

**Consumer Council**

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**A Study of Motor Gasoline, Diesel and LPG  
Markets in Hong Kong**

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**Energizing the Energy Market**

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**A Study of Motor Gasoline, Diesel and LPG  
Markets in Hong Kong  
Findings and Recommendations**

Consumer Council  
December 1999

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**3 Petroleum Products**

- Gasoline 
- Diesel 
- LPG
  - Cylinder 
  - Piped 

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### Examined:

- industry trends and structure
- Government regulations
- the different functional levels involved from supply to retail
- the state of competition in the various markets; and

making recommendations for the Government and industry to consider .....intended as a starting point...

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### Overall market structure & behavior

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### An Oligopoly Market

- Highly concentrated

		<b>Market Share</b>
3 oil companies	LPG	70%
	Diesel	30%
	Gasoline	90%

- Largely vertically integrated
- Small total demand
- Limited growth opportunities
- Barriers to entry

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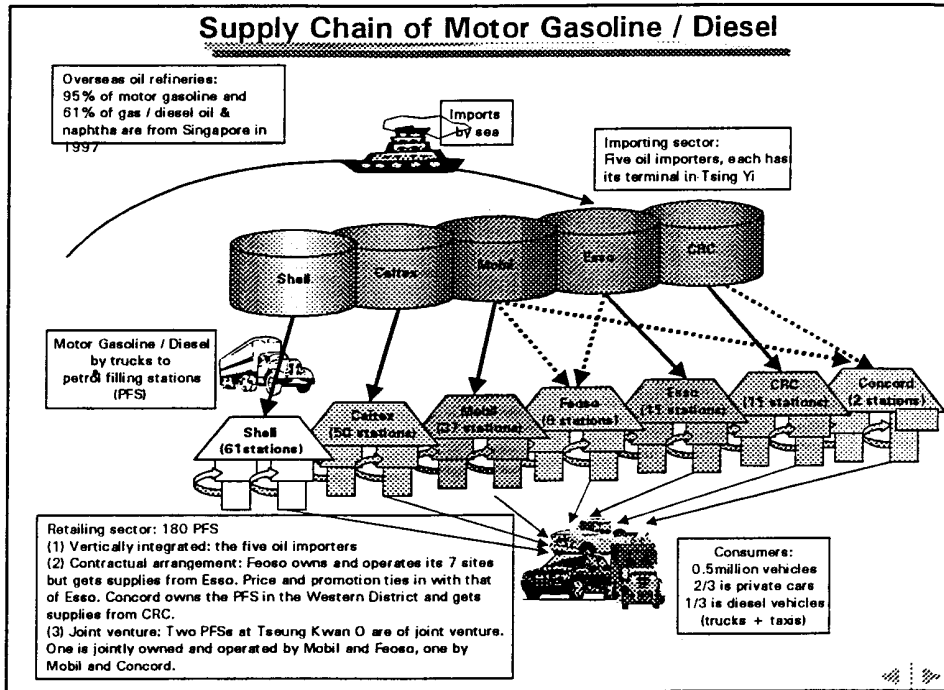
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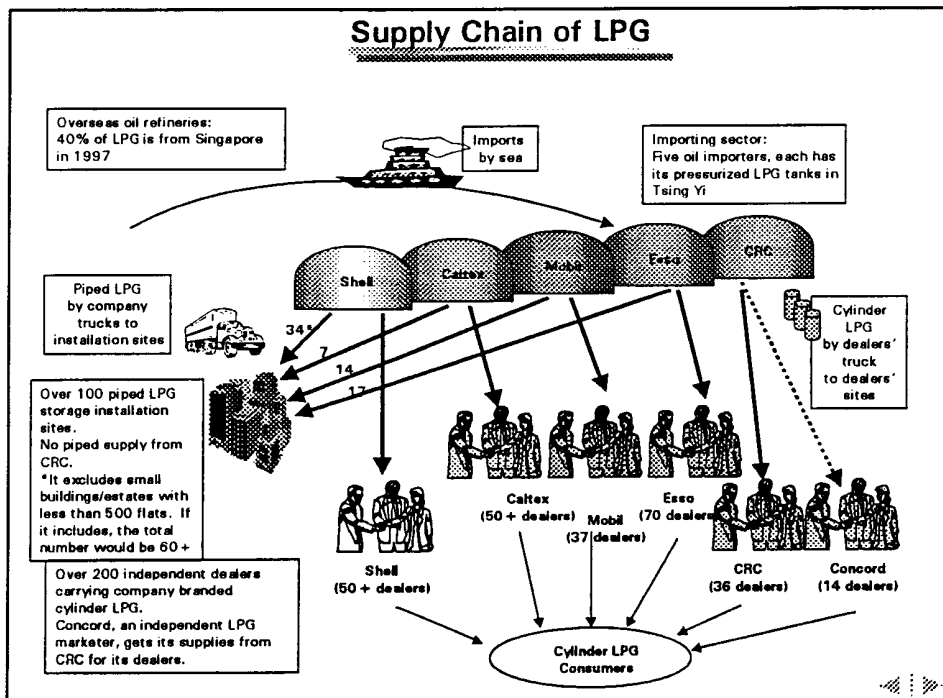
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## Supply Chain of Motor Gasoline / Diesel



## Supply Chain of LPG



**Overall market structure & behavior**

Despite uniform pump prices,  
no direct evidence of explicit  
collusion.

Oligopoly market can lead to  
implicit co-operative behaviour:

firms recognize mutual  
interdependence, not in their  
interests to drive prices down to  
marginal cost level

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**Existence of:**

- Some forms of non-price competition (give  
aways)
- Jan 99, instance of limited price competition  
in certain geographic areas

But:

Recently, all but one oil company have  
stopped giving away "free" tissues and  
bottled water (the remaining company will  
cease doing very soon)

In view of oligopoly characteristic,  
question whether competition will continue

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**Price comparison \$**

**Prices**

- Prices (exclusive of taxes) higher than  
most other countries, particularly in the  
region
- Oil company: higher quality product,  
higher octane level for gasoline

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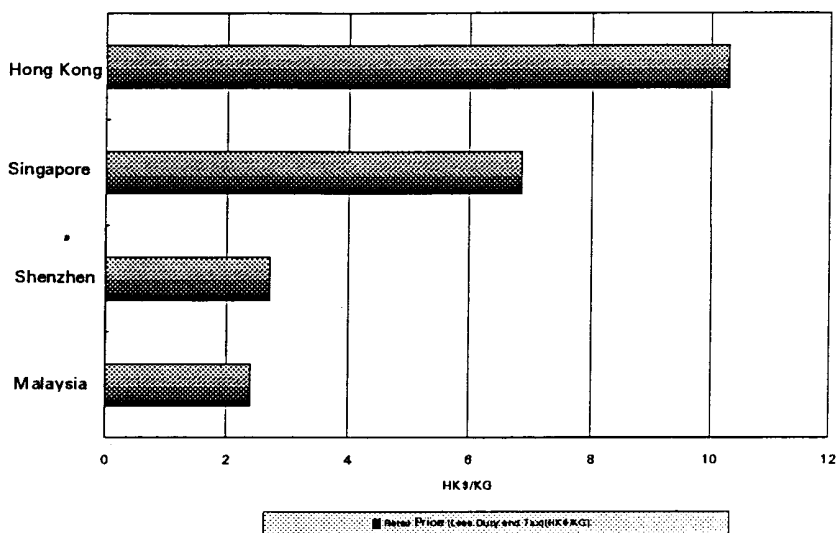
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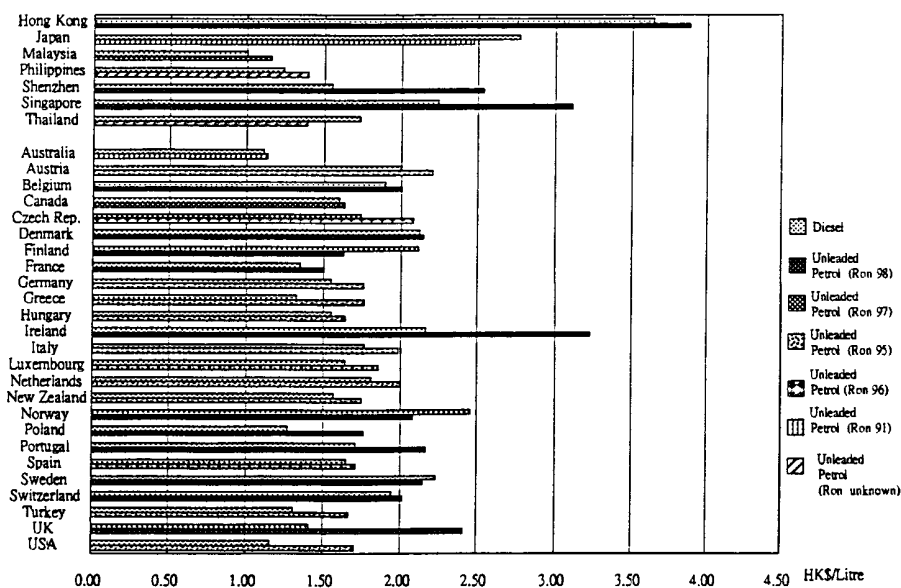
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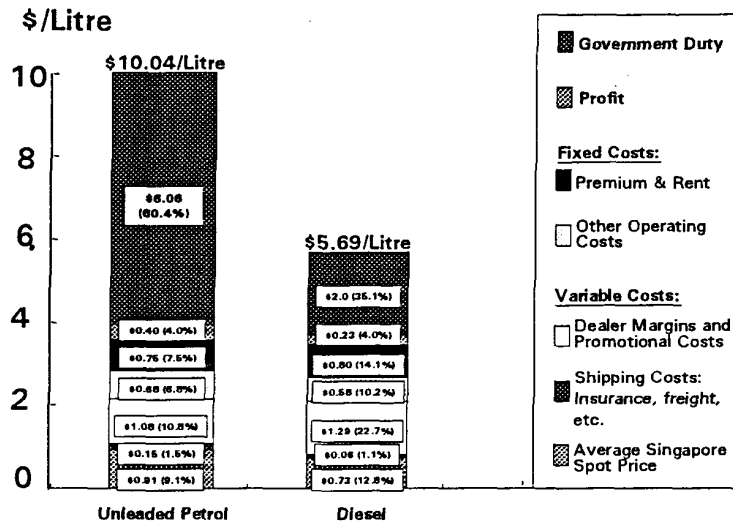
**Retail Price (Exclusive of taxes) of Cylinder LPG (4th Quarter of 1998)**



**Retail Price (exclusive of taxes) of Diesel & Unleaded Petrol (4th Quarter of 1998)**

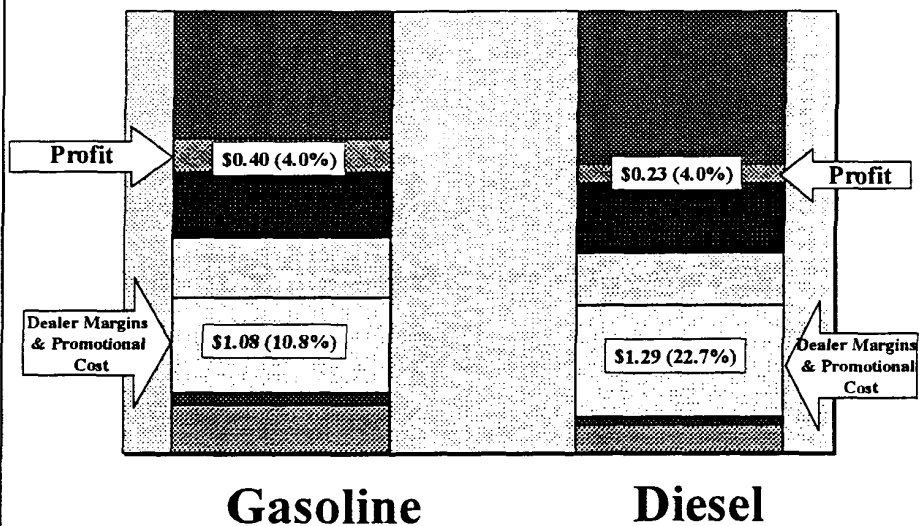


## Components of Retail Prices of Unleaded Petrol and Diesel



Figures are of 1998 and compiled by Consumer Council based on ESB's submission to Legco Panel on Economic Services

## Profit Analysis



## Future Development

### Demand

Unleaded Petrol	limited
Diesel	decline
LPG (motor fuel)	grow
LPG (piped) (cylinder)	uncertain decline

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## Findings on Operations

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## Motor Fuel Retailing

- Uniform Pricing (public concern)
- pump service appears to be the same except: discounts based on loyalty schemes and give aways
- little or no opportunity to diversify

*Oligopoly Market Characteristics - can lead to cooperative behaviour - not in their interest to constantly drive prices to marginal cost levels.*

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## Motor Filling Stations



- at strategic locations
- safety regulations
- no competition oversight re:
  - ownership of sites within geographic markets
  - renewal of lease
  - auction for new sites (goes to highest bidder)
- no price information boards

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## LPG

### **Cylinder**

- new entry unlikely
- competition can be induced by:
  - standardizing connecting equipment enhances mobility of distributors between suppliers
  - consumers to shop around

### **Piped**

- safety concerns addressed, a viable means for introducing common carrier arrangements in Hong Kong (private & public housing)

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## Government Regulations and Oversight

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### **Government Regulations and Oversight**

**Previously:** safety and stability of long term supply

**Of equal importance:**

- need for competitive markets
  - lower cost of doing business in Hong Kong
  - alleviate pressure on household expenses

**Need for better co-ordination of government policies:**

- example:
  - policy for bidding filling sites
  - utilization of piped LPG infrastructure at residential estates for LPG filling sites for vehicles,
  - policy for PFS to enhance competition

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### **Recommendations of the Consumer Council to Promote Competition & Enhance Consumer Welfare**

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### **Recommendations**

**Objectives of**

- 1 Encouraging Entry by New Operators**
- 2 Inducing Price Competition**
- 3 Improving Government Oversight**

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**Objective 1: Encouraging Entry By New Operators**

- 1 Removal of bidding restrictions: reduce barrier to entry
- 2 Scrutinize the ownership of petrol filling station sites: avoid market over-concentration
- 3 Flexibility in filling sites
  - encourage mixed retailing of filling sites
  - filling sites need not be confined to sites identified by the government. Conversion of land lease should be flexible
- 4 Safeguarding adequate storage facilities: commercial pressure on oil companies, new entrants to lease spare storage capacity

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**Objective 2: Inducing Price Competition**

- 5 Ensuring competitive behaviour: lease conditions to prohibit collusive anti-competitive conduct
- 6 Price information boards: easy viewing and comparison by consumers
- 7 LPG common carrier: separation of fixed costs of the LPG network and storage area from the variable costs LPG supply
- 8 Standardization of cylinder LPG connecting equipment: greater mobility and choice between suppliers

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**Objective 3: Improving government oversight**

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  - Creation of an Energy Commission
    - develop long term strategy
    - competition oversight for the energy sector
  - Creation of Competition Authority
    - bring about consistency in the application of competition policy rules
- 10 Monitoring the industry profitability trend, prompt information on difference between import and retail prices
- 11 Competition implications of regulatory interventions

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# Implementation

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**Implementation**

Government action: will not involve great cost increases to the Government

Industry action: take up the suggestions  
provision of information to government

Consumer action: comparing prices  
by shopping around  
making their views known to the preference for price competition compared to promotional giveaways

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# Agenda for the Future

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**Agenda for the Future**

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- Further Monitoring of Market Structure: further work for Government on competition in the industry
- Alternative Land Leasing Procedures: combination of premium and offer of price ceiling formula
- Remote Storage: enhancing competition?

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**Conclusion**

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**Conclusion**

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- The study is a starting point
- Issues to be studied
- Council has made practical recommendations where it can to energize the three petroleum products markets

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