



FAIR TRADING COMMISSION:

POSITION ON THE INCLUSION OF GOODWILL COMPENSATION IN CONTRACTS BETWEEN BULK DISTRIBUTORS AND RETAILERS OF PETROLEUM PRODUCTS

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INTRODUCTION

1. There is strong support in the disciplines of Accounts and Economics, that retailers of finished petroleum products contributes to, and therefore should be compensated for goodwill.
2. The Fair Trading Commission argues that contracts between retailers and bulk distributors of petroleum products should include a scheme for measuring and compensating the goodwill between both parties at the conclusion of the contract.

Background

3. This paper addresses the merits of including “Goodwill” considerations in the contract between bulk distributors of refined petroleum products (‘marketing companies’) and their dealers (‘retailers’). Such compensation would become payable to the retailers upon the expiration/termination of said contract. It is the view of the Jamaica Gasoline Retailers Association that retailers generate and therefore should be compensated for goodwill upon the termination/expiration of a contract. In a meeting with the Fair Trading Commission on January 14, 2016, the Jamaica Association for Petroleum Marketers (JAPM) expressed the view that all the goodwill generated at retail locations is solely attributable to the efforts of the respective marketing companies.

Accounting Perspective

4. From an accounting perspective, “...Goodwill is an intangible asset that arises as a result of the acquisition of one company by another for a premium value. The value of a company’s brand name, solid customer base, good employees relations and any patents or proprietary

technology represent goodwill...The amount the acquiring company pays the targeting company over the target's book value usually accounts for the value of the target's goodwill..." (source: investopedia.com).

5. Based on the accounting definition of Goodwill, it is clear that a petroleum retail location may generate value that is not reflected on the balance sheet. It is reasonable to presume that Goodwill at a particular location would be generated based on the joint efforts of the marketing company and the retailer at the location. Building a strong customer base is viewed as a significant reflection of goodwill. A marketing company would have, for instance, exerted considerable efforts to build a strong brand name with the aid of, but not limited to, the development of proprietary technology such as "additives" designed to enhance the efficiency of vehicles and therefore attract final consumers to that brand irrespective of the location in which the brand is available. Similarly, retailers would have exerted considerable efforts to ensure that final consumers of petroleum products are attracted to its retail location in particular because of, say, the high customer service standards available at the location.

Economic Perspective

6. Retailers benefit from greater sales of petroleum products and therefore have some incentives to increase sales in the absence of goodwill compensation.
7. Economists view goodwill compensation as a reward to creating value for consumers. Accordingly, the retailer's decision of how much effort to undertake at a given location is merely a marginal cost/benefit analysis. The level of effort to increase sales is directly proportional to the marginal costs whereas the level of goodwill compensation is viewed as the marginal benefit.
8. As such, retailers who are not compensated for the portion of the goodwill they generate are unlikely to undertake the costly efforts at a level that would generate the optimal level of goodwill. Further, the efforts to generate greater goodwill will ultimately benefit final consumers.
9. Accordingly, the absence of goodwill compensation to retailers means that retailers have insufficient economic incentives to adequately engage in conduct which would create added value for final consumers of petroleum products.

CALCULATING GOODWILL COMPENSATION

10. Goodwill to a retailer would become payable upon the expiration/termination of a contract with a bulk distributor of petroleum products. While goodwill compensation is not common in Jamaica, the Fair Trading Commission has information suggesting that in at

least one instance, the Marketing Company of the Texaco brand compensated retailers at three dealer locations for goodwill generated at the respective locations. In this instance, the goodwill deliberately measured and apportioned between the marketing company and the retailer based on (i) location; (ii) quality of product; (iii) retailer; (iv) brand; (v) price; and (vi) customer loyalty/ quality of service. (information provided by the Jamaica Gasoline Retailers Association in a meeting of the Petroleum Trade Reform Committee held on February 8, 2016.) In this instance, retail outlets received 46% of the (joint) goodwill generated at the respective locations.

11. Alternatively, goodwill may be calculated as either a percentage of Gross Profit, percentage of three years' Net Income, or other appropriate measure of profitability.

(source: <https://conveniencestorenews.wordpress.com/2008/09/08/7-eleven-start-up-costs/>).

CONCLUSION

12. In summary, marketing companies and retailers have the opportunity to generate goodwill at retail locations, to the benefit of final consumers of petroleum products.
13. Retailers benefit from greater sales of petroleum products and therefore have some incentives to increase sales in the absence of goodwill compensation.
14. With goodwill compensation, however, retailers have incentives to exert greater levels of effort to generate sales. Accordingly, goodwill compensation to retailers, by stimulating retailer efforts to drive sales, is likely to increase the value of the product to final consumers.