

PERSPECTIVES

Foreword by the Minister of Minerals and Energy

Message from the Chairperson of the Parliamentary Portfolio Committee on Minerals and Energy

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DIRECTOR'S REPORT



Colin McClelland
Director of Sapia

Sapia – like South Africa's young democracy which made its formation possible – has entered its ninth year. And, like the nation as a whole, Sapia's members face major, continuing change and challenges.

DRAMATIC CHANGES AHEAD

A snapshot of the some of the key events of the past year indicates the dramatic nature and extent of the changes and challenges:

- The Petroleum Products Act is being materially redrafted.
- The "in bond landed cost formula" (IBLC) is being replaced.
- Plans are afoot to phase out leaded petrol by 2006.
- Mandatory low sulphur diesel by 2006.
- Efforts are being made to make LPG and paraffin more affordable.
- The World Summit for Sustainable Development in Johannesburg has re-emphasised industrial environmental issues.

"This process of open communication will continue in line with our commitment to transparency . . ."

- A draft White Paper on the Promotion of Renewable Energy and Clean Energy Development has been published.

Any one of the above would have been a major event in its own right. But that is not all. During the year under review:

- There was continued progress on Black Economic Empowerment.
- Sapia members joined hands to combat HIV/AIDS and crime.
- 2001 was the fourth successive year of slow or no growth in the market.
- Rand oil prices remained high.

These events represent a circle of interaction impacting on the physical and social environment on a grand scale. Some of them will require vast investments by the industry, and together they will result in serious pressure on industry's profitability.

It is estimated that the removal of lead from petrol and the reduction to 500 parts per million (ppm) sul-

phur in diesel, as required by Cabinet by 2006, will cost the refining industry in the order of R10bn to R15bn. The only part of this cost that can be recovered from the consumer is the higher cost on international markets of 500ppm sulphur diesel versus the 3000ppm grade, currently some 6 to 7c/l. All other costs, capital and operational, will have to be absorbed by the oil companies if they wish to stay in the refining business in South Africa. Thus some very important decisions will have to be made by the oil companies on how they are going to meet their post 2006 product requirements. They have to decide whether to invest in the refining plant required or whether to import certain product grades. There are important national economic consequences that will flow from these decisions.

Other issues affecting the industry include the new Competition Act, which influences the way the industry is regulated, and the need to renegotiate the Sasol Supply Agreements.

A SENSE OF ACHIEVEMENT

Throughout the first eight years of its existence, Sapia has worked consistently with Government and other stakeholders to find “win-win” solutions to the many problems facing us all. The petroleum industry has been able to do this because of the willingness of Government and other stakeholders to engage in debate and to work towards constructive solutions. Consequently, we believe that as an industry, collectively and as individual member companies, we have been able to pioneer paths of transformation within the private sector.

We believe our preparedness to accommodate change and lead the search for novel solutions has already been demonstrated. One example, (referred to in another context by our chairman in this Report)

is black empowerment. We were the first to sit down with government and seriously address this issue. Together with government and other stakeholders, we were able to produce the concept of an Empowerment Charter. It gives us a sense of achievement to see the concept now being adopted in other industries. We shall continue on this path in the belief that it is a fundamental goal, and that the more we toil at empowerment, the less the nation will bleed in turmoil.

We will accept the challenge set out in the Portfolio Committee Chairperson’s Message to play a positive role in facilitating the implementation of the Empowerment Charter by helping to address the problems that are common to all members.

THE WAY FORWARD

The near future will see more changes in the industry. Some of the issues that have to be addressed are:

- A restructuring of the entire energy sector of the economy which will include the increasing role of natural gas in the energy supply patterns of Southern Africa. (While the entry into a wider market of gas will affect coal more than oil, the new mix of energy sources will be felt everywhere).
- The ‘managed liberalisation’ of the liquid fuels industry.
- The full attainment of black empowerment targets.
- Greater development of human resources within our rapidly restructuring industry.
- Changes in product specifications to meet new and increasing environmental needs.
- An evaluation of the importance of self-sufficiency

in product supply in South Africa.

- New arrangements for the marketing of synfuels, including entry to retail markets by the synfuel producers.
- Restructuring and regulation of the petroleum products pipelines.

Most of these changes are likely to occur within the next few years and will impact in different ways on Sapia’s member companies. The key imperative for the industry is that these huge changes take place in an orderly, efficient and fair manner.

No doubt there will be more issues emerging – but the above list indicates the extent of the exciting challenges facing the industry.

CONFLICTING OBJECTIVES

In the coming years, some difficult decisions will have to be made in prioritising policy objectives which are in conflict with each other. For example:

- Cleaner fuels to protect the environment versus the cost of these fuels to the economy.
- Greater competition versus protection of jobs and businesses in the small, medium and micro enterprise (SMME) sector.
- Lower priced fuels for the poor and primary industry versus returns that are sufficient to sustain local refining in the medium term.

OIL PRICES

In March 1999 crude oil prices bottomed at some \$10 per barrel. OPEC then cut production to bolster prices. OPEC had attempted this, without success, on several previous occasions. In March 1999 the move was successful.

This success can be attributed to rising world demand for oil – buoyed by recovery in Asia – meeting a constrained supply.

Since then OPEC, by managing its output, has sought to keep the price in a narrow range around \$22/28/bbl and has been largely successful.

Rand weakness against the US dollar has meant that increases in oil prices in South Africa have been greater than those expressed in dollar terms.

PETROL AND DIESEL PRICING

Although the Monthly Pricing System has been severely tested by the prolonged periods of rising and/or volatile prices in recent years it has continued to function well. The system has become increasingly well understood by the public and this has assisted in their acceptance of the reality of a climate of high and volatile prices.

Certain amendments to the system were needed to compensate for the inability of the “slate” adjustments to take account of the continuous price rises. Sapia would like to express its appreciation to the Government for the timely actions that have been taken in this regard whenever it has been necessary.

The high pump prices have, however, dampened demand for some petroleum products and sales vol-

umes, notably petrol, have declined in recent years. The two systems that influence industry profits are the Marketing of Petroleum Activities Return (MPAR) and the In Bond Landed Cost (IBLC) system.

MARKETING OF PETROLEUM ACTIVITIES RETURN (MPAR)

The Marketing of Petroleum Activities Return (MPAR), when consistently applied, has proved to be a reasonably effective mechanism in the regulatory environment.

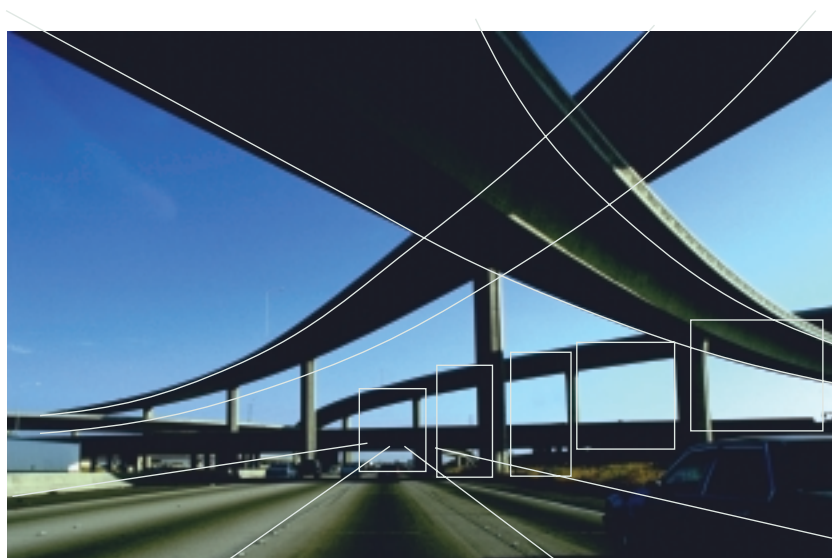
This system achieves the goal of fostering efficiency. It does so by basing margins on aggregate industry returns. This encourages each company to earn more for itself by striving to beat the average and so driving down the margin to the advantage of the consumer.

During the period under review, certain minor improvements were made to the guidelines, and MPAR exercises covering 2000 and 2001 were completed and adjustments granted.

The improved efficiency in operating the MPAR mechanism is important, and has reduced the uncertainty with regard to the future profitability of the marketing sector. This is the first time in some years that the granting of margin increases has been fully up-to-date.

IN BOND LANDED COST (IBLC)

In-Bond Landed Cost (IBLC) is a mechanism that links South African petroleum product prices to world markets. The details of the system, which are widely published and are available from Sapia, have in essence been in place for a long time. In 1994 the Liquid Fuels Task Force – then a sub-committee of the forerunners of Nedlac – reviewed the detail and made certain



changes to make prices more competitive. It was reported in last year's Annual Report that the system was under review, the objective being to investigate whether a system more appropriate to today's increasingly complex world markets could be developed.

This process has been taken further and it is expected that a new system, which will more accurately reflect world markets, will be introduced at some time in 2003.

(See special section on the Pricing of Petroleum Products on page 38)

INFORMING THE PUBLIC

In its first eight years, Sapia has dealt with a large number of issues. However, one over-riding aim has been to increase the level of public understanding of the industry. It has been done constantly and in many ways. We believe that some success has been achieved and this is demonstrated through:

- Our official published reports – of which this is the sixth.
- Our website.
- Correspondence and answers to queries.
- Speeches and conferencing, press releases and media interviews.
- Direct interaction with members of the public and with public representatives.

This process of open communication will continue in line with our commitment to transparency and the free flow of information about the industry.

ACTIVE ON SOCIAL ISSUES

As the Chairperson's Report makes clear, member companies are active on the major social issues of education and training, poverty alleviation, HIV/AIDS

and crime and corruption. In terms of corruption and crime, the Industry plays the strongest role it can, by being vigilant about ethics and white-collar crime within its own structures, by protecting its assets and workers from the abnormal spate of theft and violence, and by encouraging social upliftment. The high and increasing incidences of armed robberies and hijacking of our delivery vehicles and the commensurate trauma, injuries and loss of life are of great concern to us.

(See Social Responsibility Report, page 31 and Crime Report on page 34)

We also endeavour to lead the way in the areas of Health, Safety and Environment. *(For more information see Environment Report on page 23)*

WORLD SUMMIT ON SUSTAINABLE DEVELOPMENT (WSSD)

The WSSD, held in Johannesburg in September 2002, was a resounding organisational success for South Africa. Many issues contained in the WSSD Johannesburg Declaration and the Plan of Implementation have relevance to our industry. Sapia and its members are already moving in the right direction in respect of key issues such as:

- **USE OF CLEANER FOSSIL FUELS:** We are in line with the goals of phasing out of lead in petrol and the significant lowering of sulphur levels in liquid fuels.
- **RENEWABLE ENERGY:** Whilst the WSSD did not set targets or a timetable, the South African Department of Minerals and Energy is seeking to do so, including a strategy for the production of liquid fuels from renewable sources.
- **STRONGER CORPORATE GOVERNANCE:** Sapia

already encourages the strongest possible policies *(See Ethics and Good Governance, page 36)*

- **ENERGY AND ITS ROLE IN POVERTY ALLEVIATION:** This is, as recorded elsewhere in this report, a key concern of Sapia members. The Chairperson of the Portfolio Committee has, in his Message to this report, called on Sapia to play a vital role in co-ordinating industry efforts in the provision of safe and modern fuels such as LPG for poor households. We accept this challenge.

NEW PARTNERSHIP FOR AFRICAN DEVELOPMENT (NEPAD)

Sapia hopes to extend its relationships with its sister organisations in other African countries and explore methods of working together for the mutual benefit of all Africans. This process has started and taking it further will be a key challenge in the years ahead.

We have recorded in previous Reports how Sapia members add value to South Africa by investing billions of rands annually; by helping the economy grow and by providing technology, training, managerial skills and quality products. Because many Sapia members operate extensively in several parts of the African continent, and support the vision and goals of NEPAD in active and practical ways, this value adding by our members applies to most parts of Africa.

TAXI INDUSTRY

Sapia once again records its support for the plans to improve the position of the taxi industry. The taxi industry is responsible for moving a large proportion of commuters using public transport, and is vital to both urban and rural needs. However, unlike other forms of public transport with which it competes, it receives no state subsidy.

Sapia supports the plan to upgrade, assist and regulate this vital private-enterprise service.

If taxi fleets are to change from petrol-driven vehicles to diesel-powered ones, as envisaged, the change could more than offset the current market demand/supply imbalance between these two products. Lead times and clarity with regard to policy are important to ensure that the change does not lead to a diesel shortfall and a petrol surplus in the country.

FUEL SAVING

Despite the short-term negative effects on its members' sales volumes, Sapia constantly supports, encourages and seeks innovative ways of improving fuel efficiency. It does so, actively, in the national interest. (See *Fuel Saving Tips*, page 42.)

Sapia members also continuously upgrade their management systems to discourage theft and waste.

WELCOME

Sapia wishes to welcome Mr Mbulelo Goniwe as the Chair of the Parliamentary Portfolio Committee on Minerals and Energy, and wishes the former Chairs Mr Duma Nkosi and Mr Ronald Mofokeng well in their important new roles. We thank former Deputy Director General Mr Smunda Mokoena for his contribution to our industry and wish him well in his important new role. We congratulate Dr Rod Crompton on his appointment as Deputy Director General and we welcome Mr Manny Singh as Director – Petroleum Policy. We look forward to working with them in the future.

CONCLUSION

The past year has again been one of great change within Sapia and externally. A number of important decisions were made and active steps taken during the year.

Sapia is pleased that it has once again been a year in which it was possible to find "win - win" solutions to many pressing issues and one in which the industry has remained at the forefront of those committed to building a better life for all in South Africa.

