ECONOMIC EFFECTS OF LIBERALIZING THE OIL INDUSTRY IN KENYA

BY

MICHAEL MWANGI

UNITED STATES INTERNATIONAL UNIVERSITY NAIROBI

FALL 2004
Economic effects of liberalizing the oil industry in Kenya

By

Michael Mwangi

Research Project submitted to the School of Business in partial fulfillment of the requirement for the degree of masters in Business Administration.

United States International University
Nairobi

Fall 2004
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to another college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: Michael Mwangi (ID-605544) Date: 30-11-2004

The project has been presented for examination with my approval as the appointed supervisor.

Signed: Dr. Michael Kirubi Date: 14/12/04

Signed: [Signature]
Dean, School of Business Date: 21/12/2004

Signed: [Signature]
Deputy Vice Chancellor, Academic Affairs Date: 26 Jan 2005
ACKNOWLEDGEMENTS

I wish to express my gratitude to all those people who helped me accomplish this project. I am sincerely grateful to Dr. Michael Kirubi who patiently guided me and helped me fulfill this task according to the requirements recommended by the United States International University – Africa; To Dr. George K’aol and Dr. Nancy Dubosse who gave me the technical preparation to undertake the job.

I also acknowledge the staff of the Petroleum Institute of East Africa for giving me their publications which provided me with invaluable information about the oil industry in Kenya.

I am grateful to my wife and other family members who gave me moral support and encouragement during my studies. Finally, to all those who I have not mentioned here for your help in completing this project.

Thank you.
<table>
<thead>
<tr>
<th>CHAPTER</th>
<th>TOPIC</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Declaration</td>
<td>iii</td>
</tr>
<tr>
<td>II</td>
<td>Acknowledgements</td>
<td>iv</td>
</tr>
<tr>
<td>III</td>
<td>Table of Contents</td>
<td>v</td>
</tr>
<tr>
<td>IV</td>
<td>List of Tables</td>
<td>vii</td>
</tr>
<tr>
<td>V</td>
<td>Abbreviations and Acronyms</td>
<td>viii</td>
</tr>
<tr>
<td>VI</td>
<td>Abstract</td>
<td>ix</td>
</tr>
<tr>
<td><strong>Chapter 1</strong></td>
<td><strong>INTRODUCTION</strong></td>
<td></td>
</tr>
<tr>
<td>1.1</td>
<td>Industry Background</td>
<td>1</td>
</tr>
<tr>
<td>1.2</td>
<td>Statement of the Problem</td>
<td>6</td>
</tr>
<tr>
<td>1.3</td>
<td>Purpose of the Study</td>
<td>7</td>
</tr>
<tr>
<td>1.4</td>
<td>Research Questions</td>
<td>8</td>
</tr>
<tr>
<td>1.5</td>
<td>Justification for the Study</td>
<td>8</td>
</tr>
<tr>
<td>1.6</td>
<td>Scope of Study</td>
<td>9</td>
</tr>
<tr>
<td>1.7</td>
<td>Definition of Terms</td>
<td>10</td>
</tr>
<tr>
<td>1.8</td>
<td>Chapter Summary</td>
<td>10</td>
</tr>
<tr>
<td><strong>Chapter 2</strong></td>
<td><strong>LITERATURE REVIEW</strong></td>
<td></td>
</tr>
<tr>
<td>2.1</td>
<td>Introduction</td>
<td>11</td>
</tr>
<tr>
<td>2.2</td>
<td>Business Arena in a Liberalized Environment</td>
<td>11</td>
</tr>
<tr>
<td>2.3</td>
<td>Role of Economic liberalization</td>
<td>13</td>
</tr>
<tr>
<td>2.4</td>
<td>Effects of Economic Liberalization</td>
<td>13</td>
</tr>
<tr>
<td>2.5</td>
<td>Strategy Posture in a Liberalized Environment</td>
<td>14</td>
</tr>
<tr>
<td>2.6</td>
<td>Competitive Forces in a Liberalized Market</td>
<td>16</td>
</tr>
<tr>
<td>2.7</td>
<td>Broad Strategic Options</td>
<td>19</td>
</tr>
<tr>
<td>CHAPTER</td>
<td>TOPIC</td>
<td>PAGE</td>
</tr>
<tr>
<td>---------</td>
<td>------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>2.8</td>
<td>Specific Strategies that firms could adopt</td>
<td>21</td>
</tr>
<tr>
<td>2.9</td>
<td>Chapter Summary</td>
<td>22</td>
</tr>
<tr>
<td>Chapter 3</td>
<td>RESEARCH METHODOLOGY</td>
<td></td>
</tr>
<tr>
<td>3.1</td>
<td>Introduction</td>
<td>23</td>
</tr>
<tr>
<td>3.2</td>
<td>Research Design</td>
<td>23</td>
</tr>
<tr>
<td>3.3</td>
<td>Population and Sampling Design</td>
<td>23</td>
</tr>
<tr>
<td>3.4</td>
<td>Data collection Method</td>
<td>24</td>
</tr>
<tr>
<td>3.5</td>
<td>Research Procedure</td>
<td>26</td>
</tr>
<tr>
<td>3.4</td>
<td>Chapter Summary</td>
<td>26</td>
</tr>
<tr>
<td>Chapter 4</td>
<td>RESEARCH FINDINGS</td>
<td></td>
</tr>
<tr>
<td>4.1</td>
<td>Trend analysis on demand of petroleum products</td>
<td>27</td>
</tr>
<tr>
<td>4.2</td>
<td>Market penetration by new oil firms</td>
<td>28</td>
</tr>
<tr>
<td>4.3</td>
<td>Analysis white oil sales volumes</td>
<td>31</td>
</tr>
<tr>
<td>4.4</td>
<td>Financial performance of Oil firms quoted in NSE</td>
<td>34</td>
</tr>
<tr>
<td>4.5</td>
<td>Outcome of interviews with oil industry executives</td>
<td>38</td>
</tr>
<tr>
<td>4.6</td>
<td>Strategies to counter challenges in oil industry</td>
<td>42</td>
</tr>
<tr>
<td>4.7</td>
<td>Chapter Summary</td>
<td>47</td>
</tr>
<tr>
<td>Chapter 5</td>
<td>CONCLUSION AND RECOMMENDATIONS</td>
<td>48</td>
</tr>
<tr>
<td>5.1</td>
<td>Introduction</td>
<td>48</td>
</tr>
<tr>
<td>5.2</td>
<td>Summary</td>
<td>48</td>
</tr>
<tr>
<td>5.3</td>
<td>Discussions</td>
<td>49</td>
</tr>
<tr>
<td>5.4</td>
<td>Recommendations</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>References</td>
<td>52</td>
</tr>
<tr>
<td>APPENDIX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>I</td>
<td>Letter of Introduction</td>
<td>54</td>
</tr>
<tr>
<td>II</td>
<td>Research Questionnaire</td>
<td>55</td>
</tr>
</tbody>
</table>
LIST OF TABLES

Table 1  Local demand of refined petroleum products  27
Table 2  Distribution of service stations in Nairobi Area  30
Table 3.1 Analysis of market penetration by new players in 2000  31
Table 3.2 Analysis of market penetration by new players in 2001  32
Table 3.3 Analysis of market penetration by new players in 2002  32
Table 4  Financial Highlights for Total Oil (K) Ltd  34
Table 5  Financial Highlights for Kenol Oil (K) Ltd  36
Table 6  Profitability and performance Ratios  37
Table 7  Analysis of non-oil businesses offered by oil firms  46
<table>
<thead>
<tr>
<th>Abbreviations</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>LPG</td>
<td>Liquidified Petroleum Gas</td>
</tr>
<tr>
<td>KBS</td>
<td>Kenya Bureau of Standards</td>
</tr>
<tr>
<td>KPC</td>
<td>Kenya Pipeline Company</td>
</tr>
<tr>
<td>KPRL</td>
<td>Kenya Petroleum Refinery Ltd</td>
</tr>
<tr>
<td>NSE</td>
<td>Nairobi Stock Exchange</td>
</tr>
<tr>
<td>NOCK</td>
<td>National Oil Corporation of Kenya</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organization of Petroleum Exporting Countries</td>
</tr>
<tr>
<td>PIEA</td>
<td>Petroleum Institute of East Africa</td>
</tr>
</tbody>
</table>
ABSTRACT

The oil industry in Kenya was deregulated in 1994 through an Act of Parliament. The significant implication was that the Kenyan government relinquished its role of determining the prices for petroleum products. The current role of the government through the Ministry of Energy is to monitor industry operations to curb unethical business practices such as formation of a cartel and other exploitative tactics.

Before liberalization, there were seven major market players. Following this move, the government licensed over 10 new oil companies, thus breaking the oligopolistic market structure previously in existence. Among these entrants, the aggressive ones were Elf, Engen, Fuelex, Gapco, petro and National Oil Corporation (NOCK).

This study set out to establish the economic implication of liberalization to the existing oil companies. In addition the study sought to establish the strategies undertaken by oil firms to counter competitive pressure. The study used diverse data collection methods to assess the impact. These included surveys on number of service stations in Nairobi area and the study specifically verified the number of service stations owned by the new firms vis-à-vis the total retail network. The other complimentary method used was the analysis of the refined oil sales volumes for the established oil firms vis-à-vis the new-comers. This study managed to obtain data for 2000 to 2002 through market intelligence and was useful in evaluating the level of market penetration by new players.

Other techniques used included detailed evaluation of financial performance and trend analysis using published financial reports of oil companies listed in Nairobi Stock exchange. The financial analysis conducted by this study concentrated on the
period 1998 to 2002. Lastly the study also conducted interviews with marketing executives from two leading oil firms on this subject.

The findings of this study did establish that the established oil firms were adversely impacted by the liberalization. This was evident in terms of lost market share and reduced profitability. The emergence of unethical business practices in the post liberalization era such as dumping of oil consigned for exports through fake exports and sale of adulterated fuel are some of the adverse trends.

According to this study, the existing oil firms were ill prepared for liberalization and consequently their defensive strategies have not been quite effective. However over the time some of them have undertaken differentiation strategies whereby they have capitalized on uniqueness of their products and services. Others have taken turn around strategies that included restructuring and re-engineering. These were intended to have a lean and efficient structure to enable them compete effectively. Overall the local environment in the oil industry is still turbulent and the key players need to be more proactive and assertive for their own survival.
CHAPTER ONE

1 INTRODUCTION

1.1 Industry Background

According to 2002 Economic Survey, there are no known oil deposits in Kenya. There has been intensive oil exploration over the last ten years carried out in blocks but there are no positive results as yet. Explorations are still in progress. The same report indicated that petroleum products provided 67% of the country's commercial energy needs. Virtually all the petroleum used is imported mainly from the Gulf countries.

Petroleum products refer to a range of refined oil products produced from crude oil. For the sake of this project, this study restricted its scope of petroleum products to popular white oils namely:

1 Premium (super) petrol. This is the most popularly used fuel for petrol-powered engines in Kenya.

2 Unleaded premium. This brand of petrol was introduced in the Kenyan market in 2001 and is considered more environmentally friendly. It has lower lead content and other emissions which are hazardous to human life and the environment. Fuel emissions contribute to global warming and also can lead to ailments such as blood poisoning and cancer.

3 Regular petrol: This is a close substitute of premium but has lower octane rating. Octane rating is the combustibility of fuel at a certain temperature.
4 Diesel gas oil is the fuel used in diesel-propelled engines such as tractors, buses, heavy commercial trucks and locomotives.

5 Kerosene is used to power thermal turbines to generate electricity. Its other use is for domestic cooking and lighting.

6 Jet A-1 is dehydrated kerosene and is used as aircraft fuel.

Petroleum products excluded from this study include heavy diesel oil, fuel oil and asphalt. These are collectively referred to as black oils. These were excluded from this study because they are used mainly in less competitive sectors such as in the industrial boilers and ocean tankers.

Kenya has only one oil refinery known as Kenya Petroleum Refinery Ltd (KPRL) and is located in Mombasa. This refinery was built as a joint venture between Kenya government, which controls 51% of the shares, Shell/BP 35% and Caltex 14%. Like in any other state controlled company, the day-to-day running of the refinery is done by some government appointees. The responsibility of importing crude oil lies with the oil companies. The refinery’s role is to handle the refining processes of crude oil at some agreed fees.

Statistics from 2002 Economic Survey showed that Kenya petroleum refinery processes 85% of the country’s petroleum requirements and the 15% shortfall is imported. After crude oil is processed, the refined oils produced are stored in the refinery tanks ready for distribution. Oil companies have large installations at Mombasa where they store their fuel requirements to supply the coast region and for exports. The bigger domestic market for petroleum products is in the interior particularly in Nairobi and about 80% of the white oils are pumped upcountry through the pipeline.
The country has one oil pipeline running from Mombasa to Nairobi, Nakuru and there after branches to Kisumu and Eldoret. Kenya Pipeline Corporation (KPC), a government parastatal, mans this pipeline. Products transported through the pipeline include premium, regular, diesel, kerosene and Jet-A-1. KPC owns storage installations and depots at Nairobi, Nakuru, Kisumu and Eldoret where the oil companies get supplies for their customers. KPC also has jet A-1 storage facilities at Mombasa and Jomo Kenyatta airports.

1.1.2 Competitive forces

Before liberalization, the government used to regulate the number of firms in the industry and it was difficult for new players to enter the market. In addition, the government used to determine the fuel margins up to retail level. Thus there was an assured level of profitability to the oil firms. The players were also certain of availability of foreign exchange from the Central Bank for crude oil importation. The above conditions clearly indicated that there was minimal turbulence in the market. The protection by the government gave the oil firms an assurance of substantial returns to their investment. Pricing of petroleum products took into account the following variables:

a) Free on Board (FOB) prices.

These are the crude oil prices posted in Bahrain (import parity prices) for popular crude oil brands like Murban, Zurkum and Arab Light which are determined by the cartel of oil producing and exporting countries (OPEC). Murban and Zurkum constitute 90% of crude oils intake at KPRL.
b) Cost insurance and Freight (C.I.F) charges. Insurance and freight charges vary depending on the political animosity in the Gulf region, the cargo size and the age of the vessel.

c) Exchange rate:
Between 1998 and 2002, the Kenya Shilling depreciated from 60 to 78 against the US Dollar. This 30% currency devaluation translated to higher petroleum prices.

d) Refining fees:
Currently KPRL charges a refining fee of US Dollars 2.8 per metric tone. This is considerably 50% higher than the fee charged by modern refineries in the gulf region.

e) Fuel usage by the refinery:
The furnace at the refinery uses a lot of fuel oil because the processing technology used at KPRL is old and inefficient. Consequently the refinery has high fuel consumption rate that translates to higher product cost. This cost is factored in the production cost and then passed to the consumers.

f) Government taxes:
A recent survey by the Petroleum Institute of East Africa (PIEA) indicates that excise and import duty on premium petrol comprises 48% of the retail price.

The scenario in the liberalized era has changed significantly due to the influx of new firms. According to Bhagavan, Oketch and Nyoike, (1999) the industry is experiencing stiff competition due to the influx of new players. Below is the profile of the new oil firms:
Mobil Oil
Initially, Mobil Oil pulled out of the Kenyan market in 1984 and sold off her interests to Kobil. However, Mobil re-entered the Kenyan oil market in 1997 when it bought the assets of Esso (K) Ltd, an affiliate of Exxon International.

Elf Petroleum
Elf, a French firm with strong presence in West and North Africa ventured in to the market in 1996 and the focus was in the retail sector. However, her operations merged with Total Oil (Kenya) in 2001.

Engen Petroleum
Engen is a South African owned firm which bought Mobil interests in South Africa during the anti apartheid era. It has an aggressive expansion strategy to other African countries and already it has a presence in Zambia, Zimbabwe and Tanzania. It entered the Kenya market in 1996 and has invested in several service stations in Nairobi area.

National Oil corporation of Kenya
National Oil Corporation of Kenya (NOCK) was incorporated by an Act of Parliament and commenced operations in 1985. By then it was importing crude and refined oils to cater for the shortfall in crude oil imports by the industry. However, following liberalization, it has gone downstream by investing in several retail outlets.

Other petroleum firms that have entered the market but have not invested in the retail segment include Fuelex, Gapco, and Petro. These firms act as whole sellers and target the independent dealers as outlets for their products.
Besides the above firms, there are several retail outlets built by individual investors and they are commonly referred to as independent dealers. These dealers source their petroleum products from any established oil firm and of course they go for the best price and credit offers. Among the independent dealers, we have names such as Astrol, Hass and Lenjoka.

1.2 Statement of the problem

The Kenya government formally announced the liberalization of the oil industry through Kenya Gazette Legal Notice number 1036 of November 1994. However, the government retained some strategic investments in the oil industry such as the refinery where it owns 51% shares. Other government interests include the Kenya pipeline that is fully government owned and NOCK.

The rationale for liberalizing the oil industry was to minimize the bureaucracy in a controlled business environment. Such controls hinder fair competition, creativity and industry efficiency. Ultimately such an environment would facilitate oil industry growth, more profits and better shareholders net worth.

Apparently, contrary to industry expectations, most of the established oil firms seem not have taken advantage of the liberalization. This indeed is the problem statement of this study. The study intended to establish why the major oil firms are worse off in terms of performance, market share and lack of visible expansion programs in the post liberalization era. Specifically this study intended to establish:

1. The resultant impact of liberalization of oil industry to industry players
2. The challenges facing the oil industry in the post liberalization era
3. The strategies key players have adopted to mitigate these challenges.
1.3 Purpose of the Study

Preliminary studies indicate that a few researches have been conducted on liberalization of the oil industry. Among these was the study carried out on liquid petroleum gas (LPG) marketing in Kenya by J. Mburu Kariuki in 2001. None of the new firms has ventured in to the LPG business. The probable reason is that the market is small and may not justify investing hefty capital expenditure in a crowded market. Thus the coverage in this study excluded LPG. There was also an earlier research by J. Abekah in 1996. His study about the strategic response by the oil industry did not address the effect of liberalization. Moreover it was carried out almost immediately after deregulation. Major changes have evolved in the oil industry landscape as the full effect of deregulation took effect. Among the major changes include:

1. Formation of the Petroleum Institute of East Africa, which is a lobby group for the oil industry. It has been instrumental on anti dumping campaigns against fake oil exports. It also championed the public awareness on the hazards of using adulterated fuel.

2. The re-entry in to the market by Mobil and the exit of Esso.

3. Acquisition of Agip by the Shell/BP alliance.

4. The extension of the Kenya Pipeline to Kisumu and Eldoret.

5. The entry of Elf in to the market and subsequent merger of Elf and Total Oil (K) Ltd in 2001.
This study intended to investigate why key oil firms seem to have been negatively impacted by the liberalization of this industry. In addition, this study intended to establish what strategies or measures that were put in place by key players to mitigate pressure from competition.

1.4 Research Questions.

This research will attempt to address the following questions:

1. What has been the impact of liberalization of the oil industry especially to the oil marketers?

2. What challenges are the key market players facing in the post deregulation era?

3. Which strategies have oil firms taken to brace them for the new competitive force?

1.5 Justification for the Study

The rationale of trade and economic liberalization is to eliminate the bureaucracy and inefficiencies that are predominant in market controlled economies and other business controlled environments. Adam Smith’s publication on the Wealth of Nations advocated that businesses should be allowed to operate in an environment without government intervention and control. This allows level playing ground in competition, which ultimately leads to efficiency because bureaucratic and rigid firms may not cope with competitive forces hence they will windup. Thus
competition on level playing ground is healthy as it leads to effectiveness and efficiency in utilization of available resources.

This study focused on investigating why the key stakeholders seem not have realized the anticipated benefits of free trade. Among the beneficiaries of the findings will be the government of Kenya as this will provide useful feedback on the liberalization process. This is of significance because other sectors such as telecommunication are scheduled for liberalization and using the findings of this study, the government would be in a position to weigh if it is beneficial to proceed with the program.

The top management who are the decision makers in the oil industry will equally benefit from this study as they will be able to evaluate the significance of deregulation. Moreover the findings are useful in determining whether the strategies adopted by the industry were worthwhile.

Lastly this study is valuable to potential investors in the oil industry. The findings will provide useful insights on liberalization and its impact on the industry performance.

1.6 Scope of study.
This research was designed to collect data on the oil industry for the last five years. This span was considered fairly adequate to evaluate the aftermath of liberalization. Overall, the coverage of the study was deemed adequate. However, the findings may not be entirely comprehensive given that they were based on samples. For example, the study conducted interviews with marketing executives from two oil firms and their opinion may not be representative of the entire industry. These are some of the shortcomings of this study but they are inevitable due to resource constraints.
1.7 Definition of Terms

1.7.1 According to Bhagwati (1987), Economic Liberalization can be defined as the relaxation of economic activities by the government through trade and economic policies. Such policies include tariffs and other barriers in the economy. Their removal allows entry of new firms thus effectively allowing more competition and also allowing the market forces to determine prices.

1.7.2 Environmental Turbulence according to Ansoff (1987) is the measure of changeability and predictability of an industry’s environment. It refers to the complexity of the environment relative novelty of change and uncertainty.

1.7.3 Positioning; According to Kotler (2000) positioning is an action of designing unique goods and services that gives a firm distinct competitive advantage.

1.7.4 Strategy, according to Strickland (1987) is the concise effort to proactively think through the short and long run direction of an organization.

1.8 Chapter summary
This chapter has given a brief background about the oil industry in Kenya, the liberalization and the influx of new firms in to the market. The study also outlined the problem statement, purpose of this research, the objectives of the study, the research questions and scope of the study. The next chapter is on literature review that explored the justification of this study.
CHAPTER TWO

2 LITERATURE REVIEW

2.1 Introduction

This chapter is seeking to explore the opinion from diverse authors on the subject of liberalization, its consequences and how organizations have responded to challenges arising from economic turbulences. Although the study has adopted a broad approach, emphasis focused on the oil industry.

2.2 Business Arena in a Liberalized Environment

The business arena in the 21st century is becoming increasingly sophisticated and complex than ever before. It is characterized by a lot of uncertainties and business upheavals, which Drucker (1999) referred to as the violent environmental turbulence. He considered the 21st century as an era of business uncertainties and discontinuity. He attributed the volatility of the business environment largely due to the external environmental forces.

Leading among the external factors are technological changes. This is indeed a major cause of environmental turbulence due to the fact that technology is changing at whizzing speed. There is no doubt that the 21st century experienced phenomenal technological revolution and an increase of knowledge in all dimensions of humanity. This knowledge has led to technological innovations at such a fast pace such that some products are becoming obsolete as soon as they are launched. (Kotler, 2000). The technological turbulence has not spared the oil industry. For example, Shell is among the oil industry firms leading in innovativeness. In the last
decade it has upgraded its petroleum refineries with a new technology known as catalyst cracker that facilitates optimization of refinery yields in middle distillates and less heavy oil and residue. Middle distillates are high margin petroleum products like petrol, kerosene and diesel. In the local scene, KPRL failed to invest in this new refining technology and this makes it inefficient, expensive and uncompetitive. (Petroleum Insight Journal, 2002)

The other factor is that markets are becoming more customers driven. Customers' tastes and preferences drive the markets in this era where customers are well informed and are demanding value for money. Thus business managers and entrepreneurs have to be proactive to satisfy customer needs otherwise they cannot survive. The Shell Report (2002) acknowledges that the need for "cleaner" or less hazardous fuel pushed petroleum companies to expensive research ventures whose resultant effect was the introduction of unleaded petrol and low sulfur diesel.

Other issues include mounting pressure from stakeholders such as pressure groups against environmental degradation. For example, among the multinational oil companies, Exxon nearly wound-up due to lawsuits and resultant compensations arising from the Exxon Valdez oil spillage in Alaska. In terms of environmental destruction, this oil spill that occurred in 1989 is still ranked as the most devastating and Exxon spent over 2.1 billion US dollars to clean up\(^1\).

\(^1\) http://www.oilspill.state.ak.us/facts/qanda.html
2.3 Role of Economic Liberalization.

Liberalization has played a significant role in the environmental turbulence because it eliminates protection offered to industries within a given market. The scrapping of government controls and barriers to entry by new firms effectively allows more competition. Furthermore, the absence of government’s price fixing mechanism allows market forces to determine prices. Thus proponents of liberalization advocate free trade. This involves opening up markets, which were once protected through stiff tariffs and other non-tariff barriers. Non-tariff barriers include use of quotas, subsidies to local firms intended to give them undue advantage over foreigners. Others involve bureaucratic legislation controls all intended to frustrate entry of new firms. (Bhagwati, 1987).

2.4 Effects of Economic liberalization

According to Gray (1987) the following are some of the merits of economic liberalization:

1. It leads to optimal utilization of scarce resources in that investors endowed with resources namely capital, technological and entrepreneurial resources end up competing effectively. The benefits of economies of scale are realized in terms of improved quality and low cost of production. This pushes other inefficient producers out of the market and therefore resources are channeled to other sectors. From an economic perspective it means that the benefits derived from “invisible hand” concept advocated by Adams Smith are realized in terms of lower prices and better living standards of living (Bhagwati, 1987).
2 Liberalization leads to technological transfer, which stimulate economic development. Countries are able to attract investors who will specialize in the field best suited for them. This leads to innovation and hence technological advancement. This has an aspect of technological transfer because foreign investors will device production systems that are efficient. According to the Shell report for 2002, the Royal Dutch and Shell group have spent a fortune in research and development researching on alternative source of fuel. Recently their researchers were part of the team that discovered hydrogen cell as a substitute for petroleum fuel. Trial runs on hydrogen cell have been successful in the USA and Europe and now they are working on logistics of storage and refilling. Hopefully, this innovation breakthrough will be passed over to developing countries.

3 Economic liberalization eliminates monopolists who are anti social due to their exploitative pricing policies. Furthermore, it eliminates inefficient quasi government entities that rely heavily on handouts from the exchequer. Ultimately the resources previously spent on such inefficient ventures can now be utilized to improve the social infrastructure and uplift the well being of people in developing countries. In the Kenyan business arena, several sectors such as the banking sector, the transport/motor industry sectors are now fully liberalized. Liberalization of the oil industry has witnessed entry of over 10 new oil companies. However, according to Bhagavan et al (1999) it is only 7 of the new entrants who are active. These are Nock, Gapco, Elf, Engen, Fuelex, Somken and Galana.

2.5 Strategic Posture in a Liberalized Environment.

One of the objectives of this study was to evaluate the responsiveness of the oil industry in Kenya to the turbulent business environments. The responsiveness calls
for tact, and visionary leadership, which are elements of strategy. It is imperative for this study to define strategy and identify its role in the business arena. Several authors have written on this subject. Among them is Strickland (1987) who defines strategy as a process used by managers in establishing vision or long-term goals of an organization and then set action plans and milestones for achieving these objectives.

Mintzberg (1997) define strategy by his 5 “P”s and identifies strategy as comprising of a plan, ploy, pattern, position and perspective.

a. A Plan refers to a consciously intended or predetermined course of action in the future. It could also mean a path to steer on specific direction.

b. Strategy could also take form of a ploy. This is a specific tactic or maneuver intended to outwit competitors.

c. The other dimension is that strategy could imply a pattern. This is a stream of actions pursued by a company. For instance, a company that perpetually markets expensive products could silently be pursuing a high-end strategy. This brings in the dimension that strategy can either be deliberate or emergent.

d. Peter Drucker (1994) asserts that a strategy could be a position, for example the launching of particular products in a given market.

e. Lastly strategy is a perspective in that a company can repackage its services to tap a new customer segment. For example, a company selling cereals for breakfast can repackage the same for snacks and lunch.

According to Kotler (2000), strategy is an action of designing unique goods and services, which gives a firm distinct competitive advantage.
Strategy has levels or hierarchical order. Stickland (1990) asserts that the highest level is the corporate level strategy. At this level, the chief executives define their vision, which is internalized through the mission statement. This is followed by the business level strategy that is built on the vision captured at corporate level. Then there are the operational and functional level strategies, which are developed by line and functional managers to fulfill the goals spelt out at business level strategy. For strategic implementation to be successful, it is imperative that all the 3 levels of strategy should have the same aspirations, focus and thrust. The vision at corporate levels should be embraced at functional and operational strategy levels.

In order to implement the desired strategy, Ansoff (1990) asserts that an organization should have an organizational structure that facilitates the implementation of that strategy. He emphasizes that the best structures are fluid or organic structures that are flexible enough to accommodate the intended strategies.

Strategy is about being different and deliberately choosing a unique action plan. In addition strategy is about positioning and differentiating your products and services from competition hence creating a competitive advantage. (Porter, 1990)

2.6 Competitive Forces in a Liberalized Market

In order to analyze the competitive forces in Kenya’s oil industry this study applied Porter’s (1985) five competitive forces. Below is the analysis of each force.

2.6.1 Rivalry among existing companies

This takes place through tactics such as advertising and price wars. The level of rivalry is dependant on market size and market growth. Usually where growth in a given sector is slow, there is tendency for market players to use defensive marketing strategies in order to sustain their market share. In the last 6 years, the economic performance in Kenya has been on a downward trend with economic growth
ranging between 5 and 1%. The demand for petroleum products registered dismal performance. Porter asserts that this scenario stimulates stiff competition because each firm is defending its market share.

The other factor that stirs rivalry among competitors is lack of clear leadership. Where there is no clear or undisputed market leadership, there is a tendency of jockeying for market leadership. The Shell/BP was the undisputed market leader in Kenya and this was enhanced by the acquisition of Agip. The strongest challenger in the last five years has been the Kenol /Kobil group which embarked on an aggressive expansion program.

2.6.2 Powerful Supplier

Suppliers can pose a major threat if they are able to influence the price of the raw material thus eroding the margins of the buyers. For example, manufacturers of ingredients used to produce soft drinks have been consistently accused of skimming the prices of these raw materials thus leaving the distributors with thin margins (Pearce and Robinson, 1997). In the Kenya oil industry scenario, KPRL has the refining monopoly. The refinery transfers its inefficiency to the oil firms and this translates to higher production cost. This has adverse effects especially due to the enforcement of the Base-loading rule that stipulates that multinationals have to import crude oils to meet 70% of their refined oil requirements.

In the oil industry, the strong cartel of OPEC members is to blame for the volatility of crude oil prices in the world market. Also where oil exploration and refining companies adopt a vertical forward integration strategy by venturing in downstream market, they are bound to pose unfair competition especially if they are making windfall gains in the crude oil production and refining operations. Among this category are multinational companies such as BP, Amoco and Shell. (Warren, 1989)
2.6.3 Competitive forces arising from suppliers of substitute products
In the petroleum industry the substitutes are fire wood, charcoal and hydro
electricity. In Kenya’s commercial energy sector, these are not considered serious
competitors to the oil firms given that the country does not have large endowment
of these resources. (Baguant et al, 1992)

2.6.4 New entrants
This is the strongest competitive driving force in any industry. This poses a real
threat depending on the strength of the new comers. If they have massive
resources and reputation of being low cost producers then they can push existing
players out of the market.

In any industry, new entrants may face several barriers. One of them is the capital
outlay. The capital required to invest in an industry such as the oil industry would
be colossal hence a deterrent to new comers. Perhaps to get a vague idea, it costs
between 30 and 40 million Shillings to build a modest service station within the
city (Bhagavan et al, 1999). Most of the leading multinationals own between 70
and 150 service stations. Thus based on the above cost structure, it means that it
would cost an investor over 3 billion Shillings to construct 75 service stations.

Further to the issue of capital outlay, the other major barrier is the economies of
scale enjoyed by existing firms. The leading established companies enjoy economies
of scale in terms of bulk imports especially in LPG. They also enjoy excellent credit
facilities with banks and can negotiate preferential interest rates in the money
market. These are advantages that are beyond the reach of small time operators.
2.6.5 Distribution channels
When companies have been in the market for some time, they develop reliable distribution channels in the form of wholesalers and retailers. Additionally, established firms have the advantage of owning retail outlets at strategic sites. Others have invested heavily in terms of tankage and other installations in their big customers’ premises. For example, it is common to find fuel storage tanks built by competitors in big corporations such as Bamburi and E.A. Breweries. All these tactics create strong barriers for new entrants to break (Bhagavan et al, 1999).

2.6.6 Government’s influence to the competitive forces equation
Austin (1990) considered the government to be the sixth competitive force. This phenomenon is common in many third world countries where governments shape the competitive forces. This is because governments determine the economic policy framework that may be favorable to indigenous companies. For example, government monetary and fiscal polices do determine the interest rates and the cost of money. Like wise Government trade polices such as elimination of trade barriers can create either favorable or adverse competitive environment. Also Austin asserts that governments in third world countries control resources such as land and minerals. They also own business entities (parastatals), which may have undue advantage over the rest of the firms.

2.7 Broad Strategic Options in Liberalized Markets
According to Porter (1990) a firm can adopt one or a combination of the following generic strategies to compete effectively:

2.7.1 Low Cost leadership
According to Pearce and Robinson (1997), cost leadership is a strategy adopted to enhance internal efficiency and by so doing reduces a firm’s operational expenses.
This gives the firm a pricing advantage whereby the firm is able to compete effectively through price reductions and discounting against non-efficient firms and yet remain profitable. Operational efficiency in a firm’s production, manufacturing distribution and administrative functions is achievable through automation, business re-engineering and continuous research and development.

In the Kenyan oil industry, some key players have adopted this strategy through effective inventory management hence cutting down inventory holding costs and rationalization of their operational areas. For example, the leading oil firms closed their depots in Nakuru, Eldoret and Kisumu and now get petrol supplies to their customers from KPC terminals because it is cheaper. Others have sought the much-coveted ISO certification and this process streamlines a firm operational efficiency. (Petroleum Insight Journal, 2002)

2.7.2 Differentiation strategy

Kotler (2000) defines differentiation strategy as an intended move to distinguish the uniqueness of a firm’s product or services from the rest in the market. A firm can differentiate its products through superior quality, reliable distribution channels, convenience, added features, back up service and after sales service. In the oil industry several, firms partly apply this strategy in branding their service stations, offering additional forecourt service such as car wash, convenience stores, stocking of more environmentally friendly products like low sulfur diesel and unleaded Super petrol. (Petroleum Insight Journal 2002)

2.7.3 Focus

This strategy is adopted by small or medium size firm, which owing to their resource limitation, they concentrate on personalized service usually targeted to the up-market customer segment. This is the strategy whereby the business targets
specific clientele or segment niche. For example, in the motor industry, the target market for brand names such as Jaguar and Porche is the extremely rich. Sometimes, these luxurious vehicles are designed to customers specifications and the price tag is unaffordable by the average consumer. (Warren, 1989).

2.8 Specific Strategies that firms can adopt.

Given the stiff competition in the business arena, Kotler (2000) recommends the following marketing survival tactics to diverse firms in the market place.

2.8.1 Market leaders can maintain their domineering positions through market expansion and by venturing in to untapped markets. For example, in the recent past, some oil firms have invested in aviation installations in Lokichoggio to meet the fuel requirements for relief operations in the refugee camps and in northern Kenya and southern Sudan.

Companies can also woo new users to their products and encouraging more consumption by existing customers can increase demand. This is evident in the oil industry during sales promotions where motorists get gift vouchers after buying specified values of petroleum products.

Kotler (2000) recommends defensive tactics through innovation, improved customer service and distribution efficiency. Other specific defensive tactics include preemptive and counter offensive strategies. The Shell/BP alliance is perceived to be applying this strategy to fortify their position as market leaders by acquiring about 60 service stations from Agip.

2.8.2 Market challengers are firms ranking second or third position in the market. They can take over the market by attacking smaller firms while defending
their position in the market. Market challengers can garner more market control through the following strategic attacks:

1. Efficiency in the value chain activities of a company such as purchasing, production and distribution translates to lower unit cost. This is the strategy that Kenol and Kobil used in their “quick saves” service stations. Engineering experts have confirmed that these stations are cheaper to construct as compared to conventional service stations. (Petroleum Insight Journal, 2001)

2. Enhancing distribution innovation efficiency. The construction of the oil pipeline (KPC) not only reduced the freight charges for hauling fuel to the interior but also greatly improved the efficiency of fuel flow.

3. Intense advertising promotion. This strategy is expensive and is only recommended as a stopgap to launch in the market or when launching a new product. Apparently the oil industry in Kenya used it intensively soon after liberalization but they have now slowed down.

2.9 Chapter summary
In conclusion, this literature review has explored the possible benefits accruing from liberalizing markets with special attention to the oil industry. It tried to identify the competitive forces relevant to the oil industry, and generic strategies advocated by scholars of strategic management. In addition the review zeroed down to specific strategies that could be relevant to market leaders and market followers. The next chapter will address the research methodology applied in this study.
CHAPTER THREE

3 RESEARCH METHODOLOGY

3.1 Introduction
The content of this chapter addresses issues such as research method adopted, determination of population and sampling method used, data collection and data analysis methodology applied in this study.

3.2 Research Design
The study adopted a descriptive approach whereby key oil industry indicators were used to assess the impact on liberalization. Among the indicators used included market share, market presence in terms of service station and profitability.

The study sourced its data both from primary and secondary sources. A survey of the number of service stations served as the primary source of this research’s data. The secondary data was obtained from publications such as financial statements, the economic survey and market intelligence. Lastly, interviews were conducted with executives to get first hand information on the subject of the study. This wide variety of data sources was adopted to ensure completeness and minimize biases.

3.3 Population and Sampling Design
The population comprised of the number of firms in the oil industry. With the exit of Agip, there are currently 6 major oil firms in the market. Also among the new entrants 7 are already well established. Since not all of them are listed in the Nairobi Stock Exchange, our sample concerning financial performance focused only on the two oil firms that are listed.
Again concerning the population of sales outlets, Bhagavan et al (1999) indicated that the population of service stations owned by the seven major firms was 697 in 1997. According to an article in the PIEA 2001 journal, there were 1050 sales outlets in 2000 that included filling stations owned by the independent dealers. To determine the market penetration by new oil firms, this study concentrated its survey on service stations in Nairobi Area. Nairobi area was considered as an ideal research site because as the capital city it has a sizeable population of motorists. Statistics from PIEA estimates that Nairobi has between 45% and 50% of the total retail market for petroleum products.

An alternative method to evaluate market penetration was conducted. This involved an analysis of sales volumes for popular petroleum brands of the new firms vis-à-vis the sales volumes for the entire industry.

3.4 Data collection method

This research took the following data gathering approach:

3.4.1 Trend analysis on Domestic petroleum demand
From the Kenya Economic Survey publications, the study extracted data on crude oil imports as well as imports of refined petroleum products for the period 1997 to 2001. This data was useful to verify the trend in fuel consumption in the domestic market. Also, this data was useful in assessing whether there is growth or decline in the local oil market.

3.4.2 Data on Financial performance.
Two of the oil firms; Total Oil (K) Ltd and Kenol Oil Ltd are quoted companies in the Nairobi Stock Exchange (NSE). According to NSE regulations, quoted firms have an obligation to publish their annual financial reports. The study analyzed the
last 5 years financial statements (1998 to 2002) for these two firms in order to get
the insight of the performance by the oil industry. This study was of the opinion
that the performance of these two firms was indicative of industry performance. In
addition, the study extracted data from the financial reports to conduct ratios and
trend analysis. Such ratios included performance, efficiency and return on
shareholders and ratios on efficiency.

3.4.3 Market penetration in terms of service stations
Statistical data obtained from PLEA shows that between 45% and 50% of the
Kenyan petroleum market is located in Nairobi and its environs. With this
understanding, Nairobi was selected as the sampling site. The study conducted an
inventory of the number of service stations in Nairobi Area. The survey also
identified the number of stations opened by the new marketers. This was useful
information for assessing their level of market penetration.

3.4.4 Data on Sales Thruput.
KPC maintains data on all white oil supplied to the domestic market by each oil
firm. Through market intelligence, the study managed to get data of total industry
sales volumes for popular brands such as premium, regular and diesel for the last
three years. This was more reliable data to ascertain market share of the new
entrants.

3.4.5 Strategies adopted
Regarding the strategies adopted by key industry players, the study relied on the
annual reports by the two listed companies. The directors report in the annual
financial reports normally contain snapshots of the intended strategies adopted by
the firm. Another yardstick of evaluating the strategies undertaken by oil industry
was to analyze investments in non core business such as convenience stores and fast
food restaurant. The study conducted a survey on the number of convenience stores and fast food restaurants built in service stations in Nairobi area.

Another method of evaluating the oil industry strategies was by interviewing key personalities in the oil industry. The marketing managers in leading oil firms were approached for an interview on this topic. Caltex oil and Mobil responded positively to the request and interviews were conducted in April 2003.

3.5 Research Procedure

In an attempt to achieve the objectives of this research, the study carried out a trend analysis on market share and a trend for the period 1999 to 2002. In addition, the study used the financial reports of Total Oil and Kenol Oil to ascertain any correlation of their net sales revenue for the period 1998 to 2002.

This research used Excel and ESSP intensively as analytical tools. These tools were useful in Statistical analysis for evaluating the distribution, frequency and the standard deviation and the regression on the research data analysis.

3.6 Chapter Summary

This research depended on primary data and information as well as data gathered from third parties. Gathering and analysis of this information took over one and half months. Overall it took close to three months to complete this research.

This study had the opinion that there are overwhelming benefits to the stakeholders in liberalizing the oil industry. Liberalization created healthy competition that encourage efficiency and ultimately weeds out incompetent firms. This is beneficial to customers because they are assured of getting value for their money in form of quality services.
CHAPTER FOUR

4 RESEARCH FINDINGS

4.1. Trends on local demand for petroleum products

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium &amp; Regular</td>
<td>399</td>
<td>397</td>
<td>-1%</td>
<td>396</td>
<td>-0.3%</td>
<td>385</td>
<td>-2.9%</td>
<td>366</td>
<td>-5.2%</td>
<td>374</td>
<td>2.1%</td>
</tr>
<tr>
<td>Diesel Gasoil</td>
<td>646</td>
<td>616</td>
<td>-5%</td>
<td>608</td>
<td>-1.3%</td>
<td>602</td>
<td>-1.0%</td>
<td>713</td>
<td>15.6%</td>
<td>664</td>
<td>-7.4%</td>
</tr>
<tr>
<td>Kerosene</td>
<td>354</td>
<td>268</td>
<td>-32%</td>
<td>318</td>
<td>15.7%</td>
<td>407</td>
<td>21.9%</td>
<td>384</td>
<td>-6.0%</td>
<td>306</td>
<td>-25.5%</td>
</tr>
</tbody>
</table>

SOURCE: ECONOMIC SURVEY 2002

According to the data in Table 1 above, the local demand for super and regular brands of petrol was 399,000 metric tones in 1996. Trend analysis showed that demand for petrol declined over the last six years (1996 to 2001). For example, in 2000, the local consumption of petrol was 366,000 metric tones, signifying 8% decline as compared to 1996. Correspondence from Petroleum Insight Journal (2001) and extracts from the annual reports of Total Oil (K) Ltd attributed the decline in petrol demand to the country’s stagnated economy. The Economic Survey indicated that the poor economic performance of the Kenyan economy was a contributing factor to suppressed petrol demand. According to the Economic Survey for 2002, Kenya’s economy registered 4% economic growth in 1996 as compared to negative 0.5% in 2000.
The demand for diesel increased from 646,000 metric tones in 1996 to 713,000 tones in 2000. Available statistical data from PIEA indicated that the growth was in the energy sector, mainly due to large diesel consumption by the independent power generating firms. The severe drought in 2000 reduced the water volumes in rivers that resulted in lower hydroelectric power generating capacity. The alternative was to switch to thermal power as a stopgap measure. In 2001, the consumption of diesel dropped to 664,000 metric tons due to favorable weather conditions. Thus overall the demand for diesel increased by a mere 2.5%.

The above economic indicators clearly showed that the oil firms have been operating in a shrinking or stagnated economy. Such an environment is not favorable to any business. Consequently the entry of new oil firms merely fueled severe competition as each firm fought for survival in a shrinking market.

4.2 Market Penetration by New Entrants in the Oil Industry.
This study used two parameters to assess the level of market penetration by the new companies in the oil industry. One way was to establish the number of service stations built by the new oil players. This parameter was considered reliable because according to statistical extracts from PIEA, the retail market for petroleum products, accounts for 60% of the petrol consumption. This research took an inventory of the number of service stations in Nairobi Area. It went a step further to establish the number of service stations constructed by the new marketing and independent dealers. This survey made the following observations:

4.2.1 Population of stations owned by new marketers
This study established that as of April 2003, there were 205 service stations in Nairobi area. According to industry intelligence, 38 of these stations were built in the last six years, which is in the post regulation era. The newcomers own 26 out
of the 38. In comparative terms, it means that the new entrants in the industry own about 12% of the retail oil outlets in Nairobi area. The leading investor among the recent entrants was Engen with 6 stations followed by Elf with 4. It’s also quite clear that independent dealers have aggressively ventured in the retail oil business and have built 15 service stations. It is worthwhile noting that following the merger between Total and Elf in 2001, the Elf service stations have subsequently been re-branded with Total brand image. As regards the location of the stations, most of them are along the major highways of the city and in the upcoming suburbs.

This survey established that the leading oil firms have not been aggressive in building new service stations. It is only Kenol and Kobil who have constructed a total of six additional service stations in Nairobi in the last six years. The others have either been undertaking major image upgrade on their existing retail network in the city. According to an article in Petroleum Insight Journal for 2002 fourth quarter, Mobil earmarked 1 million dollars budget for branding and image upgrade in 2002.
### Population and Distribution of Service Stations in Nairobi Area

#### Table 2

<table>
<thead>
<tr>
<th>ZONE</th>
<th>Stations owned by old firms</th>
<th>New Stations built within the last 6 yrs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>KAREN AREA</td>
<td>11</td>
<td>2 Engen, 1 Mobil, 1 Elf, 3 ind dealers</td>
<td>18</td>
</tr>
<tr>
<td>NGONG ROAD</td>
<td>11</td>
<td>1 Engen, 2 Elf</td>
<td>14</td>
</tr>
<tr>
<td>LAVINGTON &amp; KILERESHWA</td>
<td>10</td>
<td>1 Elf, 1 Engen</td>
<td>12</td>
</tr>
<tr>
<td>WAIYAKI WAY</td>
<td>10</td>
<td>1 Engen 1, Mobil</td>
<td>12</td>
</tr>
<tr>
<td>WESTLANDS SURBURB INCLUDING SPRING VALLEY</td>
<td>10</td>
<td>1 Elf</td>
<td>11</td>
</tr>
<tr>
<td>PARKLAND/MUTHAIGA</td>
<td>9</td>
<td>1 Engen</td>
<td>10</td>
</tr>
<tr>
<td>THIKA ROAD</td>
<td>10</td>
<td>1 BP 1 Kenol, 1 Lenjoka, 1 Wasafiri, 1 Jokiland, 1 Engen</td>
<td>16</td>
</tr>
<tr>
<td>PANGANI, NGARA &amp; EASTLEIGH</td>
<td>21</td>
<td>1 Kenol, 1 Kobil, 1 BP, 3 ind dealers</td>
<td>27</td>
</tr>
<tr>
<td>CITY CENTRE</td>
<td>15</td>
<td>1 Ind dealer</td>
<td>15</td>
</tr>
<tr>
<td>LANGATA RD</td>
<td>10</td>
<td>1 Ind dealer</td>
<td>11</td>
</tr>
<tr>
<td>MOMBASA ROAD</td>
<td>11</td>
<td>1 Ind dealer</td>
<td>12</td>
</tr>
<tr>
<td>INDUSTRIAL AREA and SOUTH &quot;C&quot;</td>
<td>14</td>
<td>1 Ind dealer</td>
<td>15</td>
</tr>
<tr>
<td>JOGOO ROAD and BURURIBRUI Estate</td>
<td>13</td>
<td>1 Kenol</td>
<td>14</td>
</tr>
<tr>
<td>OUTERRING ROAD AND EASTLAND</td>
<td>12</td>
<td>1 Kenol, 3 ind deal, 1 NOCK, 1 Kobil</td>
<td>18</td>
</tr>
<tr>
<td>TOTAL POPULATION</td>
<td>167</td>
<td></td>
<td>205</td>
</tr>
</tbody>
</table>
Based on the above survey, it is apparent that most of the established oil firms were not on a growth or expansion strategy. On the contrary several of them seemed to have adopted a differentiation strategy through strong brand positioning. They emphasized their uniqueness in terms of high quality products and reliable customer services. The flashy billboards and signage in their service stations is an affirmation of the differentiation strategy.

The other strategy evident in the market is that of acquisitions instead of organic business growth. This is affirmed by the acquisition of Agip Oil (K) Ltd interests in Kenya by the Shell/BP alliance in 2000 and the merger between Total and Elf in 2001. The takeover of Agip interests by Shell/BP alliance boosted their market position to be the clear market leader currently with over 166 service stations.

4.3 Analysis of sales volumes and market Share of white oils.

Table 3.1

<table>
<thead>
<tr>
<th>ANALYSIS OF INDUSTRY SALES VOLUMES FOR OLD AND NEW FIRMS</th>
<th>VOLUINES IN CUBIC METRES</th>
<th>Year: 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRODUCT</td>
<td>Old Firms</td>
<td>Market Share</td>
</tr>
<tr>
<td>PREMIUM</td>
<td>276,710</td>
<td>89%</td>
</tr>
<tr>
<td>REGULAR</td>
<td>120,636</td>
<td>78%</td>
</tr>
<tr>
<td>DIESEL GASOIL</td>
<td>369,799</td>
<td>82%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>767,145</td>
<td>83%</td>
</tr>
</tbody>
</table>
Table 3.2

<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>Old Firms</th>
<th>Market share</th>
<th>New Entrants</th>
<th>Market Share</th>
<th>Industry Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>PREMIUM</td>
<td>273,671</td>
<td>89%</td>
<td>34,970</td>
<td>11%</td>
<td>308,641</td>
</tr>
<tr>
<td>REGULAR</td>
<td>122,652</td>
<td>78%</td>
<td>35,431</td>
<td>22%</td>
<td>158,083</td>
</tr>
<tr>
<td>DIESEL GASOIL</td>
<td>373,498</td>
<td>82%</td>
<td>83,850</td>
<td>18%</td>
<td>457,348</td>
</tr>
<tr>
<td>TOTAL</td>
<td>769,821</td>
<td>83%</td>
<td>154,251</td>
<td>17%</td>
<td>924,072</td>
</tr>
</tbody>
</table>

Table 3.3

<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>Old Firms</th>
<th>Market Share</th>
<th>New Firms</th>
<th>Market Share</th>
<th>Industry Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>PREMIUM</td>
<td>285,949</td>
<td>89%</td>
<td>35,358</td>
<td>11%</td>
<td>321,307</td>
</tr>
<tr>
<td>REGULAR</td>
<td>114,244</td>
<td>77%</td>
<td>33,378</td>
<td>23%</td>
<td>147,622</td>
</tr>
<tr>
<td>DIESEL GASOIL</td>
<td>381,037</td>
<td>83%</td>
<td>79,435</td>
<td>17%</td>
<td>460,472</td>
</tr>
<tr>
<td>TOTAL</td>
<td>781,230</td>
<td>84%</td>
<td>148,171</td>
<td>16%</td>
<td>929,401</td>
</tr>
</tbody>
</table>

The other method of assessing the market penetration by new market players was by analyzing total local product sales of the new entrants vis-à-vis the combined total industry sales. The analysis of sales volumes for the last three years data availed by market intelligence established the following:

The degree of market penetration by new entrants varied from product to product but on average was about 15%. Refer to table 3.1 to 3.3 above. The highest
penetration was in regular petrol whereby the new entrants command a market share of 22% followed by diesel 15% and lastly super petrol, 11%. The trend analysis showed that the market shares have relatively stabilized. For example, for the last three years the market share for premium petrol was 11% and the same trend was evident in the other two products.

According to industry analysts, the explanation for higher penetration in diesel was because most of the consumers are public service vehicles particularly matatus. This category of motorists is overly price sensitive and their buying patterns are determined by the cheapest price. Price survey conducted during this research established that the independent dealers are slightly cheaper than the branded service stations.

It is interesting to note that among the aggressive new entrants in the oil market such as Jovonna, Mafuta and Petro do not have service stations or retail sales outlets in Nairobi area. Industry insiders claim that these companies target the independent dealers as their main sales outlets. To succeed in this strategy, they compete through pricing strategy that involved undercutting the prices of the established firms. Bhagavan et al (1999) indicated that it costs on average 30 to 40 million Shillings to construct a modern service station. Thus by not investing in retail network of their own, these new players can compete effectively on lower prices because they have insignificant long-term investments. As a matter of fact some insiders are already crying foul that the “briefcase oil merchants” (oil firms who have no retail outlets) could be dumping in the other companies’ retail outlets.

From the above analysis it is evident that there is intense competition in the oil industry arising from liberalization as the new players exert pressure to penetrate the
market. As Porter (1990) put it, the level of rivalry becomes more intense when aggressive firms enter the market.

Overall a loss of 15% market share by the existing oil firms is a significant blow especially in a depressed market. Kotler (2000) advocates strategic decisions such as divesture, re-engineering and restructuring, as some of the possible options that firms should adopt in such a market scenario. Through re-engineering, a firm is able to re-evaluate its processes with a view of making them efficient.

4.4 Analysis of Financial Performance of oil firms quoted in NSE

TABLE 4

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ex Rate Ksh to US$</strong></td>
<td>60.4</td>
<td>70.3</td>
<td></td>
<td></td>
<td>76.2</td>
<td></td>
<td>78.6</td>
<td></td>
<td>78.3</td>
<td></td>
</tr>
<tr>
<td>Gross Revenue</td>
<td>14,068</td>
<td>10%</td>
<td>14,715</td>
<td>4%</td>
<td>23157</td>
<td>57%</td>
<td>17,926</td>
<td>-29%</td>
<td>16,291</td>
<td></td>
</tr>
<tr>
<td>Net Sales</td>
<td>9,864</td>
<td>6%</td>
<td>10,418</td>
<td>5%</td>
<td>18395</td>
<td>77%</td>
<td>14,273</td>
<td>-29%</td>
<td>12,665</td>
<td>-10%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>7,853</td>
<td>100%</td>
<td>8,306</td>
<td>5%</td>
<td>16594</td>
<td>100%</td>
<td>12,922</td>
<td>-28%</td>
<td>10,767</td>
<td>-13%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>2,011</td>
<td>100%</td>
<td>2,112</td>
<td>5%</td>
<td>1801</td>
<td>-15%</td>
<td>1,351</td>
<td>-33%</td>
<td>1,898</td>
<td></td>
</tr>
<tr>
<td>Profit Before Tax</td>
<td>515</td>
<td>59%</td>
<td>856</td>
<td>40%</td>
<td>333</td>
<td>-83%</td>
<td>(318)</td>
<td>205%</td>
<td>605</td>
<td>-20%</td>
</tr>
<tr>
<td>Profit after Tax</td>
<td>321</td>
<td>60%</td>
<td>551</td>
<td>42%</td>
<td>206</td>
<td>-63%</td>
<td>(222)</td>
<td>193%</td>
<td>360</td>
<td></td>
</tr>
<tr>
<td>Earnings per share</td>
<td>6</td>
<td>10</td>
<td>2.46</td>
<td>(2)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6</td>
<td>29%</td>
</tr>
</tbody>
</table>

Sources: Published Financial statements for 1998 to 2002

The study obtained financial reports for Kenol Oil (K) Ltd and Total Oil (K) Ltd. These are the only listed companies in the Nairobi stock exchange and thus their annual reports are available to the public. In order to get adequate trend analysis, the study extracted the financial summaries from 1998 to 2002. For analytical purposes, this study used the “net sales revenue” instead of gross sales revenue numbers because the net revenue excludes excise duty and other taxes levied by the government.
Below are the highlights of the findings:
Between 1998 and 2000, the net sales revenue for Total Oil (K) Ltd showed an upward trend from Ksh 9.9 billion Shillings to 18.4bn in 2000. Extracts from the Nation Business week of November 16th, 2000 attributed this upsurge of sales revenue to spikes in crude oil prices from 18 US Dollars per Barrel in 1999 to 27 US$ per barrel in 2000. Moreover, there was a 9% devaluation of the Kenya Shilling against the US dollar from an average of Ksh 70 in 1999 to 76 in 2000. The subsequent annual reports for 2001 and 2002 showed that Total Oil (K) net revenue dropped to 14bn and 12.6bn Shillings respectively. This in effect means that Total oil Ltd 2002 sales revenues were at par with 1996. In US dollar terms there is a sharp decline in revenue considering that the Kenya Shilling depreciated substantially against foreign currencies. For example in 1998 the Kenya Shilling exchanged against the US Dollar at 60.4. In 2002, the exchange rate against the dollar was 78.6 signifying 39% devaluation.

On the other hand, financial extracts show that the net sales revenue for Kenol Oil (K) Ltd has grown steadily from 2 billion Shillings in 1998 to 9.7 billion in 2002. (Refer to table 5). The firm’s revenues doubled in 2000 from 2 to 4 billion Shillings and again in 2001 from 4 to 8 billion Shillings. In the director’s report, Kenol management attributes this sterling performance to aggressive expansion strategy both locally and regionally.

As regards the profitability of both firms, tables 4 and 5 show that the profit margins for both firms have been on a downward trend but the decline in Total Oil (K) Ltd is much steeper. Total’s margins dropped from 20% in 1998 to 9% in 2002. The same trend was evident in Kenol in that the profit margins dropped from 38% in 1998 to 20% in 2002.
Over the last 6 years, the net profits for Total Oil (K) Ltd were very erratic. According to Table 4, the profits increased from 321 million in 1998 to 551

35
million in 1999. In 2000 the profits nose-dived to 206 million, which is equivalent to 63% decline. The performance for 2001 was devastating with the firm posting a loss of 222 million.

Market analysts attributed the poor performance in 2001 to intense competition, unfavourable economic environment in terms of volatile exchange rate and unstable crude oil prices. The management report also cited the lack of fair play due to massive dumping of oil consignments purported to be exports. They seem to blame the menace to lack of will power by the government to curb this malpractice.

Besides the competitive forces, there could be other factors that contributed to the poor performance of Total Oil. For example, in 2000, the company incurred hefty interest costs amounting to 42 million Shillings. This was equivalent to 14% of the operating profits. This is an indication of high short-term borrowing, which is expensive hence not recommendable. Moreover, the amounts owed by trade debtors were considerably high. Thus the firm needs to address its credit policy because proper credit policy can improve the cash flow and ultimately lower financing costs.

Table 5

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Revenue</td>
<td>3,665</td>
<td>4,097</td>
<td>6,566</td>
<td>10,959</td>
<td>12,350</td>
</tr>
<tr>
<td>Net Sales</td>
<td>2,212</td>
<td>2,254</td>
<td>4,491</td>
<td>8,658</td>
<td>9,757</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>1,605</td>
<td>1,745</td>
<td>3,798</td>
<td>7,219</td>
<td>8,148</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>607</td>
<td>509</td>
<td>693</td>
<td>1,439</td>
<td>1,609</td>
</tr>
<tr>
<td>Profit before Tax</td>
<td>255</td>
<td>316</td>
<td>251</td>
<td>595</td>
<td>679</td>
</tr>
<tr>
<td>Profit after Tax</td>
<td>170</td>
<td>211</td>
<td>156</td>
<td>375</td>
<td>441</td>
</tr>
<tr>
<td>Earnings per share</td>
<td>23.61</td>
<td>29.3</td>
<td>15.54</td>
<td>37.21</td>
<td>37.21</td>
</tr>
</tbody>
</table>

Sources: Published Financial statements 1998 to 2002
On the other hand, the trend analysis showed that Kenol posted steady profit growth, from 170 million Shillings in 1998 to 221 million in 1999. This was followed by a spectacular profit improvement to 441 million Shillings posted in 2002. The firm's management attributes the firm’s superb performance to prudent cost management and regional expansion strategy in the last three years. The regional expansion strategy involved extending their business horizon to Tanzania, Uganda and recently to Rwanda.

Although the financial performance of these two leading oil firms reflects a lot of inconsistencies, one striking features common to both firms’ financial reports is that there has been general decline in profit margins. This could imply that the competitive pressure is eroding their profit margins. Apparently the costs of sale reported by Total (K) Ltd were consistently higher than Kenol and this can raise some suspicion of transfer pricing. This could imply that the competitive pressure is eroding their profit margins. The intense pressure from competition may explain why Kenol opted to take an expansion program in the regional market where there could be bigger margins.

| TABLE 6 |
| KEY PROFITABILITY RATIOS |

<table>
<thead>
<tr>
<th>Total oil (K) Ltd</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sale revenue as a % of gross sales</td>
<td>70%</td>
<td>71%</td>
<td>79%</td>
<td>80%</td>
<td>78%</td>
</tr>
<tr>
<td>Cost of sales as a % of net sales</td>
<td>80%</td>
<td>80%</td>
<td>90%</td>
<td>91%</td>
<td>85%</td>
</tr>
<tr>
<td>Gross margin</td>
<td>20%</td>
<td>20%</td>
<td>10%</td>
<td>9%</td>
<td>15%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Kenol Oil (K) Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sale as a % of Gross sales</td>
</tr>
<tr>
<td>Cost of sales as a % of net sales</td>
</tr>
<tr>
<td>Gross margin</td>
</tr>
</tbody>
</table>

Sources: Published Financial statements 1998 to 2002
4.5 Outcome of Interview with Marketing executives in the Petroleum Industry.

An interview with Caltex retail marketing manager on the impact of liberalization affirmed that the oil industry welcomed this move. As a matter of fact, he asserted that the leaders in the oil industry hailed this move as an opportunity for fair play. The general consensus was that the market forces should make the industry self-regulating.

The reality is that the benefits that the oil industry was anticipating have become elusive. To support their argument, both Mobil and Caltex executives interviewed used the industry financial performance as the yardstick. According to reliable industry information, most of major oil firms made heavy losses in 1999 to 2001. It is only the Kenol/Kobil that posted meaningful profits. They also claimed that it’s an open secret in the industry that influential personalities in the former government had vested interests in the Kenol/ Kobil group. Thus the KK sisters, (as they are known in industry circles) had undue advantage especially in negotiating government contracts. To prove their case, they asserted that in the last ten years the KK group managed to build cheap filling stations under the banner “quick save” yet most of them especially in Nairobi are built on road reserves. This implies that they are illegal structures because they violate Nairobi city by laws. Similar sentiments have been expressed by articles in PIEA journals.

Recent press statements expressed frustration and despair among key industry players. When the minister for energy was recently speaking in the launching ceremony of Kenol gas, he cautioned oil firms that the government might consider instituting controls due to their cartel like behavior. In response to this ministerial statement the Kenol CEO, Mr. Segman was quoted as saying that the industry
would welcome such a move. Market analysts interpreted his reaction as an outburst of frustration by key players. This is due to lack of attention to glaring industry problems by the ministry of energy. Other major events such as the exit of Agip from the market are an indication that the industry is in serious trouble.

The following are major challenges that the oil industry is facing in the post deregulation era.

4.5.1 Stiff competition arising from new competitors

The retail-marketing manager of Caltex confirmed that the new firms have been waging severe pricing wars in order to penetrate the market. As a defensive strategy the other firms are forced to match the lower prices leading to thin margins. He conceded the fact that the new entrants have clinched about 18% market share of petrol and 15% of diesel due to aggressive market entry pricing among other offensive marketing tactics. He however was confident that the market has stabilized in the last 2 years or so and pricing wars are of lesser scale.

4.5.2 Lack of a level playing ground

The interviewees lamented that despite deregulation, there was no level playing ground in some critical area of industry operation. For example, by current technology standards, (KPRL) is archaic and operationally very inefficient. A World Bank report done in 1997 estimated that the economy loses 22 million dollars annually due to abnormal losses and its inability to optimize production of high value middle distillates i.e. petrol, diesel and kerosene. This makes it more expensive to refine the products locally than importing refined petroleum products.
It is estimated that a major refinery upgrade would cost about $300 million (Bhagavan et al 1999).

To keep the refinery operational, the government formulated a crude oil supply requirement known as the Base Loading Rule. This compels the marketing firms to import adequate crude oil to meet 70% of their domestic petroleum requirements. It is against any rational business decision to impose this expensive and draconian rule all in the name of protecting an archaic refinery. To enforce this requirement and to protect the refinery, the government imposed taxes on direct white oil imports. Worse still, early this year, the ministry of Energy gave a waiver to the independent oil firms by exempting them from the above rule. This gave them undue advantage because they have access to cheaper products at the expense of the multinationals.

4.5.3 Dumping of fake exports

Export goods are exempted from import and excise duties. Refined petroleum products attract duty amounting to 50% of the domestic retail price. It means that export products that are smuggled back in the market will have evaded duty and hence will be much cheaper. Suspicion is rife that some of the newly registered firms are perpetuating fuel dumping. These fake exports are apparently rampant in Western Kenya because following the extension of the pipeline to Kisumu and Eldoret, these are now the export bases to Uganda, Rwanda, Burundi and Eastern Zaire. These mal-practices are apparently defrauding the government a lot of revenue considering that a truckload of 50,000 litres of premium petrol attracts excise duty amounting to over a million Shillings. According to PIEA 2001 annual report, it is estimated that Kenya Revenue Authority loses over 7 billion Shillings annually through fake exports.
This syndicate thrived due to corruption in the Customs Department of Kenya Revenue Authority. This is obviously killing the genuine local firms. In 2000, the oil industry through Kenya Bureau of Standards (KBS) and Customs Dept appointed SGS (Kenya) Ltd to be administering the marking of export destined fuel consignments using biocode coloring compound. In order to enforce this process, KBS and SGS were mandated to be conducting regular inspections in all service stations countrywide. This excise involved taking random samples of fuel in service stations and testing if it contains the biocode marking compound.

This control mechanism is financed by the oil industry at a cost of about 50 million Shillings annually. Unfortunately, this menace is not fully eradicated and there is grave concern by the key players that the government seemingly did not have the will power to curb it. For example, they claim that the syndicate of perpetuators seems to be enjoying police protection. Worse still the court fines imposed on the culprits are not punitive and hence the malpractice continued unabated.

4.5.4 Selling of adulterated fuel

Adulterated fuel refers to sub standard petroleum products offered to unsuspecting motorists that do not meet expected specification. Usually this concoction comprises of super petrol deliberately mixed with a generous proportion of kerosene and then sold to unsuspecting motorists as pure petrol. Similarly sizeable proportions of kerosene are mixed with diesel and sold as diesel. The driving force to this unethical practice is because there is a large price difference between super, diesel and Kerosene and thus by selling the adulterated fuel either as super petrol or diesel, the scrupulous dealers make bigger margins. According to PIEA 2001 annual report, this malpractice is rampant mainly in the independent dealers service stations. In the 2001 PIEA annual report, it is estimated that the Industry lost revenue amounting to 300 million Shillings through
sale of adulterated fuel. Additionally, the government could be losing over 1 billion Shillings annually due to this malpractice.

4.6 Strategies to counter above Challenges

In order to cope with the challenges cited above, different oil firms have taken diverse measures to enable them steer through the stormy environment. The interviewee from Mobil was of the view that mergers such the one between Total (K) Ltd and Elf was intended to generate synergies. The resultant effect of that was higher sales revenue and cost savings arising from job cuts as departments with similar functions merged. In addition, in situations where there was duplication of some assets, some were disposed off.

Both interviews with Mobil and Caltex executives conceded that virtually all the oil firms have undertaken major restructuring or re-engineering programs intended to make them lean and efficient. Among the key features of the restructuring programs include:

1. Changes in the organizational structures and the organization chart. Some companies have merged certain functions and scrapped others. As a result their organizational structures have become flatter and lean. This implies fewer employees with bigger workloads. This move resulted to substantial labour layoffs. Statistics from PIEA indicated that in 1996 the industry directly employed 2745 people. Currently the industry employs about 2235 people signifying 18% job cuts.

2. Rationalizing their assets by closing down non-viable installations, while investing in high potential sites. A case in point was the closure of the oil depots in Nanyuki and Mt Kenya region. In 1990, all the major oil firms had operational oil depots in Nanyuki town and Total Oil (K) Ltd had one in
Narumoru. However, by the year 2000 all the companies had closed these depots citing that they were no longer viable. Consequently, their customers in that region including Meru, Isiolo get their supplies from Nairobi. In addition, all the oil firms closed their depots in Nakuru and some in Eldoret and nowadays they get product supplies directly from KPC terminals in Nakuru and Eldoret respectively.

3. Besides rationalizing their operations, some oil firms took radical measures like disposing off some of their non-performing sales outlets. For example, on March 18, 2003, it was reported by the Standard Newspaper that Shell/BP were selling about 40 service stations in Western Kenya region due to poor performance. Industry analysts were speculating that one of the new entrants bid for all of them. This sent a distress signal to the market in that Shell/BP as the market leaders could be down sizing their operations. Policy makers should have taken that advert seriously because for a market leader to take such a move, it’s a symptom of deeper industry problems that needed urgent attention.

4. Another cost cutting measure is that several oil firms have also shifted their administrative operations from the city center to up market suburbs where office rentals are cheaper. Examples are Caltex and Mobil who moved out of the central business district to Parklands and Muthaiga. All the above are cost cutting measures intended to lower the cost of operations and also make the firms more efficient.

4.6.1 Discarding of non-core business functions.
In the 1990s, several oil firms had their own fleet of trucks for fuel, LPG and lubricants distribution. Several of them have since disposed them off and sub-contracted these operations to transporters. The rationale of this move was that it
required enormous management resources to manage sizable fleet operations. Other services previously handled in-house that are now outsourced included equipment maintenance. It made business sense to discard these peripheral functions so that management could concentrate on core business activities.

4.6.2 Proactive strategies

Besides the defensive tactics highlighted above, this study gathered from the interviews and correspondence from the industry that the industry players are becoming more innovative to cope with the eternal forces. For example; All the leading six firms have been awarded the much-coveted International Standards of operation (ISO) accreditation. This is a major milestone because the certification gives an assurance that the processes adopted by the recipient are reliable and as a result, the ultimate goods and services are of international quality. Basically the ISO certification awarded to firms like Kenol/Kobil provided a competitive edge when they ventured to the regional markets. These two firms recently opened branches in Uganda, Zambia and are conducting visibility studies for Rwanda and Burundi markets.

4.6.3 Venturing to non-oil related Businesses

In the last five years, the oil industry experienced a dramatic diversification from the traditional oil business. The interviews confirmed that this move was intended to maximize returns on investments in a retail outlet. Extracts from the PIEA 2002 quarter 3 publications featured an article from Mobil CEO indicating that the company’s focus was to make service stations a-one-stop families shop. What he implied was that owing to shrinking margins on petroleum products, oil firms have invested in non-oil related businesses to supplement their returns. In this regard,
Mobil entered into a strategic partnership with Innscor Ltd, a fast food chain incorporating among others Nandos and Chicken Inn brands. Kenol Oil (K) Ltd has entered into a similar arrangement with Kengelas, a local hotelier brand that offers restaurant and pubs in “local setting” environment.

The most popular non-oil businesses venture is investment in convenience stores. These are mini super markets that stock household goods such as milk and groceries which motorists can quickly buy while their cars are being serviced. Most convenience stores are built on service stations in the major motorways and suburbs. These shopping outlets are quite appropriate and appealing to motorists given that they are located at strategic service stations with ample parking where motorists can enjoy shopping without the parking hassles in the city center.
<table>
<thead>
<tr>
<th>Locality</th>
<th>Convenience store</th>
<th>Snack shop</th>
<th>Fast cum pub</th>
<th>Food</th>
<th>Car Wash</th>
<th>Others services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Westlands Area</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shell - Westlands</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobil Westlands</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>ATM facility &amp; credit cards</td>
</tr>
<tr>
<td>Mobil Walyaki Way</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caltex Walyaki Way</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Mountain View</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>Caltex Next to Aga khan</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BP fronting Landmark</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total next to Holiday inn</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caltex next to Consolata</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>THIKA ROAD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caltex Pangani</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caltex fronting NYS HQ</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>Shell Northview Stn</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenol Alsopps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Barclays ATM</td>
</tr>
<tr>
<td>Kenol opp Breweries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>BP Thika Rd</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thome (formerly Lenjoka)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>Wasafi Rd S.Sun</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total opp. Breweries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>OUTERING ROAD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kobil Karibangi Rd/about</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total opp Karibangi South</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>flats</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caltex Kangundo Rd Junction</td>
<td></td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>Shell fronting Tena Estate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobil Opp Shell at Tena Estate</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caltex Donholm</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
<tr>
<td>NOCK station airport Roundabout</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
<td>Spacious parking</td>
</tr>
</tbody>
</table>
4.7 Chapter Summary

This chapter has documented the findings of this study. The information compiled included the trend analysis in consumption of petroleum products, the market penetration by new comers, the financial trend of existing firms, the challenges facing the industry and some of the remedies to counter these adversities.

The next chapter addresses the outcome of the research in relation to the set objectives of this project.
CHAPTER FIVE

5 DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter is a recap of this research study. It summarizes the objectives the methodology, findings and overall evaluation of whether the set objectives were fulfilled. The layout of this chapter includes the summary, discussions, conclusions and recommendations.

5.2 Summary

The main objectives were clearly spelt out in that this research intended to evaluate the consequences of liberalizing the oil industry. In addition, the research sought to establish the major challenges facing the oil industry in a liberalized environment. The last objective was assessing the response of the industry to the underlying challenges.

The study designed appropriate research questions addressing the set objectives. The view held in the research was that liberalization was indeed beneficial to the oil industry and that oil-marketing firms are now better off in the liberalized environment. This opinion was based on the fact that liberalization eliminates bureaucracy and other “red tape” or obstacles in a controlled business environment that hamper efficiency and level playing ground. Obviously, proponents of lazier faire propagate that an efficient market enhances value to the stakeholders and this research had the same view that the oil industry has realized these benefits in a liberalized market.
This research had a clearly defined population in terms of the number of the oil firms. Also it had the population of sales outlets from reliable sources. The data collection methods used were considered reliable and comprehensive. Both primary and secondary data sources were used in this research. Statistical sample were applied on diverse dimensions of this research.

5.3 Discussion

From the onset, this study held the opinion that oil companies are more profitable and valuable in the liberalization environment. However, the findings were quite contradictory. This is demonstrated by the market share clinched by new entrants. This confirmed that there is intense competition in a stagnated market. Moreover the financial performance of the two firms reflected mixed performance that showed erratic performance in one of the firms. Again in dollar terms there was no revenue growth in Total (K) Ltd despite the merger with Elf.

The other key indicators which revealed that the oil industry is worse off in the deregulated era was the pull out of Agip from the market by selling her interests to Shell /BP group. Esso, also sold off their business to Mobil. Perhaps the more recent development that sent shivers in the market was the announcement by Shell/BP group that they are disposing off about 40 service stations in Western Kenya and Nyanza region. Apparently some of these service stations are the ones the group bought from Agip and were sold soon after an expensive renovation and re-imaging project to meet Shell international standards. The statistics on the magnitude of lost revenue arising from fake exports clearly demonstrates that the government is equally a looser among the stakeholders due to revenue lost in fake exports.
Concerning the challenges facing the industry, this research has articulated what are considered to be the pressing challenges. These include fuel-dumping, bias in the crude oil/white oils supply formula and lastly the unethical practice of selling adulterated fuel.

The oil firms came up with defensive strategies to counter these challenges. Apparently most of the strategies adopted fall under survival tactics. These are turn-around strategies intended to re-engineer and restructure the industry.

5.4 Recommendation

5.4.1 Enactment of stringent legislation against fuel dumping and adulteration.
Fuel dumping is top on the list of challenges facing the industry. There is a draft petroleum bill whose enactment is in progress. Among the recommendations in that bill was to criminalize offenders in fuel dumping and adulteration by introducing punitive fines and penalties for offenders. These range from minimum fine of Ksh 2 to 5 million or 2 years jail term. This study strongly recommends that this bill be enacted expeditiously to curb these malpractices.

5.4.2 Enhance industry level playing ground.
The undue advantage whereby some local firms are allowed to import petroleum products should be scrapped so that the base loading rule is applicable to all the oil marketing firms. It’s also strongly recommended that the government should invest heavily in a major upgrade of the refinery. This will enhance efficiency while at the same time the government will be able to protect its strategic interest in the refinery and also safeguard the 1000 or so jobs at the refinery.
5.4.3 Dissemination of information

The average Kenyan believes that oil companies operate as a cartel and have been exploiting the consumers through exorbitant prices. The oil industry should be able to come out strongly to dispel this misconception. In addition, the industry should seek a forum whereby they can voice concerns such as the dangers of fuel adulteration. Again they need to come out transparently over their performances so that the public can get first hand information that impact oil industry dynamics such as the effect of fluctuation of crude prices and exchange rates.

Overall, based on the findings of this research, the players in the oil industry especially the old players did not reap much from the liberalization as earlier anticipated. It also came out clearly that the oil firms are reacting to the market instead of taking proactive strategies. This is an indication that the oil industry was ill prepared for the liberalization and no wonder some firms have been hit hard.

Overall most of the challenges and shortcomings have been analyzed and hopefully they will be addressed in the petroleum draft bill.

Lastly owing to the dynamism of the oil industry, this study recommends further research especially after the petroleum draft bills are enacted.
References


Appendix 1  Letter of Introduction

Date

The Marketing Manager
Mobil Oil (K) Ltd
P.O Box 19002
Nairobi

Dear Sir,

Research on effect of Liberalization to the Oil Industry in Kenya.

I am carrying out a research on how the liberalization of the oil industry impacted the players in this industry. This study is intended to assess how the oil firms positioned themselves to cope with challenges in the post deregulation era. I have selected Mobil as one of the firms in my sample. In this regard I will be grateful if you offered me the opportunity to interview you on this subject. This work will enhance my Masters in Business administration project that I’m pursuing at United States International University, Nairobi campus.

The oil industry was among the first sectors of the economy that the government took a bold step to liberalize. Thus in my view the outcome of this research will be useful in evaluating whether the intended benefits of deregulation have been realized. Specifically it was assumed that industry efficiency would be enhanced due to the strategic positioning of the oil firms in the market. I believe that the findings of this research will provide useful insights for other sectors earmarked for deregulation.

Your availability and contribution for this interview will be appreciated.

Yours sincerely,

Michael Mwangi
Appendix II

Questionnaire used to interview marketing executives in the oil industry

What in your opinion prompted the government to deregulate the oil industry?

How did the industry respond to liberalization?

What benefits have accrued from this bold move?

What would you consider to be the major challenges that have arisen particularly in the liberalized environment?

What measures have the key players undertaken to mitigate these challenges?

In your opinion is the industry self-regulating in the post liberalization era?

In your opinion, is there a level playing ground among the industry’s key players?

Overall who among the following stakeholder do you consider to have benefited from the liberalization of the oil?

- Oil companies
- The government
- The consumers
- The economy