# Lubricant Market 2009

As the shadow regulator in the lubricant market, the Public Utilities Commission of Sri Lanka collects and records operational information of the market. This report provides an overview of the lubricant market and summarizes the operational information in respect of the year 2009

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**Public Utilities Commission of Sri Lanka**

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# Overview

## Introduction to Lubricants

### *Definition*

A lubricant is a substance (usually a liquid) introduced between two moving surfaces to reduce the friction and wear between them. A lubricant provides a protective film which allows for two touching surfaces to be separated, thus lessening the friction between them.

### *Basic Categories*

**Mineral oils** are refined from naturally occurring petroleum, or crude oil. Mineral oils are the most commonly used, because the supply of crude oil has rendered them inexpensive and a large body of data on their properties and use already exists. Another advantage of mineral-based lube oils is that they can be produced in a wide range of viscosities to suit varied applications.

**Synthetic lubricants** are engineered to do the job of a conventional lubricant and are better, as they can be specifically designed to fulfill particular needs. Synthetic oils are manufactured from chemical constituents or by the polymerization of hydrocarbons. Though a bit more costly to produce and therefore more expensive to buy, synthetic lubricants can offer significant performance advantages because they remain stable in extreme temperatures.

### *Applications*

The **automobile** industry is the major user of lubricants. Engine designs have been continuously improving to reduce weight, increase fuel economy, increase power output, and at the same time meet environmental emission guidelines. The main lube consumed is the engine oil, whilst other lubes include gear oils, brake oils, power steering oils etc.

**Industrial** lubricants are used for machinery and equipment used in various manufacturing processes. Lubricants play a vital role in the business operation of manufacturers, and therefore their suppliers are considered as key business partners.

## Evolution of the Market

In 1971, the Government of Sri Lanka (Government) vested the right to import, export, blend, produce, supply, distribute or sell lubricants exclusively with Ceylon Petroleum Corporation (CPC), and CPC commenced blending lubricants locally at the blending plant constructed in Kolonnawa installation. Thereafter, in 1992, the GOSL incorporated Lanka Lubricants Limited (LLL) as a wholly owned subsidiary of CPC to take over the lubricant operations. Subsequently, in 1994, the GOSL divested a majority of shares in LLL to Caltex Trading & Transport Corporation of Dubai with certain concessions.

In 1998, the market was partially liberalized with the introduction of competition when six concessionaires (two of them merged later) were allowed to import, export, supply, distribute or sell (not blend or produce) finished lubricants.

In 2006, the market was fully liberalized and was opened-up for any party subject to meeting the specified entry criteria. As a result, eight (8) more parties entered into the market and altogether there are fourteen (14) authorized parties operational in the market at present.

## Regulation

The market is regulated by the Minister in charge of Petroleum under the Petroleum Products (Special Provisions) Act, No 33 of 2002, and Ceylon Petroleum Corporation Act, No 28 of 1961. In 2006, the Public Utilities Commission of Sri Lanka (Commission) was appointed as the shadow regulator in the market by the Government and at present advices and assists the Ministry of Petroleum Industries on policy and regulatory related matters.

## Market Entry

### Entry Criteria

As per the Request for Qualifications (RFQ) issued by the Government of Sri Lanka in year 2006, an applicant must meet specified technical, operational and financial criteriain order to enter the Sri Lankan lubricant market.

#### *Technical capability*

- An undertaking that all products imported and sold in Sri Lanka meet the minimum standards of quality imposed by the Government
- At least one lubricant formulation under the proposed brand to have obtained API[1] certification
- At least one lubricant formulation under the proposed brand to have recommended by an Original Equipment Manufacturer (OEM) from the list of specified OEMs

#### *Operational experience*

- possesses at least 5 years experience in the lubricants business either local or international

#### *Financial capability*

- capability of investing a minimum of US $ 1 Million for importation and sale of finished lubricants
- capability of investing a minimum of US $ 7.5 Million forblending of lubricants locally in addition to importation and sale of finished lubricants as well as importation of raw materials for blending.

### Authorization

The successful parties meeting the aforementioned entry criteria are authorized to engage in the Sri Lankan lubricant market by way of an agreement executed with the Government. In addition, the parties are also required to obtain an import license from the Department of Controller of Imports and Exports. The import license is issued bi-annually upon payment of the fixed component (explained in the section below) of the registration fee to the Secretary to Treasury.

[1]API - American Petroleum Institute

## Standards

The Sri Lanka Standards Institute, on the request of the Ministry of Petroleum, is in the process of developing standards for lubricants. The process is being followed up and coordinated by the Commission. Sri Lanka standards for the Gasoline Engine Oil, Diesel Engine Oil and Automotive Gear Oil product categories are completed and the standards for Four Stroke Motor Cycle Oils are almost finalized. The preparation of standards for two stroke engine oils and grease is to commence shortly.

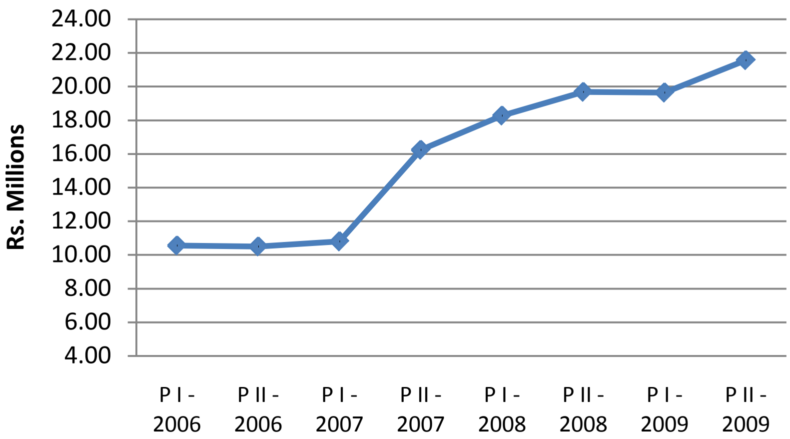
However, the standards developed are yet to be enforced by the Ministry of Petroleum. Until the development of Sri Lanka standards are completed and enforced, the minimum standards applicable are as follows:

| Product Category | Minimum Standard |
|---|---|
| Gasoline Engine Oil | API-SG[2] |
| Diesel Engine Oil | API-CF |
| Two Stroke Engine Oil | API-TC and/ or JASO[3]-FC |
| Four Stroke (Motorcycle) Engine Oil | API-SG |
| Automotive Gear Oil | API-GL 4 |
| Automatic Transmission Oil | DEXRON-IID, MERCON, ALLISON C4 or JASOM315 type 1-A |

## Registration Fee

Each authorized party is liable to pay bi-annually a fixed and a variable registration fee equivalent to a sum of Rupees one million (Rs. 1.0 million) or 0.5% of total invoiced sales for that period, whichever is higher, subject to a maximum sum of Rupees five million (Rs. 5 million). In making the said bi-annual payment, a sum of Rs. 1.0 million (fixed component) shall be paid prior to the commencement of the bi-annual period to the Secretary to the Treasury, and in the event of 0.5% of total invoiced sales for that period being greater than the Rupees One Million, such additional amount (variable component) is to be paid within 30 days of the end of that period to the Public Utilities Commission of Sri Lanka.

Accordingly, the Government at present receives a sum of Rupees Forty (40) million (approx) per annum as the (fixed and variable) registration fee from lubricant market. The amounts received in respect of each bi-annual period commencing from year 2006 are indicated in the chart. A steep increase in the income to the Government is seen year 2007 onwards, due to the entrance of new parties following the liberalization of the market in 2006.




[2] Scheduled to be upgraded to API-SJ with .effect from 1st July 2010
[3] JASO - Japanese Automotive Standards Organization

## Authorized Parties/Brands

As at end of year 2009, there were fourteen (14) parties authorized to import, export, sell, supply and distribute lubricants under twenty two (22) authorized brands in Sri Lanka. Out of such authorized parties, two (2) are authorized to import raw materials (base oils and additives) and blend lubricants locally namely,Chevron Ceylon Limited (Chevron) and Indian Oil Corporation Limited (IOC).

Table below shows that list of authorized parties/brands, in the order of entered into the market.

| Brand(s) | Company | Nominee |
|---|---|---|
| (Caltex, Chevron, Texaco, Lanka) | Chevron Ceylon Limited | Chevron Lubricants Lanka PLC |
| (Servo) | Indian Oil Corporation Limited | Lanka IOC PLC |
| (ExxonMobil, Esso, Mobil) | ExxonMobil Asia Pacific Pte. Ltd. | McLarens Lubricants Limited |
| (Valvoline) | Ashland Inc. | United Motors Lanka Limited |
| (Shell) | Shell Trading (Middle East)Private Limited | N. M. Distributors (Pvt) Limited |
| (BP, Castrol) | BP France S.A. | Associated Motorways Limited |
| (Laugfs) | Laugfs Holdings Limited | Laugfs Lubricants Limited |
| (MAK) | Bharat Petroleum Corporation Limited | TVS Lanka (Pvt) Limited |
| (Motul) | Motul France S.A. | CH Engineering (Pvt) Limited |
| (Gulf) | Gulf Oil International Limited | Western Auto Lanka Pvt. Limited |
| (Greatwall) | Lubricant Company Sinopec Corporation | Interocean Services Limited |
| (Toyota) | Toyota Tsusho Corporation | Toyota Lanka (Pvt) Limited |
| (Total, Elf) | Total Lubricants India Limited | ABC Lubricants (Pvt) Limited |
| (Hyrax) | Ceylon Petroleum Corporation | - |

## Competition

The critical success factors in the Sri Lankan lubricant (mainly the automotive segment) market are: the price; availability; quality and brand awareness. Since the opening up of the market in 2006, the competition in all such aspects seems being increased. The industrial products are mainly marketed based on the OEM recommendations while the price and availability also affects the sales of such products. Discussed below are critical success factors of the market with respect to the automotive segment.

### *Pricing*

The lubricants are priced based on the quality/performance of the product. For e.g. mono grade oils are cheaper to multi grade oils. Also the brands with international recognition for reliability and performance are priced higher. The pricing also heavily depend on import tariff structure (discussed below) of lubricants resulting in lower prices for the locally blended products.

Majority of customers are highly price sensitive and do not place much value on the quality. Hence the market participants are compelled to market low-end lubricant formulations (meeting just the minimum standards) at the lowest possible prices whereas the higher quality formulations are marketable at premium prices to quality-conscious consumers.

### *Availability (Market Access)*

The lubricants are mainly marketed through fuel filling stations and service stations while some are also sold at street outlets and super markets.

Chevron was granted the exclusive rights to sell its products through the filling stations of CPCfor ten (10) years from 1994. This exclusivity left no room for any effective competition in the market even after the entrance of concessionaires in year 1999. The IOC was able to capture a notable market share upon entering in to the fuel retailing market in year 2003 and thereby selling their own brand of lubricants through its filling stations.

With the exclusivity granted to Chevron lapsed in 2004some parties such as ExxonMobil Asia Pacific Pte. Ltd. (Mobil) have been able to enter into agreements with CPC to sell their brands of lubricants through fuel filling stations.

### *Quality and Brand Awareness*

The quality of the locally marketed lubricants is ensured through the entry requirements as well as imposition of minimum standards. However certain lubricant brands such as Mobil and Castrol have earned international recognition for quality and hence are attractive for quality-conscious consumers regardless of the price.

Majority of market participants have not been paying much attention to promote their brands, except the market leaders who earn adequate revenue for brand promotion activities and are determined to keep away the new entrants from capturing market.

### *Tariff Structure*

The privatization agreement granted Chevron a tariff protection for 10 years, involving an ad valorem duty rate for imported base oils and additives that is at least 10% points lower than the ad valorem duty rate for finished lubricants. However, even after the agreement lapsed in 2004 the duty differential was continued and even had increased to around 15% by 2006.

This differential hindered the price competitiveness of the imported products and upon representations made by industry participants the Commission studied the tariff structure and recommended to conduct a study on local value addition from local blending and short-term measures to be taken by the Ministry of Finance and Planning to rectify the same. As a result, a Cess was introduced on the import of base oils to reduce the duty differential. At present a tariff protection of 11.6% is granted for local blending, which would have been 18.25% in the absence of the Cess imposed on base oil imports.

# Performance 2009[4]

## Imports

An 11,451 Kilo Liters of finished lubricants worth of Rs. 2,032 Million were imported during the year 2009. Automotive, industrial, marine and greases segments accounts for 58%, 19%, 6% and 18% of the total imports, respectively.

28,543 Kilo Liters (Rs. 2.4 Billion) of base oils and 2,515 Kilo Liters (Rs. 0.8 Billion) of additives were imported by the two parties who are authorized to blend and produce lubricants in Sri Lanka i.e. Chevron Lubricants Lanka PLC and Lanka IOC PLC.

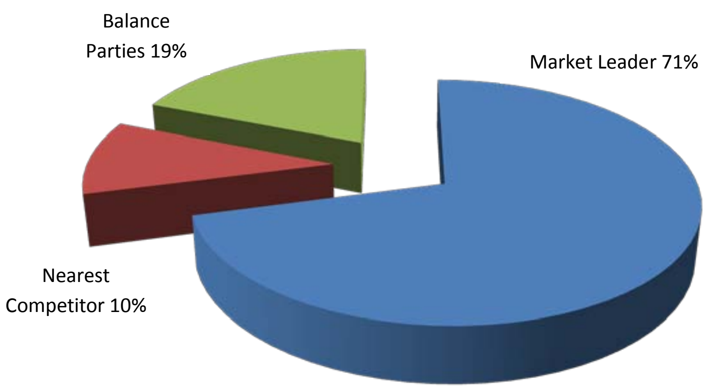
## Production

During the year 2009, around 80% (36,231 KL) of the local lubricant requirement was produced (blended) locally. Around 90% (32,753 KL) of the blending was carried out at the lube blending plant of Chevon located at Kolonnawa while the balance 10% (3,478) was produced at lube blending plant belonging to IOC located at China Bay.

The two authorized parties to blend and produce lubricants in Sri Lanka i.e. Chevron and IOC has produced about 90% and 75% respectively of their sales locally, mainly to gain the advantage from the prevailing import tariff differential between raw materials and finished lubricants.

## Sales and Market Share

46,195 KL of lubricants worth of Rs. 11 billion were sold during the year 2009. 75% of total sales were automotive products while industrial, marine and greases accounted for 15%, 9% and 1% respectively of the market.




Market leader holds a share of 71% (reduction from 78% in year 2008) whilst its nearest competitor has maintained its share of 10%. The share of remaining twelve (12) participants has increased notably to 19% (increase from 12% in year 2008). This is a result of several parties, entered upon full liberalization in 2006, consolidating their positions in the market. Some of those parties commenced aggressive marketing campaigns while competing on the price, targeting the high-volume low-end users. Increased availability of newly entered products through street outlets and super markets has resulted in more choices for customers.

[4] The results presented are subject to the accuracy of the data received and excludes the data for 3 parties (together accounting for less than 3% of the market) who are yet to submit the operational information in respect of 2009.