

PGC “C”

**Case Study: Further market development in areas
deeply involved in gas-market opening and
increased pressure of competition**

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Thanks to all the other PGC “C” Members and to all the people in the
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1. Introduction/Key Findings

- By adopting the EU Gas Directive, the natural-gas business in the Central-Eastern European Countries is facing a new era:
 - Competitive Market
 - Non-discriminatory (Regulated) access to infrastructure
 - Transparent, fair Tariffs

- Liberalisation and privatisation of the gas industries are the main drivers of the change.

- Most of the supplies to Central-Eastern Europe are delivered by countries that do not have to comply with the EU Gas Directives.

2. Methodology and results of the survey

- The analysis has been performed on the following countries of the Central-Eastern Europe:
Bulgaria, Czech Republic, Croatia, Estonia, Former Yugoslavia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Slovakia, Slovenia and Ukraine.
- In 2004 a questionnaire was sent to the gas companies of the above countries, before that many of these countries joined the EU and harmonized their gas legislations with the provisions of the EU Directive.
- The results of the survey represent the point of view of the Central-Eastern Europe gas industries, which may differ significantly from the official position of the institutional bodies.

3. Privatisation in the gas industry

3.1 Pre-privatization status

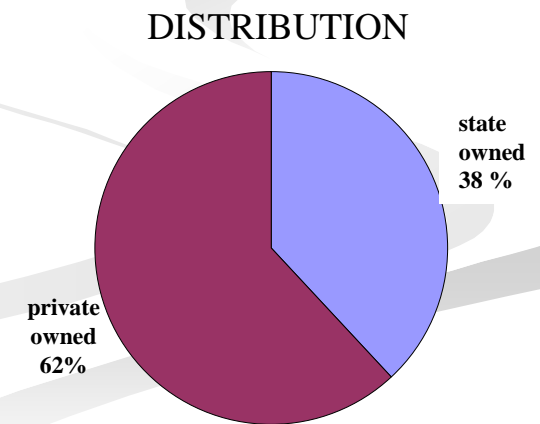
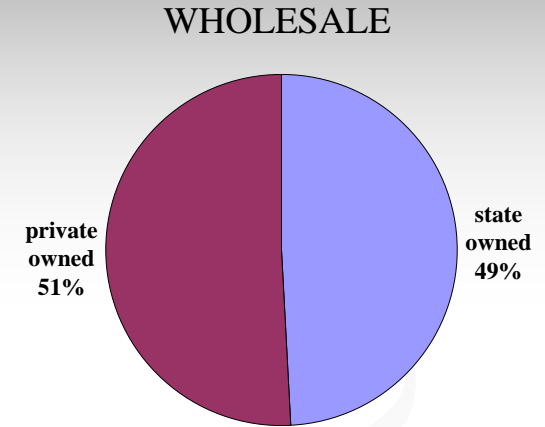
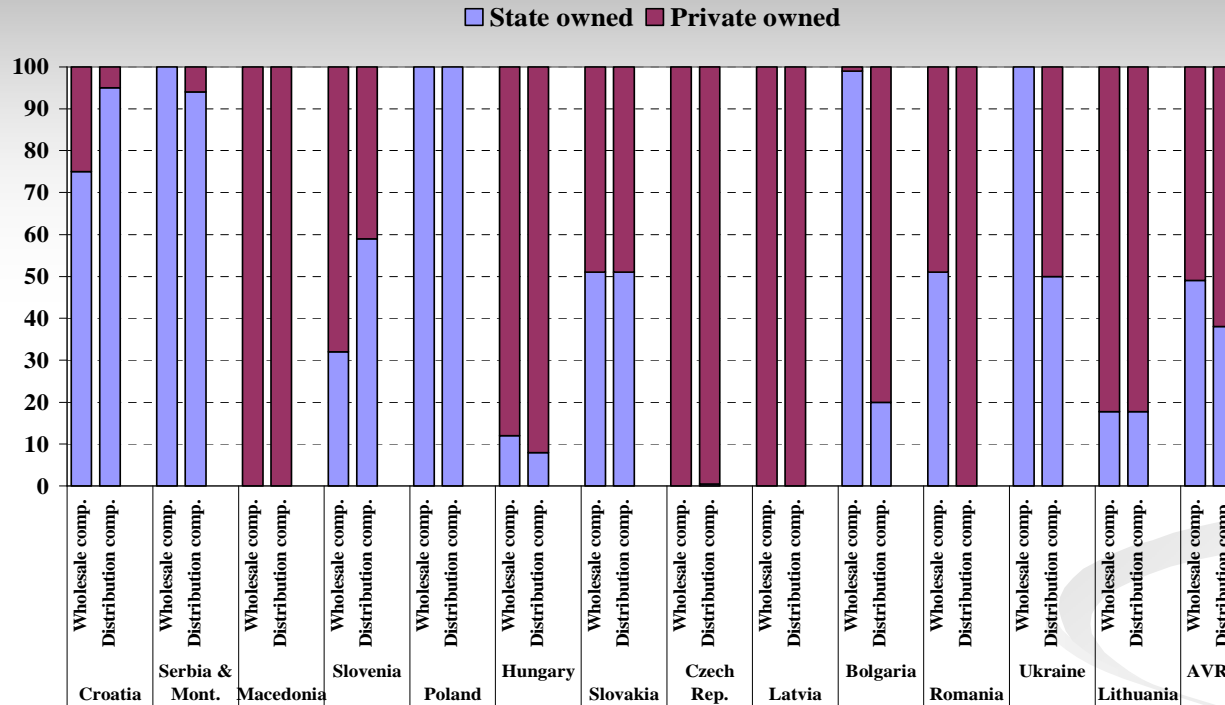
- In most cases the analyzed gas companies had the following characteristics:
 - state owned
 - monopoly position along the whole chain
 - vertically integrated
 - prices cross-subsidized
 - low economic efficiency

- It is practically impossible to define a “standard” recommendation on the appropriate privatization model.

- Sometimes lack of clear strategic goals could possibly lead to unpredictable results in the process.

3. Privatisation in the gas industry

3.2 Actual Ownership in wholesale and distribution sectors



Average private share:

in wholesale companies is 51 percent

in distribution companies is 62 percent

3. Privatisation in the gas industry

3.3. The main reason for privatisation

The answers from questionnaire showed nearly the same importance to:

- investment needs
- budget income
- strategic partnership

3.4. Strategic partnership

- know how for commercial operations
- know how for investments and maintenance
- financial support

3.5. Privatisation in gas industry has a significant effect on pricing policy

4. Liberalisation in the gas industry

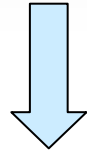
4.1 The role of the state in a liberalized market

- Define the objectives of energy policy and the degree of market openness with its impact on security of supply (S.O.S.)
- Define the principles and mechanisms for the definition of gas-pricing mechanisms driven by market forces
 - sustainable for consumers
 - attractive for industry, including investitures
- Establishment of the time and extent of the privatisation process
- Unbundling transport/distribution and commercial activities
- Establishment of a dedicated regulator and its powers

4. Liberalisation in the gas industry

4.3 Main goals of the liberalisation process

Arrive at a fully operational and competitive market



- Non-discriminatory access to networks and storage (TPA)
- Fair and transparent transportation prices and tariffs
- Gradual opening up to competition
- Unbundling of transmission and commercial activities

4. Liberalisation in the gas industry

4.4 Is the security of supply granted in a liberalized market?

- A liberalized market allows the final customer to choose its supplier.
- The drivers of the choice are mostly dictated by economic reasons.
- The new suppliers aiming to be competitive and acquire more market share might reduce the level of services and also S.O.S..
- A customer has to evaluate carefully the services provided by a supplier, being aware that the customer itself becomes responsible for its own security of supply.
- The state and its regulatory bodies should give licences to reliable suppliers with a secure gas portfolio.

4. Liberalisation in the gas industry

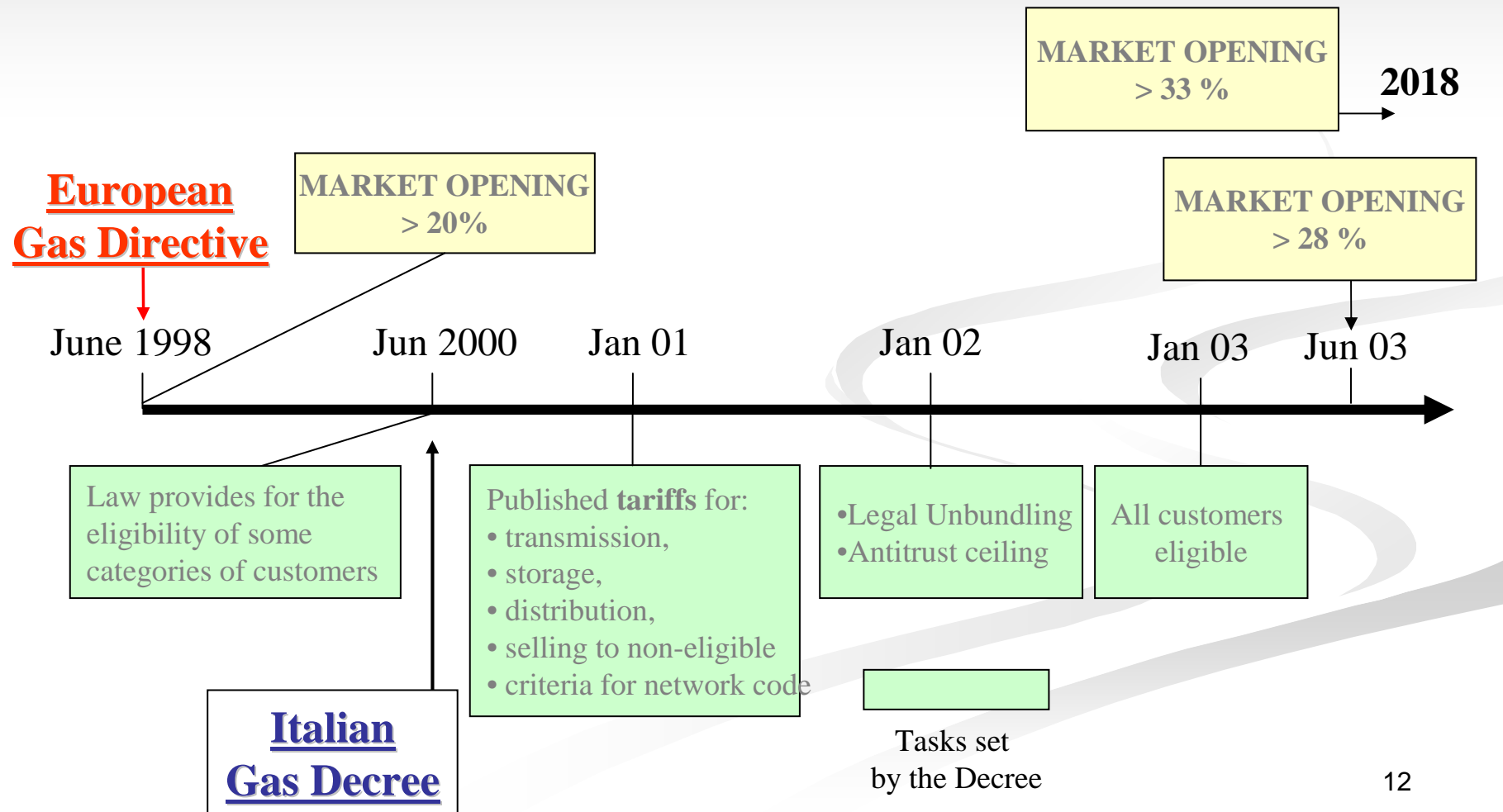
4.5 Diversification of supply for Central-Eastern Europe

- Diversification of sources increases security but....
- What is really changing is the trading company and not the supply source.
- New physical imports require significant investments.
- The necessity to establish a stable regulatory environment will help to attract new players.

4. Liberalisation in the gas industry

4.6 The Italian experience

Timeline for Market Opening Italian Gas Decree vs. 1st EU Gas Directive



5. Market Development

5.1 Future demand for natural gas

Fundamental factors that influence natural-gas demand

- Level of the economy and its expected growth
- Energy efficiency of a country
- Country energy policy
- Own sources of energy and their price level
- Availability of gas sources and their price level
- Gas reliance of a country and conditions for its further development
- Potential for new methods of using natural gas
- Active approach of a gas company to the seeking of potential and active customer acquisition

5. Market Development

5.2 New gas market's segments

- **Current market segments are based on:** volume of gas consumption
regulation method
(households, other customers)

- **Basis for a new approach is market segmentation where:**

customers will be divided into homogeneous groups in terms of characteristics and needs, such as:

target market definition
differentiation
targeted marketing mix
opportunities and threats

- **The future market segments must be developed based on understanding the customer needs, leading to higher efficiency in the customer service, higher profitability and thus also higher competitiveness of companies.**

5. Market Development

5.3 Tools to be adopted

- Customer satisfaction
- Monitoring and matching the customer's needs
- Continuous dialogue with the customers
- Building a new chain of values
- Provide a flexible and easy solution to a customer's needs
- Ability to conduct the company towards the competition
- Creation and implementation of a new corporate process/culture

6. Conclusions

6.1 Consequences of the privatisation process (1)

In transition countries privatisation is of course a political matter. The consequence of any chosen solution could hardly be foreseen over the long term. One has to take care of the following:

- real impact of the process on the countries' future, not only for natural gas but for the whole energy policy,
- possible acquisition by powerful energy conglomerates, with their own strategy and goals driven by the profit motive, where natural gas could not be a core business,
- real responsibility for the security of supply, especially in terms of political risks,
- impact on the possible absence of a real political influence on the energy policy as a part of a general economic policy for a country.

6. Conclusions

6.1 Consequences of the privatisation process (2)

- Gas companies in transitional countries are, after being privatized, restructured to produce higher efficiency, greater competitiveness, modernisation, and better usage of capacity, what was done mainly by their own sources and not as a consequence of the capital invested by new owners.
- Countries with a well-developed and also strong market are keen to promote and support national champions in the energy business as a source of real strategic economic power.

6. Conclusions

6.2 Market concentration

- Globalisation in the energy market in Europe started in the oil business and is now continuing with the electricity and gas businesses.
- In the past the gas markets were held mainly by the national gas companies. The opening of the markets enables the globalisation process also in the gas industry.
- In this process it is predicted that in about 10 years the gas market in Europe might be dominated by a small number of integrated energy companies.
- In the globalisation process, capital is a paramount factor, so that big oil and electricity companies are in position to acquire pure gas companies with mostly downstream activities in their equity portfolio. In this new environment natural-gas companies become potential acquisition targets.

6. Conclusions

6.3 Growth of demand and pricing reality

- In the long-term future most of related market will probably not be affected by a significant oversupply of natural gas, which is a basic precondition for free-market competition.
- But as only few producers are in position to compete on the European gas market it appears that the competition can appear practically only among traders.
- The only reduction on price is actually limited to transportation costs, even if some significant reductions can be applied by the traders, but limited to the spot market.
- Producers are not a part of this game – they do not compete between themselves.
- Cross subsidized prices for households is not big case anymore.
- Developing LNG trading will significantly influence the market.

6. Conclusions

6.4 Security of supply

The security of supply is in close relation with the security fee one is able and ready to pay for it.

The main elements that can ensure the security of supply can be summarized as follows:

- long-term supply contracts
- diversification of supply sources and supply routes
- Storage availability
- Pipeline interconnection

6. Conclusions

6.5 Effects of the liberalisation of the gas markets (1)

- Gas companies are forced to increase their efficiency and to become market oriented, offering more and new services to customers.
- Regulatory Authorities have to introduce transparent and non-discriminatory principles for all users on the basis of TPA. Customers choose their supplier, according to their needs and to the level of security of supply they wish, being also aware of the related risks.
- Households, which in many transitional countries benefit from cross-subsidized prices, could take advantage by higher energy efficiency and increased service level.
- The expectations should not be over estimated; it is better to decrease them than to be disappointed because:

6. Conclusions

6.5 Effects of the liberalisation of the gas markets (2)

- The concentration by energy conglomerates might have serious consequences for effective competition.
- The competition between suppliers is hard to foresee because of:
 - the small number of producers close to the market
 - lack of the goods on a longer scale - deficit on natural gas market might happen because of various reasons.

6. 6. Attentions to be drawn

- Liberalisation process is necessary for the market development
- In markets in transition a “standard” liberalisation process cannot be adopted
- Key priorities are the reforms of the legal and regulatory framework, the security of supply, the quality of service level and an environmental tax premium
- Harmonisation of the rules between the gas consumer and suppliers
- Introduction of TPA is paramount for real liberalisation
- When liberalising the gas market, a really independent regulatory body must be set
- The regulators have to operate in the interest of the final customer without penalising the gas industries and without overregulating the process
- The state and its regulatory bodies should only give licences to reliable suppliers with a secure gas portfolio