



Consumer Council

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



Energizing the Energy Market

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

**Consumer Council
December 1999**

3 Petroleum Products

• Gasoline



• Diesel



• LPG

Cylinder



Piped



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 considerintended as a starting point...

Overall market structure & behavior

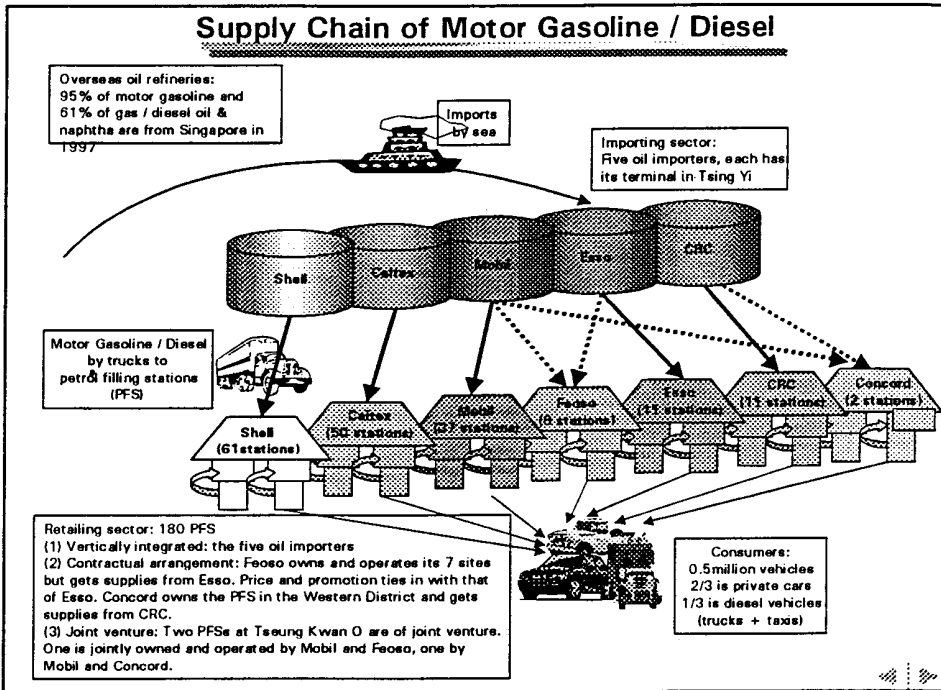
An Oligopoly Market

- Highly concentrated

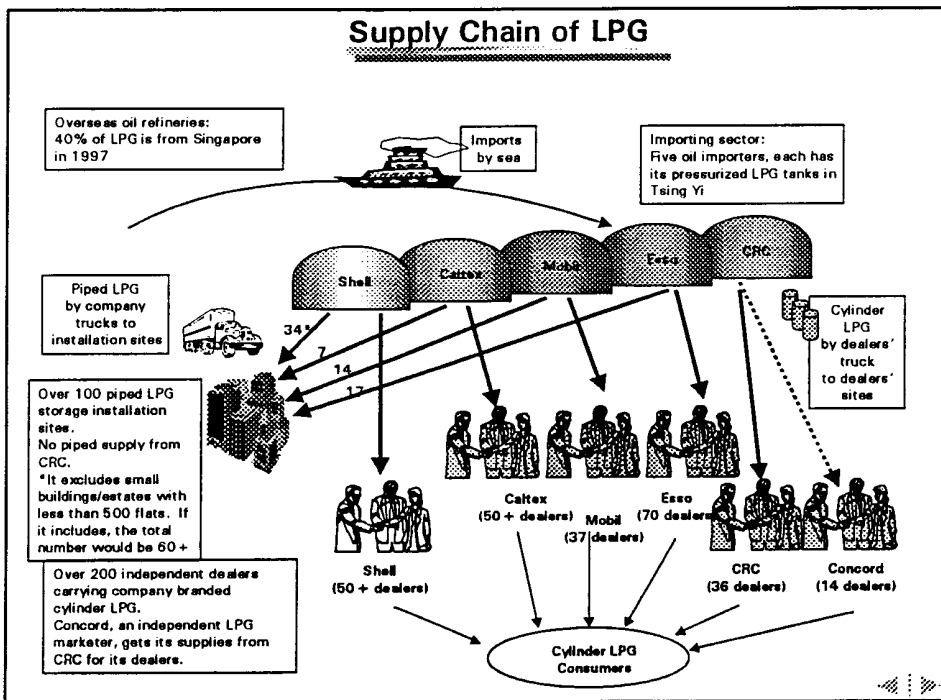
		Market Share
3 oil companies	LPG	70%
	Diesel	30%
	Gasoline	90%

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

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

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)

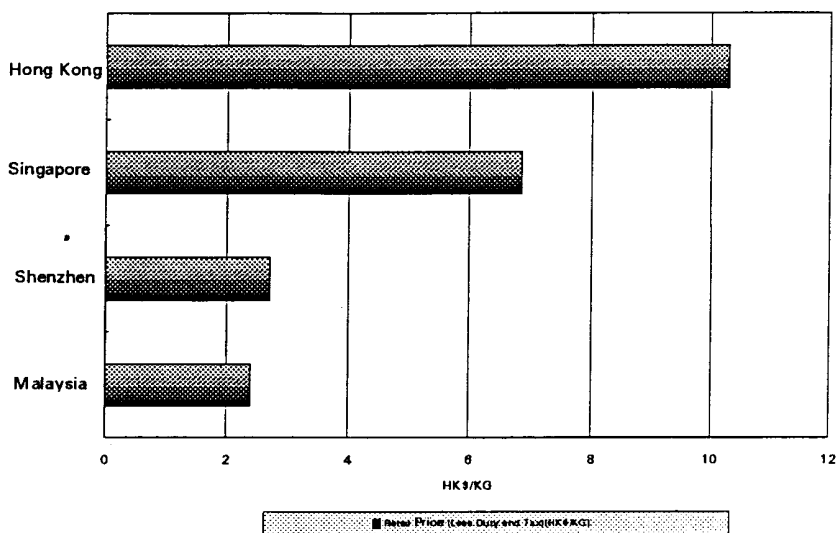
In view of oligopoly characteristic,
question whether competition will continue

Price comparison \$

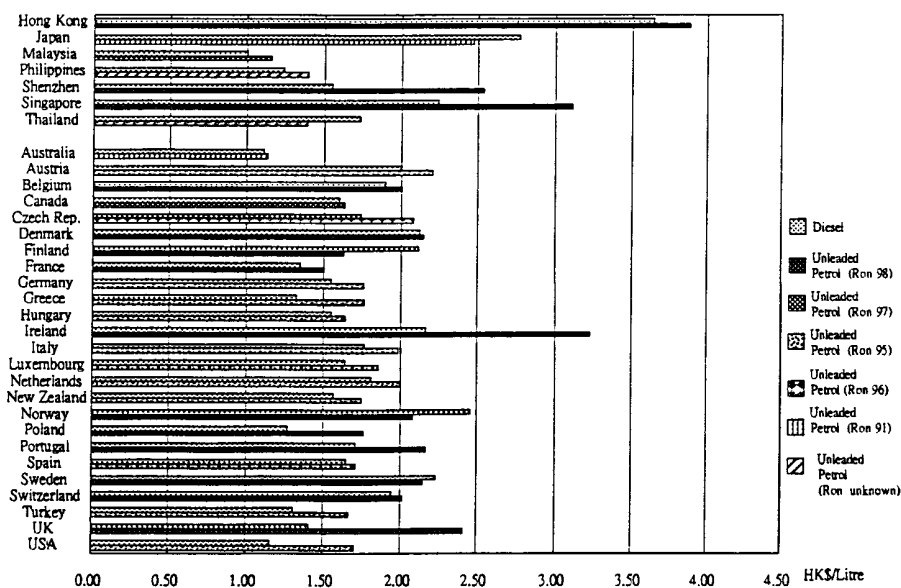
Prices

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

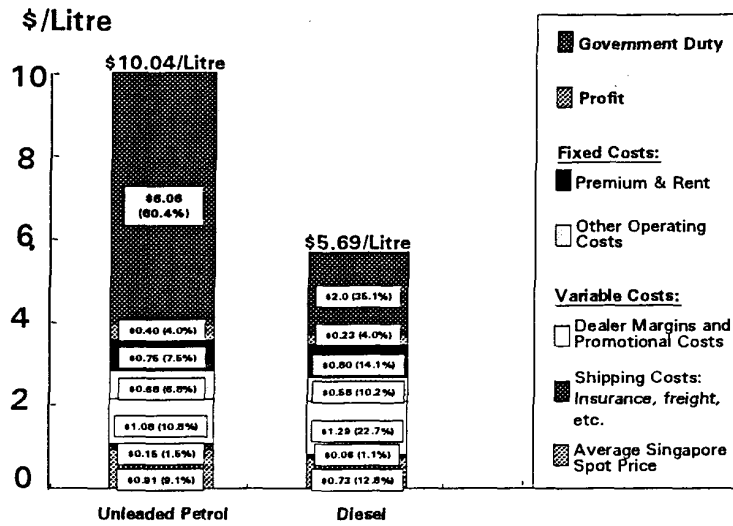
Retail Price (Exclusive of taxes) of Cylinder LPG (4th Quarter of 1998)



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

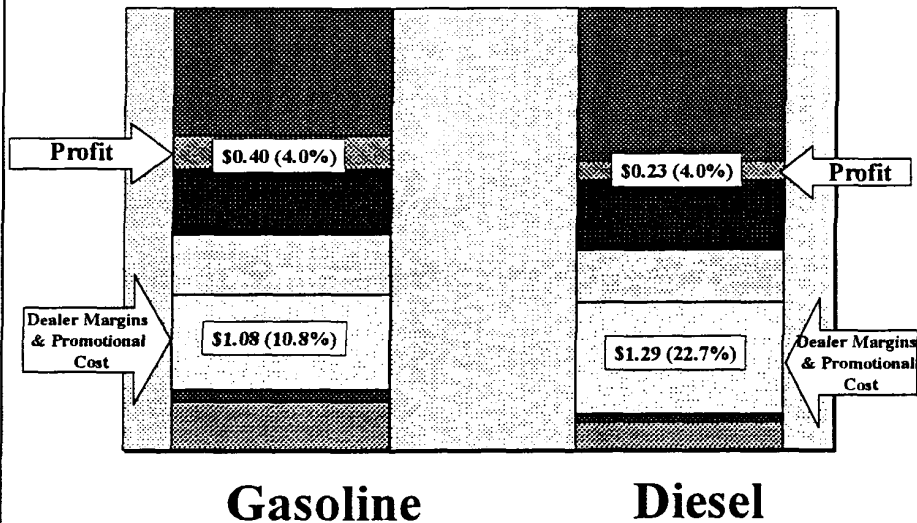


Components of Retail Prices of Unleaded Petrol and Diesel



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

Findings on Operations

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.

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

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)

Government Regulations and Oversight

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

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

Recommendations

Objectives of

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

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

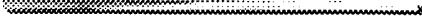
Objective 2: Inducing Price Competition

- 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

Objective 3: Improving government oversight

- 9
 - 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

Implementation



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

Agenda for the Future



Agenda for the Future

- 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?

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
