



## Overview of the Russian fuel retailing market

**After visiting the Autocomplex trade fair in Moscow, PetrolPlaza takes a look at the current situation of the Russian market, which faces challenges regarding surrogate diesel fuel, drop in car sales, and environmental issues affecting major cities.**

Although the country is still suffering from a strong economic recession, Russia's fuel retailing market is at a stable point and has undergone no major changes during the last years, according to Griogory Sergienko, manager of the Russian Fuel Union.

The current situation of stability can be attributed to the regulatory activities of the Federal Antimonopoly Service (FAS). The mechanisms initiated and implemented by the FAS, the establishment of the Russian Oil Products Exchange, as well as a number of measures aimed at competition fostering, have had a favorable effect on the Russian fuel market. Positive effects from these policies can be observed in stable fuel prices, volume and quality of fuel meeting market demands, and the stimulation in the modernization of oil refineries.

In addition to these initiatives, Russia is producing EURO 5 fuel all over the country since January 1, 2016. These measures are specially tailored for large cities in the Western Russia, which suffer from severe environmental issues. The economic recession has also taken its toll on the fuel retailing market, as businesses have reduced their activities and fuel demand has dropped. With the level of fuel production currently surpassing demand, some large oil companies have considered exporting the excesses.

The taxation system, characterized by its unpredictability, has also reported a number of problems. The government has already raised the gasoline excise duty twice in the first half of 2016. Amidst a deepening economic recession, the government's initial plans to reduce fuel duties were not well received, as they constitute one of the major revenue sources for the oil industry. Thus, the Ministry of Finance is going to maintain the present rate of the gasoline excise duty through 2016 and even slightly increase it in 2017.

Another matter of concern are the unfavorable market conditions in the Novosibirsk Region and the Altai Territory (Eastern Siberia), where the two competing oil companies, Rosneft and Gazpromneft,

carry out controversial policies, dump fuel prices, implement loyalty mechanisms, and thus reduce the economic profitability of independent retailers.

This case illustrates the long-term confrontation between large oil companies and independent gas station networks. While the main objectives of the former are simply maintaining the positive image of the company, staying on the market and ensuring a certain sales volume, the latter struggle to survive and operate on a day-to-day basis.

### **Low quality fuel across the transport industry**

Surrogate diesel continues to be an issue in Russia, as detected by an investigation conducted by the President of Rosstandard (Russian Standard). Today the volume of overhead products in Russia accounts for 30% of all diesel produced, with the average refining rate only at 74%. The same rate in Western countries accounts for 95%. If Russia managed to reach those refining rates, the volume of overheads would be reduced to 5 percent.

How did this problem arise? The economic benefit of selling such surrogate fuels instead of regular diesel has always been very strong, for such overhead products as sour distillates, gas condensates or furnace oil are tax exempt (except for furnace oil which is now chargeable). Moreover, the demand for such low-quality fuel has always been very high: over half of Russian vehicles, especially freight and construction transport, and production machine engines most often run on cheap low-quality fuel.

The other key issue that the Rosstandard inspection detected is the ambiguity of the current technical regulations. While inspectors required quality certificates on produced fuel, many refineries declined their petition as the current technical standards don't make it obligatory – in some cases prompting lawsuits between oil refineries and Rosstandard.

Industry experts are of the opinion that uniform technical guidelines and standards should be implemented and the excise duty on sour overhead products should be imposed in the nearest future, in order to drive out of the market the surrogate diesel fuel, just as the straight-run gasoline was pushed out of the market in the early 2000s. Such measures will not only result in economic profits, but will also reduce the environmental damages caused by surrogate fuel, according to experts.

Aiming at solving the problem Rosstandard introduced a law draft proposing a 15% fine on the annual production turnover to be imposed on oil refineries for producing surrogate diesel. The Ministry of Industry has expressed its doubts over the feasibility of the plan insisting only on a 1% fine.

### **Less building, more refurbishment**

Today there is not a strong demand for the construction of new filling stations, for the existing 23,000 filling stations serving around 50,000,000 motor vehicles are fully meeting the needs of the country. This can be accounted by the fact that the car sales have dropped considerably (-40%), the business activity has slackened significantly and, thus, the fuel consumption has decreased substantially.

Against this backdrop the Ministry of Transport set a goal to modernize the roadside infrastructure five years ago. The stand-out concept is the construction of multifunctional filling complexes, discussing legislative issues on the program, trying to obtain approval of financing this ambitious project. Yet, the realization of this project has been suspended due to budget constraints.

The trend for modernization and refurbishment of the existing filling station networks continues to grow. Franchising has become a key trend in the market, as in a slumped economy both large oil companies and independent market players have shared interests in such kind of partnerships and both parties benefit from them.

To sum up, the general market situation in Russia is quite stable. Against the background of the economic downturn no new reforms or ambitious projects both on the part of the government authorities and the large/medium-sized businesses of the fuel retailing industry are planned in the near future.

Written by Taya Shetle