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Competition Commission announces findings of its study into Hong Kong's auto-fuel market

The Competition Commission (Commission) today (4 May) released a report outlining the findings of its study into the auto-fuel market in Hong Kong. The report identifies a number of issues which the Commission believes to be hindering competition and which would likely have contributed to high auto-fuel prices in the territory. The report also made recommendations on how to address these issues with the aim of furthering competition in the market.

To determine the state of competition and whether potential concerns exist in the market, the Commission has looked beyond auto-fuel prices and examined the market's underlying structural and behavioural characteristics. The Commission is of the view that the auto-fuel market in Hong Kong has a number of highly unusual features that have undermined the effectiveness of competition in the market.

Market features

Market structure

The local auto-fuel market is highly concentrated with five major market players. With no oil refinery facilities, Hong Kong is wholly dependent on refined auto-fuel imports which have to be stored in terminal storage facilities that are owned by four oil companies. The market exhibits a high degree of vertical integration with the vast majority of auto-fuel sold through retail stations owned by these companies. As a result, these major retailers are likely to have broadly similar cost structures, with no low-cost "maverick" competitor. Hong Kong's unique topography also limits opportunities for alternative retailing models to emerge.

The market is also characterised by high barriers to entry and expansion. The lack of access to storage facilities and huge cost in obtaining petrol filling station (PFS) sites prevent new entrants or existing players from exerting greater competitive pressure on competitors.

The availability of effectively one single product for petrol is another unique feature of the market. Hong Kong stands alone in the world where only 98 RON, one of the most expensive and highest grades of petrol, is available for motorists. Both the "standard" and "super" varieties of petrol on offer here are 98 RON¹, which is either offered alongside a cheaper alternative or not at all in most international markets.

Market behaviour

It is harder for consumers in Hong Kong than in other markets to gauge and compare prices, partly due to the low visibility of pump prices. Some PFS sites do not have large price boards and those that are in place are not always easily visible from the streets or they are not used for displaying price information at all.

¹ The Commission notes that there have been some claims that the "super" variety of petrol on sale in Hong Kong may be of a higher RON than 98 RON, however the Commission has not been able to verify this.

Another special feature of the Hong Kong market is the prevalence of discounts. The headline pump prices serve merely as a starting point from which various discounts are applied. However, the Commission finds the discount system complex and opaque, making it difficult for consumers to compare the actual prices. Discounts are also not offered to all consumers in a uniform way. The Commission is of the view that discounts are not a perfect substitute for price competition.

It is also found that retail pump prices in Hong Kong move infrequently and exhibit no geographic variation, whereas in most international markets, prices differ geographically due to the variations in demand and supply in different areas.

Recommendations

To address the above issues, the Commission has made a number of recommendations as follows:

The re-introduction of 95 RON petrol

As shown by a consumer preference survey² conducted by the University of Hong Kong, 86.2% of the respondents in Hong Kong indicated that they are likely to switch to petrol with lower octane level than 98 RON if it is 10% cheaper. In another survey² on the car types in Hong Kong, over 99% of the petrol engine vehicles sampled could use 95 RON petrol, and only around 15% are recommended to use 98 RON petrol.

To promote greater choices for consumers, the Government should facilitate the re-introduction of 95 RON petrol by considering making it a lease condition for new PFS sites or those sites which are up for re-tender.

Increase of PFS sites

Demand for auto-fuel has grown considerably over the past decade with net imports of unleaded petrol up by more than 50%, yet there is only an around 5% increase of PFS sites compared to 2005. The Government should enable more sites for PFS use to be tendered and/or converted. If more PFS sites could be made available when overall demand is increasing, this could reduce one of the barriers to entry and expansion.

Review of tendering system for PFS sites

The Commission is of the view that the existing tendering system for PFS sites could be enhanced with a view to bring in more competition to the market. With the leases of 28 PFS sites expiring in 2018, this is an opportune time for the Government to engage different stakeholders and initiate a review of the system.

Prominent display of pump prices and walk-in discounts

Unlike other countries, the prevalence of discounts and low visibility of pump prices in Hong Kong make it difficult for motorists to ascertain the price differentials across retailers. To help consumers compare auto-fuel prices, retailers should display the pump prices and walk-in discounts for their products on prominent boards that can be read by passing motorists at every PFS site.

² The Commission commissioned the Social Science Research Centre of The University of Hong Kong to conduct the surveys in 2017 during which 625 interviews were completed and over 3,000 private cars were sampled.

Reduce entry and expansion barriers

Substantial enhancements in competition are unlikely unless smaller firms including new entrants can source imports and storage of auto-fuels at more competitive prices. The Government should explore whether potential ‘structural’ reform options, such as various interventions at the terminal storage and alternative source of auto-fuel supply could deliver benefits that outweigh costs and risks.

Commission to be provided with information gathering power

Unlike an investigation, the Commission does not have compulsory information gathering powers when conducting market studies. For this study, the Commission could only request oil companies to provide information on a voluntary basis. While co-operation was generally forthcoming, certain commercially sensitive information could not be obtained for analyses. Future market studies would be assisted if the Commission is provided with information gathering powers to compel the production of materials.

To address common perceptions that petrol prices in Hong Kong are high and consistent across oil companies, the Commission pointed out in the report that these two features on their own cannot be taken as hard evidence of anti-competitive conduct. When one firm changes its prices, others promptly follow until they are all at the same or similar level again. This is sometimes called “parallel pricing”, which is a universal feature of homogeneous product markets such as auto-fuel. The Commission in carrying out the study has looked beyond the mere similarity of prices and examined closely the market’s underlying dynamics.

Mr. Rasul Butt, Senior Executive Director of the Commission, said, “Given the vital role that auto-fuels play in day-to-day life, it is important for the markets in which they are supplied to be functioning well. The report released today outlines the issues which undermine market competition together with recommendations on how to address them. The fact that the Government will be re-tendering a number of petrol filling stations starting from 2018 creates the perfect impetus for adding more competitive dynamics to the auto-fuel market.”
