low bargaining power of buyers due to a few substitutes.

### 4. Threat of New Entrants

The oil industry requires more financial investment for reservoir allocation.

Many major oil companies have fended off the advances of these unbranded foes. However, the “upstarts” have inroads with marketing strategies. One <https://assignbuster.com/supply-chains-and-store-operations-of-oil-companies/>

of the criteria is to focus on bringing down drilling costs to keep the pace of activity. A combination of high oil price and uncertainty of oil price might bring about several government reviews of energy sector. Thus, this will have a marked impact on exploration operation in oil industry. They have applied different strategies from those of the past, enjoyed superior returns and captured value from the integrated giants.

Thirty years ago oil companies were primary operators of service stations, enjoying exclusivity in the gasoline market. Now, many factors have combined to put pressure on margins. The consumers' ties to the stations, operated by major oil companies, have been weakened. The convenience stores have begun selling gasoline and provided new services. But, major oil companies have not yet considered these retailers as a major threat. They still view these unbranded offerings as inferior in terms of quality and consumer appeal.

However, since the petroleum industry merged, consumer attitudes and the impacts on the brand choice have been changed. Unfortunately, those factors now stay largely inside the stores, not with the major oil companies. The drivers of brand choice have evolved, especially when the new consumers define brand value; these "upstart" marketers have already developed the systems and processes to stay abreast of these major oil companies. The upward trend in convenience store sales will lead to higher profit margins.

In short, the threats of new entrants are increasing in oil industry.

##### 5. Intensity of competitive rivalry

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Oil crisis during the end of the 1990's help oil investors and executives understand what conditions are driving this wave of mergers. Foremost is the chronic glut of oil that has driven crude prices to near-historic lows. Some of the oversupply are derived from flattening demand in mature markets and economic difficulties in many emerging markets.

*' In recent deals such as British Petroleum (BP) and Amoco, Total and Petrofina, Exxon and Mobil, and currently BP/Amoco and ARCO, the stated goal has had a familiar refrain: to increase profits by dramatically cutting costs, reducing inefficiencies, and expanding geographically.'* [3]

During early the 1990's, major companies have to fight back and watch their market shares for gasoline reduce at the hands of the upstarts. " In addition to the majors, in 1997 alone, an increasing number of c-store acquisitions by Amerada Hess, MAPCO Express, and FINA, to name a few, were announced. In Atlanta, Amoco, BP, and Texaco have begun to battle aggressively to maintain market share and repulse QuikTrip and RaceTrac." [4] As a result, these competitors are aggressively selecting choice properties and investing in facilities. They are also pursuing and pushing programs to increase profit margins for their branded dealers. If a backdrop of growing global economy becomes uncertainty, investors in oil industry get jittery.

As of July 26, 2005, *' in a report published last week, Merrill Lynch & Co. said the aggregate net income of the 70 largest companies in the sector is expected to rise 26% this year to \$230 billion, on sales of \$2. 57 trillion, up nearly 10%. The reasons: high oil prices and fat refining margins, plus a pickup in oil-field services, particularly in rates for drilling rigs.'* [5]

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The increased competitiveness of major oil companies can be observed in their willingness to see joint ventures or any other alliances to reduce their operating, refining and marketing costs. Furthermore, under aggressive competition, major oil companies continue to decoupling their value chains, breaking explorations and production. Merge and acquisition as well as marketing into separating different business units help reinforce efficiency and compete as standalone entities.

The intensity of competitive rivalry is high in oil industry.

STEEP (Societal, Technological, Economic, Ecological, and Political)

#### 1. Societal

It seems that the Iraq war has resulted extra expenses for multinational corporations, especially oil companies. *' Yesterday, high-profile companies, such as BP, Shell, HSBC, Barclays and British Airways, either raised or maintained their security levels, and all remained on high alert.'* <sup>[6]</sup> Together with calling for strengthening co-operation on combating terrorism, the oil giant is on the alarm mode to fight against terrorism, enhancing regional and international co-operation.

There has been a board-level group devoted to health, safety and the environment at oil companies since the early 1990's. Potential environmental hazards could do long-term damage to oil companies' image. This includes tracking issues ranging from headline grabbing ones, such as oil spills, to local but insidious problems, such as leakage from tanks on the forecourts of petrol stations.

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## 2. Technological

Efficient operations depend on the integration of technology throughout the operating activities. For years, technology has become a required tool for effectively managing the customer interface. ' According to National Petroleum News Market Facts, in 1992 the first wave of pay-at-the-pump technology was a key driver in increasing gallons of gasoline sales by 20%.'

[7]

Companies invest in technology to improve change in concession terms, reduce costs and increase efficiency.

*' Before-We estimate average reservoir thickness of 90 ft. Because we do not have an explicit measurement of the uncertainty in this estimate, we tend to ignore its uncertainty and implicitly assume that 90 ft is simply "right".*

*After-We estimate average reservoir thickness of 100 ft. In addition, the technology tells us that we are 80% certain that thickness is 80-110 ft.'*<sup>[8]</sup>

Furthermore, technology helps improve supply chain and integrate screen applications for in-store and island reading equipments. The automated replenishment system can ensure its own invoices from which its can pay vendors, and also ensure fewer out of stocks situations and accounting defaults. Additionally, the chain uses remote monitoring to make more informed decisions about fuel replenishment. Technology can provide valuable sale information that can be implemented to understand consumers and improve services.

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### 3. Economic

The free market will adjust in accordance with the demand and supply law. Oil demand not only is fragile, but also is surprisingly strong in spite of weak world economy. The transition to a global economy has been taken place during the international economic trend and arising nationalism. The slower economic growth will depress the demand for oil and oil related products worldwide.

Large oil consuming nations, such as China, the United States, should cultivate a common understanding in society on the changing aspects of global economy. Politics, wars, and economic setbacks for several years have impacted on the oil industry with the inescapable conclusion that one has to deal with the ramifications of issues before initiating the development of a new oil sector.

### 4. Ecological

Oil companies have tried to create more environmentally sensitive sources of energy. Their basic tasks are still to stick holes in the ground in search of hydrocarbons. BP recently spent nearly \$4 billion building a huge pipeline stretching from the Caspian Sea to the Mediterranean. In addition, it also asked a leading environmental group, the World Wildlife Federation, to act as an environmental consultant on the project. <sup>[9]</sup>

Oil companies have established steps in their strategies to enhance competitiveness and develop a strong trademark in anticipation of the world environmental images. Business has treated the reduction of carbon

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emissions and the development of energy policies as a technical issue, such as greenhouse gas emissions.

When the prices are down, oil producers cannot afford to expand facilities and thus hardly meet the demand when oil prices are up. “ Some people blame oil companies for not having any new refineries built in the past three decades as their current facilities operate at 88 percent capacity.” [10]

Additionally, environmentalists block the tapping domestic resources.

However, there is still a ton of oil in the world, a huge amount in Siberia and Alaska due to the tundra, but for a foreseeable future, the way oil can be extracted from earth are far different from the early 20<sup>th</sup> century images, depicting rows of jacks and derricks around towns, and destroying surrounding environment.

Oil industry is proactively and socially responsible for operations in an ethical and environmental friendly manner. Thus, overall business strategies for oil companies are considered as an integral part of new cultures and territories. Oil companies are aware of the relationship between socially responsible investment and their “ green” reputation, linked to their positive impacts on societies where they operate.

## 5. Political

In order to combat government to increase offshore activities, the oil industry has considered a new light and proved to be less flattering than the common view of any industry. The pace of new field development in the UK

will be sharply reduced if the government applies policies to save jobs in the coal mines by restricting the construction of new gas-fired power stations.

Politics has ceded to economics and confronted to cooperation at the new realism of oil producers and consumers. However, oil and politics are still a potentially combustible mixture. The fact that the British and U. S. governments have been involved with the Iraq War has proved how oil industry can be intertwined with political concerns.

OPEC might no longer be the bogey man with the West once so feared. Oil always, as essential, becomes the most politicized community in the world. There will undoubtedly be some future oil shocks, although it is difficult to know the time and directions which these oil shocks will come. <sup>[11]</sup>

## Conclusion

Oil companies should strategize that they no longer operate as manufacturing companies, but focus on improving their supply chains and store operations. Additionally, they should be willing to implement process of upstarts. They also need to refine their brand positioning and marketing strategies to be better target consumers. Although some major oil companies have been merged and acquired, the war has not yet been over. The big integrated players start with several advantages, if they could commit to reinvent themselves. One can envision the purchase of a non-gasoline retail chain in order to capture new skills and new profits.

With high entry barriers and low substitutes, oil industry has posted as an affluent, luxurious and profitable industry. As a result, the oil price keeps

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fluctuated under the pressure of the supply and demand law as well as the political influences.

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