The impact of competition in the postal sector

A Report by the Association of International Courier and Express Services

June 2001

About AICES

AICES is the trade organisation in the United Kingdom for companies handling international express documents and package shipments. AICES membership – which includes household names such as DHL, FedEx, TNT and UPS – employs over 60,000 people and is responsible for over 95% of the international courier and express shipments moved through the UK every day. Our services provide the "just-in-time" information and goods that organisations from hospitals to financial institutions rely upon.

Further details about AICES can be found at our website or by writing to:

Anne de Courcy
Secretary General
AICES
Global House
Poyle Road
Colnbrook
Berkshire, SL3 0AY

Telephone: 01753 680550
Fax: 01753 681710

www.aices.org

INDEX

Introduction and Summary

The debate about the impact of liberalisation of the postal sector continues to be a complex and emotive one. In contrast to the critics of competition who falsely claim it would impact negatively on the universal service, AICES members believe that *only liberalisation* can create the dynamic industry that is needed to meets the requirements of a modern society and economy.

AICES members have long called for a reasoned and analytical approach to this policy area so as to deliver for customers the services they want, whilst protecting the important social obligations of the universal service.

This report has been compiled in response to specific questions asked by Postcomm, the Postal regulator created by the Postal Services Act 2000. It relies on independent data and research provided by its members, to show what the impact of competition has been.

The report is divided into the following sections.

- Section 1 – looks at the benefits of competition and how they manifest in the postal sector.
- Section 2 – examines the current state of liberalisation, highlighting where progress has been made.
- Section 3 – provides case studies of how competition has worked in specific markets, demonstrating the benefits and how the ability of the universal service provider to meet its obligations has not been impeded. Markets addressed are: express services; direct mail; outbound cross border mail; domestic mail and the market for periodicals.
- Section 4 – investigates the strategies for market entry from niche to wide-scale entry.
- Section 5 – reviews the hurdles to market entry, those factors that have prevented, or continue to prevent, new players from offering an alternative to the monopoly held by the incumbent national provider.
- Section 6 – critiques the widely held view that price and weight reduction is the competition panacea.
- Section 7 – provides a synopsis of the benefits that can be achieved by introducing competition – the compelling reasons why liberalisation will provide the catalyst to make the postal market dynamic and innovative.

The different sections provide the empirical evidence to show that the impact of competition in postal markets has an overall positive effect.

AICES hopes that this report will provide some well needed factual evidence to address many of the frequently voiced fears which we believe are overstated or without foundation. The facts speak for themselves.

The conclusions of this report can be summarised as follows:

- The benefits of competition are clear.
- From the examples in the market where liberalisation has occurred, there is a net benefit to the industry and a clear benefit to customers.
- In no situation has the universal service been compromised by the introduction of competition.
- The benefit of full liberalisation is succinctly summarised by the EC Commission in the case of Sweden thus: "*any objective analysis shows that consumers, as well as businesses, have benefited from market opening through higher quality. In addition, prices have been substantially reduced for business customers while households have been protected from price increases*"[1].
- The market is a growth market and now would be good time to liberalise, before substitution by other media starts to accelerate.
- Employment rationalisation will take place, liberalisation or not. The long term preservation of employment lies in making the industry efficient and competitive with other media.
- The key barriers to entry are regulatory.
- There is no natural monopoly on delivery
- Entry at the collection level exists; entry at the collection stage could be a viable entry strategy with final delivery being provided by the universal service provider; this is dependent upon a fair access pricing regime being in place
- The universal service provider is likely to retain a dominant or even super-dominant market position even after full liberalisation.
- Diverse entry strategies are possible and small and medium sized operators are likely to represent the vast majority of market entrants.
- Reduction of weight limits to anywhere above 20g is likely to have no appreciable impact on market entry.

[1] http://europa.eu.int/comm/internal_market/en/postal/evloframe/docs/ficheen06.pdf at page 21/32

Section 1: Impact of Competition

The general effects of competition can be summarised as follows. Competition:

- **Breeds innovation**.
- Creates **new and unexpected market entrants**.
- Puts **downward pressure on prices**.
- **Improves service levels**.
- **Improves efficiency**.
- Is **driven by profitability**.
- Will **create sustainable employment** by creating jobs with postal operators

In the postal market, this can be expected to manifest itself in the following ways:

- Emergence of **new services**
- **Expansion of activities** by foreign postal operators, courier companies, transport companies and delivery companies
- Commencement of **delivery activities by utilities and start-up companies**
- **Reduction of prices for business mailers**
- **Decrease in traditional services in low population density areas and innovative alternative services offered**
- **IT-related solutions** for business customers **of which postal delivery will be part of an integrated service**
- **Growth of mail volumes** generally
- **Increase in number of time certain delivery services**
- **Decrease in the workforce of national postal operators (but this is due, mainly, to a general need for efficiency and the increase in mechanisation)**
- **Increase in the workforce of private operators**
- **Increase in efficiency and profitability of national postal operators**

In the words of the Institute for the Future[1], *"The economics of deregulation seem to work: in virtually every case prices fall, productivity increases, and investment goes up. …. Behaving now as if the market were already deregulated will pay huge dividends for post*".

[1] Surviving Deregulation: A Postal Scenario for 2010: Institute for the Future 1998, Peter Hanley and Greg Schmid (sponsored by Canada Post; Deutsche Post; La Poste; Pitney Bowes; Royal Mail; Siemens ElectroCom International; Sweden Post; TNT Post Group and United States Postal Service) at page 41.

Section 2: Current State of Liberalisation of the Postal Markets

Generally speaking, European postal markets are more liberalised than elsewhere in the world[1].

The table below sets out the current status of liberalisation in the European Union.

Country	Letter monopoly	Direct Mail monopoly	Outbound cross border mail monopoly
Austria	Up to 350g and five times basic tariff	No[2]	Up to 350g and five times basic tariff (but de facto liberalised)
Belgium	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff (but de facto liberalised)
Denmark	Up to 250g and five times basic tariff	Up to 250g and five times basic tariff	No
Finland	No	No	No
France	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff (but de facto liberalised)
Germany	Up to 200g and five times basic tariff (including catalogues)[8]	Up to 50g[3]	Up to 200g and five times basic tariff (but de facto liberalised)
Greece	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff [4]
Ireland	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff (but de facto liberalised)
Italy	Up to 350g and five times basic tariff[5]	Up to 350g and five times basic tariff [6]	Up to 350g and five times basic tariff[7]

[1] Japan and Switzerland have monopolies up to 2kg ; in the USA the basic monopoly is for items up to $3, but the price threshold increases depending on the weight of the item (outbound cross border mail in the USA is fully liberalised). Notable exceptions, however, are New Zealand and Argentina where the postal market is fully liberalised.
[2] « Printed matter » is outside the monopoly, which is interpreted by the Austrian regulator as applying to direct mail
3 B licence is required to deliver direct mail items over 50g
[4] Status of de facto liberalisation, in Greece, is currently the subject of court proceedings and a complaint to the EU Commission
[5] 67 delivery agencies had their delivery concessions revoked as of 31 December 2000
[6] Formerly direct mail was outside the monopoly, not being considered to be reserved "epistolary correspondence". It was, de facto, brought back within the monopoly under Article 23(7) of the legislative decree of 22 July 1999 No 261. Pursuant to that Article, a Ministerial Decision of 2 February 2000 provided that direct mail items only remained liberalised if the number of identical items is more than 10.000. As few mailings exceed this threshold, it amounted to a de facto remonopolisation of the entire direct mail market in Italy, based on no reliable or independent economic evidence of the need to do so.
[7] Outbound cross border mail is de facto liberalised and was, prior to the entry into force of the 1999 legislative decree (op. cit. footnote 6), de jure liberalised by the Postal Administration Communication 1989.
[8] The exclusive licence in Germany is, under the 1997 Postal Act, due to expire on 31 December 2002. In the Netherlands, the monopoly is due to be removed as from 2003. However, due to political pressure to reverse these intentions (to prevent the postal markets in these countries being liberalised far in advance of the other EU member states) the German Cabinet decided, in April, that the current monopoly should be extended until 2007 and, because

Country	Letter monopoly	Direct Mail monopoly	Outbound cross border mail monopoly
Luxemburg	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff[9]	Up to 350g and five times basic tariff (but de facto liberalised)
Netherlands	Up to 100g and three times basic tariff	No	No
Portugal	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff	Up to 350g and five times basic tariff
Spain	Up to 350g and five times basic tariff[10]	No	Up to 350g and five times basic tariff[11]
Sweden	No	No	No
United Kingdom	Up to 350g and £1	Up to 350g and £1[12]	No[13]

As can be seen, there is far from a harmonised picture of liberalisation in the European Union. There has been a tendency for certain member states to re-monopolise de facto (and sometimes even de jure) liberalised services under the guise of implementing Directive 97/67/EC. In each case, no independently verified economic data were provided to support the assertion that the re-monopolisation was necessary to guarantee the universal postal service.

In addition, case law has made it clear that express services cannot be reserved and that special services (i.e. those which differ from the conventional service) cannot be reserved unless it can be shown that allowing such services to be provided would adversely affect the "economic equilibrium" of the universal service provider. European legislation has subsequently confirmed that special services (including express services) may never be

the Dutch parliament has taken no steps to enact legislation which would end the monopoly, there is insufficient legislative time for such a law to come into force before 2003.

[9] The Luxembourg regulator considered that direct mail is not contained within the monopoly on "letters". This was disputed by P&T Luxembourg (see. Study on the impact of liberalisation in the postal sector: Direct Mail page I-24; Arthur Andersen 16 November 1998). However, under Article 15(2) of the Postal Law of 15 December 2000, direct mail has been expressly reserved to P&T Luxembourg.

[10] Local mail delivery is permitted under the law of 14 July 1998 Article 18(1)B. Inter-city delivery was, prior to the 1998 legislation, de facto liberalised with Entrega en Mano providing a connection between local delivery companies.

[11] Status of de facto liberalisation, in Spain, is currently the subject of court proceedings and a complaint to the EU Commission

[12] Under the British Telecommunications Act 1981, section 66(5), a letter was defined by content ("… relates to the personal, private or business of … either correspondent …") and was widely considered not to include direct mail and printed matter. Several operators provided such a service, without opposition from the Post Office or the DTI. There is, therefore, some evidence to show that this market is de facto liberalised in the United Kingdom. Despite Article 7(2) Directive 97/67/EC only permitting "continued" reservation of direct mail, the Postal Services Act 2000 did not take the de facto situation into account.

[13] Due, we believe, to a drafting error - in which section 67(2) British Telecommunications Act 1981 was transposed verbatim into section 7(3) Postal Services Act 2000 – the collection of overseas letters (now de jure liberalised) requires a licence under the terms of the Postal Services Act 2000. Guidance from PostComm on how to deal with this apparent oversight has been requested.

[12] Under the British Telecommunications Act 1981, section 66(5), a letter was defined by content ("… relates to the personal, private or business of … either correspondent …") and was widely considered not to include direct mail and printed matter. Several operators provided such a service, without opposition from the Post Office or the DTI. There is, therefore, some evidence to show that this market is de facto liberalised in the United Kingdom. Despite Article 7(2) Directive 97/67/EC only permitting "continued" reservation of direct mail, the Postal Services Act 2000 did not take the de facto situation into account.

[13] Due, we believe, to a drafting error - in which section 67(2) British Telecommunications Act 1981 was transposed verbatim into section 7(3) Postal Services Act 2000 – the collection of overseas letters (now de jure liberalised) requires a licence under the terms of the Postal Services Act 2000. PostComm on how to deal with this apparent oversight has been requested.

reserved[14] and has provided every member state with the tools to be able to preserve the economic equilibrium of the universal service provider.[15]

In Section 3, the impact of liberalisation in the relevant postal markets is described.

[14] Directive 97/67/EC at Recital 21 – " .. new services (services quite distinct from conventional services) … do not form part of the universal service and consequently there is no justification for their being reserved to the universal service provider".

[15] See the Memorandum of the European Commission dated 19 September 2000, at page 4 §23 of the evidence, and the Supplementary evidence of the European Commission at pages 18-19 of the evidence of the 2nd Report by the United Kingdom's House of Lords' Select Committee on the European Union Committee on "The Further Liberalisation of Community Postal Services" (op cit). In summary, the permitted reserved area and the compensation fund mechanism set out in the 1997 Directive, are adequate measures to enable a Member State to maintain the economic equilibrium. Within this framework, under which the universal service provider can set its own tariffs (subject to the requirement that the tariffs are geared to costs (Recital 26 and Article 12 – 1997 Directive) and affordable (Article 3(1) – 1997 Directive) and thus adequately cover its costs, the economic equilibrium can be assured. See also the opinion of the committee at page 19 of the Report "**In our opinion, the Corbeau judgment has been overtaken by the provisions of the 1997 Postal Directive".**

Section 3: Case studies of competition in specific markets:

a) Express Services

Express services have been formally recognised as forming a distinct, liberalised market since the beginning of the 1990's[1]. The express industry provides an excellent example of how a liberalised market can develop.

Responding to increasing globalisation and customer demand for guaranteed, express delivery of goods and documents, both worldwide and domestically, very many companies emerged as the providers of these services.

Worldwide, businesses have emerged to meet customer demand. Market forces have led to substantial innovation in the short history of express services. The existence of many efficient and aggressive competitors has also led to fierce competition on prices.

Some of the innovative features now commonly found in the industry are:

- Guaranteed delivery by 9am or 12 noon the following day (international consignments)
- Same day delivery domestically and even internationally
- A wide range of delivery options and prices
- Track and trace permitting customers to have real time information on the status of their consignment accessible via the internet; phone or EDI link
- Compensation for loss, damage and delay
- Detailed performance reporting
- Detailed reporting on shipment profiles
- Strategic stock locations enabling guaranteed delivery within a number of hours to any location in a country
- Payment by the receiver or a third party
- Periodic performance reviews
- Global pricing for multinational customers
- Customer software enabling the customer to select the most appropriate service
- Software for label printing compatible with the operator's tracking and tracing and billing systems
- Payment in arrear following invoice
- Delivery of dangerous goods (under strict safety conditions)

The express industry has created hundreds of thousands of direct jobs and many more indirect jobs. By 2015 the prediction is that the industry will employ some 4 million people worldwide. It has helped its customers to reach global markets and stimulated other related industries (e.g. aviation industry for sale of new aircraft and reconditioning of passenger aircraft).[2] In addition, it has allowed customers to cut lead times for production and move to manufacturing on a much more efficient "just in time" basis, thus reducing inventory costs. The direct savings and economies for customers and service benefits arising from the express industry are manifold.

---

[1] Confirmed by the Commission decisions in Spanish Express Courier Services [1990] 90/456/EEC and Dutch Express Delivery Services [1990] 90/16/EEC

[2] See "The importance and impact of the express industry in Europe" – a study commissioned by the European Express Association (see www.euroexpress.org) at page 2.

b) Direct Mail

Country	Market share of universal service provider
Austria	100%[1]
Germany	95%[1]
Finland	98%[1]
Netherlands	80-90%[1]
Spain	80-85%[1]
Sweden	77%[1]

As there is insignificant market entry in Austria (there is legal uncertainty as to whether direct mail remains non reserved) and Finland, we will concentrate on the experience in Germany, Netherlands and Spain.

<u>Germany</u>
Direct mail over 50g was liberalised with effect from 1 January 1998. There were a considerable number of licences granted to local providers of direct mail services (144)[2]. New jobs were created by these licensees (3,376)[3]. Despite this market entry, there has been no adverse impact on the provision of the universal service. Despite general awareness of the benefits of targeted direct marketing, there is still great potential for growth in the market. Competition for delivery is expected to put downward pressure on prices.

<u>Netherlands</u>
Direct mail has never been reserved in the Netherlands. There are several players in the Dutch market (including Royal Mail) and the general level of service is seen as good and that pricing to service ratio is “fairly good”. Innovation in targeted marketing is being driven by the will to gain and retain market share in this growing market. Close cooperation with direct marketing agencies and the development of good, accurate databases are leading to a more cost-effective source of marketing for customers. Experts in the market state that competition is not yet fully effective – in so far as it is not driving all the possible benefits to customers – due to the high market share of PTT Post.[5]

<u>Spain</u>
Direct mail has been de facto liberalised since 1965, and was formally de jure liberalised in the 1998 Postal Law. New entrants are expected to add flexibility to the types of mail items which can be sent and to act to stimulate the market by improving the content of direct marketing items[4]. Data protection legislation, however, acts as a major bar to the rapid development of targeted direct mail. Nonetheless, the potential for market growth is

1 Study on the impact of liberalisation in the postal sector: Direct Mail page I-26; Arthur Andersen 16 November 1998
2 Ulrich Dammann, RegTP – Competition by Licensing : One Year of Experience in Germany at page 12. Paper presented in Sintra, Portugal on 24 June 1999 at Seventh Conference on Postal and Delivery Economics, The Center for Research in Regulated Industries at Rutgers University.
3 op. cit. at footnote 2 – page 17
4 Study on the impact of liberalisation in the postal sector: Direct Mail page I-49; Arthur Andersen 16 November 1998
5 Study on the impact of liberalisation in the postal sector: Direct Mail page I-82; Arthur Andersen 16 November 1998

considered to be reasonable and increased competition is desirable to drive improvements in the service generally.

Summary:

- The universal service provider in each country expects to retain its existing market share of this growing market[4].
- There has been no adverse impact on universal service in any of these countries.
- The worse the level of the postal service, the higher likelihood for substitution of direct mail by other media[5].
- There is still room for improvement, maturity and growth in the direct mail markets in each of these countries.

Comment on the United Kingdom

There is no significant competition in the UK market. The UK market is seen as having “a great potential for growth”[6]. Culturally the UK is willing to accept an increase in targeted direct marketing. However, only the Royal Mail provide delivery services and they believe that market entry will reduce margins[7]. This exhibits that price competition will be possible and, given the price sensitivity, it will encourage new market entrants to offer more accurately targeted and value added direct mailing solutions.

[4] Study on the impact of liberalisation in the postal sector: Direct Mail page 15, §8.2; Arthur Andersen 16 November 1998
[5] Study on the impact of liberalisation in the postal sector: Direct Mail page III-47 Conclusion 2; Arthur Andersen 16 November 1998
[6] Study on the impact of liberalisation in the postal sector: Direct Mail page I-57; Arthur Andersen 16 November 1998
[7] Study on the impact of liberalisation in the postal sector: Direct Mail page I-60; Arthur Andersen 16 November 1998

c) Outbound Cross Border Mail

Outbound cross border mail has been de facto liberalised in the United Kingdom since the early 1980's and was formally liberalised in the Postal Services Act 2000. It has been de facto or de jure liberalised in most[1] EU countries and has led to substantial competition in these markets. Despite early claims that liberalisation of outbound cross border mail would prevent the provision of a universal service, this has been shown not to be the case.

The market shares of the universal service providers are estimated as being as follows:

Country	Market Share of universal service provider[2]
Austria	80 - 85%
Belgium	80 - 85%
Denmark	90-95%
Finland	95+%
France	90 - 95%
Germany	80 - 85%
Greece	95+%
Ireland	95+%
Italy	80%
Luxemburg	95+%
Netherlands	80 - 85%
Portugal	95+%
Spain	65 - 70%
Sweden	95+%
United Kingdom	80 - 85%

As can be seen, in virtually every country, the universal service provider has retained a dominant or super-dominant market position. In addition to this, the following features have now become common services:

- Competitive prices to those offered by the universal service provider
- Provision of customised routing depending on the destination and price : service level requirements of the customer
- Provision of customised rates to customers
- Offering of a variety of delivery options and service levels to customers
- Pick up of mail from address specified by the customer
- Express transportation out of the country of origin
- Delivery abroad by the chosen delivery subcontractor
- Invoicing to the customer with settlement in arrear
- Management of reverse mail flows in response to customers' mailings
- Where requested by the customer, provision of fulfilment services (such as database management, addressing mail items, polythene wrapping of items, franking items with local indicia of destination country)
- Compensation for loss, damage or delay
- Ability to re-route the mailing prior to postage (or prior to final delivery where delivery is by a private delivery company)

[1] See table in Section 2 and corresponding footnotes for further explanation.
[2] Estimates based on 1999 data provided by UPU statistics and AICES members

- Track and trace up to the point of mailing
- Proof of date of posting of bulk shipments

<u>Summary:</u>
Liberalising outbound cross border mail has given rise to several successful companies who provide competitive and, increasingly, value added services. There is no evidence that the liberalisation of these mail flows has had any adverse impact of the ability of the universal service provider to comply with its universal service obligation. Cross border mail continues to be a growing market with the continued globalisation of businesses, centralising of corporate activities and the increase in cross border trade including internet-generated trade.

d) Domestic Mail

Sweden

Sweden fully liberalised all postal services in 1993. Since then, there have been over 100 market entrants into the Swedish postal market, the vast majority of whom were involved in local delivery. Their share of the market was around 0.5%. In addition, there are four operators providing a non-localised service. These are CityMail (focussing on delivery of computer pre-sorted mail who has a market share of about 5%); SDR (focussing on unaddressed mail); Presam (principally a newspaper distribution company) and FDS (specialising in the distribution of financial material in Stockholm).

The local delivery companies were typically able to offer considerably lower prices than Sweden Post (usually 30-40% less than the published single letter tariff). Better quality has been witnessed, especially in areas where Sweden Post has difficulty with overnight delivery. However, only about one third of local delivery companies are profitable and a significant number of market entrants have not remained in the market. They are often very small, family-run businesses.

Barriers to entry in the local market have been low[1] with relatively low capital investment, limited necessary know how, customer confidence in the ability of an alternative provider to provide a local service and the low cost of transferring to an alternative carrier. Nonetheless, despite these low barriers and lower prices, there is still reluctance for customers to change supplier.

The larger players, such as CityMail, are less able to offer straight price reduction and are seeking to expand their service offering to incorporate mail delivery as only one part of an integrated customer solution, in which the customer will concentrate on its core business and outsource its billing, marketing, database management, customer services, payment collection, returns management and delivery activities. CityMail aims to provide a service in which it will coordinate all these elements, both domestically and internationally[2]. This type of value added integrated service is seen as a probable evolution of the postal market, allowing private operators to compete with the universal service provider by offering value added services, which include a postal delivery element, and thus avoid a straight battle on prices, which a smaller operator is unlikely to win in the long term.

In the drive for efficiency, Sweden Post has created alternatives to loss-making counter services. Franchised and agency outlets have resulted in post office counters being open for longer hours and in a network of mobile post offices, taking postal services right to the door of its customers.

Nonetheless, there are some very important lessons to be learned from the Swedish experience. The first few years following liberalisation were dogged by litigation resulting from several claims of predatory pricing. This litigation was settled only in 1999.[3] (Please see: *Barriers to Entry: Pricing by incumbent post office*, below)

New Zealand

Liberalisation took place on 1 April 1998. By March there were 28 registered operators. The immediate impact on New Zealand Post was not negative:

---

[1] "Entry on Deregulated Postal Markets: Lessons from Sweden" by Peter Anderson of Department of Technology and Social Change, Linköping University at section 8. Paper presented in Sintra, Portugal on 24 June 1999 at Seventh Conference on Postal and Delivery Economics, The Center for Research in Regulated Industries at Rutgers University.

[2] CityMail Interim Report January – September 2000

[3] CityMail Annual Report 2000 at page 14. See also www.citymail.se

1999 Profit and letter volumes increase despite first full year of competition.
Source: New Zealand Post website

There are now more than 30 competitors and it is clear that New Zealand Post has had to react to competition and, as recently summarised by the Chief Executive of New Zealand Enterprises Group:

> "*The incumbent postal operator can prosper in a deregulated market. To do so requires a renewed focus on costs. In New Zealand, only four of the 30 private operators have sought downstream access."*
>
> *"Much of the pre-deregulation debate was focussed on competitor access to the New Zealand Post network. … It has been a non-issue…This demonstrates that the postal service (including the much debated last mile) is not a natural monopoly."*[4]

One competitor, Fastway Ltd., has sought to provide services which provide easier access for consumers to postal services. Creating counters within stores and having negotiated access to New Zealand Post post boxes (but now with a more extensive network of Fastway mail boxes) has given consumers more flexibility and convenience in accessing postal services than was traditionally offered by New Zealand Post. They offer a uniform tariff nationwide (with a rural delivery surcharge of NZ$2.50 for certain locations) but, in addition, have been able to offer reduced prices to business customers[3].

Entry by new operators has not been without its casualties, though. National Mail, which sought to provide a service for pre-sorted business mail, recently ceased operations.

<u>Finland</u>
Largely due to the imposition of a 20% turnover compensation fund payment, no competition has been established in Finland.

<u>Italy</u>
Local delivery concessions were introduced in Italy 1929. In total there were 67 such agencies. They offered a service which was of a much higher quality than that provided by the Italian post office. In addition, they offered a service at the same price but paid compensation payment of Lire 300 to Poste Italiane (37.5% of turnover). Despite this payment, the agencies were moderately profitable and had sufficient volumes because of the superior service quality.

As of 31 December 2000, the Italian government has revoked all 67 concessions.

[4] John Allen, Chief Executive New Zealand Post: speech on 13 March 2001 at the Institute of Economic Affairs 4th Annual Conference on "European Postal Services", Brussels
[3] Source: www.fastwaypost.com

e) Periodicals Delivery

In the Netherlands, delivery of publications has never been monopolised. A significant part of this market is the delivery of periodicals (principally magazines).

There is significant evidence to show that competition in this market has led to both a decrease in prices (being enabled by finding operational efficiencies in order to provide a competitive service) and an improvement in delivery quality. The innovation and efficiency within the Dutch post office was principally motivated by the need to react to lost market share.

There are now four key players in the Dutch periodicals delivery market. The Dutch post office holds a market share of about 45%. The private delivery companies employ somewhere in the region of 42,500 staff. The largest private delivery company has about 24,000 staff who deliver periodicals and other material. The second largest operator employs some 16,000 staff. This compares with the 25,000 employed by the Dutch post office, to provide distribution services for periodicals and other material.

Section 4: Strategy for entry into postal markets

<u>Niche entry – collection, sortation and delivery</u>
There are several examples of niche entrants into the letters market. Many years ago, document exchange was established, providing a reliable service in the business to business market. Entry into the overnight financial information market has also taken place, providing collection and guaranteed early morning delivery in inner-city districts. In the United Kingdom, both such services have now been formally exempted from the licensing provisions of the Postal Services Act 2000. Other special services, providing a value added or even bespoke delivery service to a customer or closed user group of customers have also emerged, providing a service not filled by the standard service of the post office. In each of the above scenarios, the market, volume and turnover can be assessed in advance (with reasonable precision) and the service then developed around this. In each case, the number of users is either one entity or a relatively small number of entities. In each case, it involves the provision of business to business mail.

<u>Local entry – collection, sortation and delivery</u>
An entry strategy may be based on content. For example, provision of publications or un-addressed mail delivery services. The likely scenario of entry is to start local and grow as volumes grow. The experience in Sweden has shown that many start small and stay small. Over time, local companies might be expected to start to cooperate to provide a wider scale coverage. This is the current vision in New Zealand and was the position in Spain, where local delivery companies set up an inter-city link, called Entrega en Mano (since declared illegal, following the introduction of the 1998 Spanish postal law). In Sweden, the operator CityMail has elected to operate in three cities (Gothenburg; Stockholm and Malmo) and has specialised in the delivery of computer-sorted business-to-consumer mail.

<u>Wide-scale entry– collection, sortation and delivery</u>
It is also conceivable that a more wide-scale entry could be envisaged at the outset, but needing to rely on the universal service provider for delivery to certain areas. As volumes grow, less reliance would be placed by the new entrant on the universal service provider. The initial investment for wide-scale entry is, of course, a higher risk strategy. One example of this strategy has been Fastway Ltd in New Zealand, where decreasing reliance is being placed on New Zealand Post. An example of another entrant (but who has now ceased operations) is National Mail in New Zealand. Provided that volumes were sufficient to pay back fixed costs and capital investment charges, wide-scale entry could be a viable (if relatively high risk) strategy. This provides customers not only a choice on price but also on the nature of the delivery service.

<u>Sectoral entry– collection, sortation and delivery</u>
Targeting a particular market sector (e.g. publishers, utilities or banks) may be a possible entry strategy. The mail operator would collect all mail volumes from the customer and deliver those items which the operator is entitled or able to deliver itself and give the other items to licensed or exempted operators.

<u>Collection services</u>
Collection of domestic mail by operators, for delivery by the universal service provider, currently exists in several markets[1]. The operator makes its margin from the difference between the price it is charged by the universal service provider and the price it is able to offer its customer. An operator with sufficient volumes is able to obtain a lower price from the universal service provider by obtaining non-discriminatory, volume discounts. Any discounts

[1] In the United Kingdom, this activity is formally permitted under section 7(2)(h) Postal Services Act 2000.

offered to the operators must represent cost savings corresponding to the collection activities of the operator.

In Sweden and New Zealand, certain operators have entered the upstream market and rely on the universal service provider's delivery network. In practice, no specific access arrangements should be necessary, on condition that the terms of access are fair and reasonable and the operator is treated on no less favourable terms than a large customer. In New Zealand, this requirement has led New Zealand Post "to treat competitors no differently than it would "equivalent customers"."[2] Entry at the collection level could be a viable entry strategy.

Sortation services
It is conceivable that entry could occur only at the sortation stage only. This would only occur if (a) delivery was liberalised and it was cheaper for the delivery company to outsource the sortation services or (b) the price discount offered by the universal service provider for delivering pre-sorted mail exceeds the costs of the sortation. Operationally, it would be necessary that the collection and delivery services could easily be dovetailed with the sortation process. For the market entrant, they would need to have either fully variable costs (typically, 80+% of postal costs are fixed costs) or sufficient guaranteed volumes to be able to justify the investment in personnel and/or automated sorting machinery. These services may develop over time if several operators provide delivery services and then seek to share sortation costs.

Mixed strategy
It is possible that a mix of the above strategies may be used. Two examples follow:

a) ***collection and sortation services*** – rather than providing only one such service, the operator could provide both services or provide collection services with sortation being carried out by the consolidator to provide convenience to customers (collection) and to enable it to obtain pre-sorted mail discounts (sortation);
b) ***collection, sortation and some delivery services*** – such entry would be as in a) above but this would be coupled with some delivery by the operator's own network and the remainder of the mail being delivered by the universal service provider.

[2] John Allen, Chief Executive New Zealand Post: speech on 13 March 2001 at the Institute of Economic Affairs 4th Annual Conference on "European Postal Services", Brussels

Section 5: Barriers to entry into postal markets and possible solutions

Monopoly or legal uncertainty

Although not an absolute bar to market entry, history shows that de facto liberalisation has occurred in many markets prior to de jure liberalisation (e.g. in the express, outbound cross border, local delivery and direct mail markets). Any significant investment will, however, be avoided so long as there is a monopoly in place or where the legal position is uncertain. Where the extent of a monopoly right is not clear (such as direct mail in Austria or special services which are only liberalised by a confusing mixture of case law and EC legislation[1]), would-be entrants are discouraged from investing. Public postal operators in many countries prey on the uncertainty of the legal position to dissuade customers from using the services of a private operator. Even now, decisions to invest in Germany and the Netherlands (previously committed to liberalisation by 2003) have been thrown into doubt because of political pressure to extend the monopolies there.

Proposed solution: Any liberalising measure must be legally certain and understandable. It should be a permanent measure (and not merely a temporary measure with a possibility for extension) and, where a need for interpretation arises, there must be clear, objective, proportionate procedures under which the independent regulator can issue a binding decision.

Pricing by the incumbent post office

Liberalisation of postal services does not, automatically, spell the start of competition. This also depends on the pricing practices of the former monopolist. The Swedish experience provides two very good examples of how pricing can create a barrier to entry and even force new entrants into financial peril.

- **Pre-sorted mail price** cuts - In reaction to CityMail's offering lower prices than those charged by Sweden Post, Sweden Post cut its pre-sorted mail tariff by 47%. This was in response to a market entrant who had secured a tiny 0.5% market share. Not only did this price decrease contribute to the near insolvency of Sweden Post in 1995 but also that of CityMail. To compensate for this, Sweden Post increased its unsorted business mail prices by over 35% and managed to sustain an artificially low price for its sorted tariff. While customers of sorted mail benefited from the acute price competition, this led to an increase for customers with unsorted mail and nearly jeopardised the very existence of the universal service provider and its one significant competitor.

- **Local delivery tariffs** – Sweden Post also felt threatened by the advent of local delivery companies. These, too, managed to secure only a tiny proportion of the overall market. Nonetheless, Sweden Post was permitted to cut its prices for local delivery. After offering these prices for some time, many of the local delivery companies were forced into severe financial difficulties. Sweden Post then realised that the low prices would severely impact its viability and so, having weakened the competition, was able to increase its prices again.

Proposed solution: The lessons from the Swedish experience should always be borne in mind when trying to introduce sustainable competition. Great care must be taken to police the extent to which the dominant postal operator is able to reduce its prices.

[1] Except in Germany where "D" licences are generally available for providers of next day guaranteed mail services in certain specified geographic regions.

<u>Brand and presence</u>
The brand of the incumbent post office can be highly significant.[2] In addition, the vast retail network has a profound, beneficial impact on the perception of the universal service providers. Although customers can, in theory, move from one supplier to another relatively easily, the established brand will have an impact on the decision. Furthermore, it is usual commercial practice for the sales forces of universal service providers to stress to customers that they are the sole operator capable of delivering, through their own network, to every address in the country and the only operator who has contractual links (through multilateral treaties or agreements or, in some case, bilateral agreements) with every other post office in the world.

Proposed solution: there is little that can be done as this presence is a fact of life. It is, however, essential to bear this "benefit of ubiquity" in mind when trying to assess the cost of the universal service obligation because it also is a commercial benefit for an operator who already has such a network in place.

<u>Access to universal service provider's services</u>
Where and operator wishes to enter the upstream market and/or customers of a market entrant require a nation-wide service, it will be necessary to rely on the universal service provider's services. If access to this dominant provider's services is not guaranteed and is not on fair, reasonable and non-discriminatory terms, the ability to enter the upstream market or nationwide delivery market successfully will be limited.

Proposed solution: ensure that fair and transparent tariffs for access to services are established and, in the event of dispute as the access conditions or prices, that these are resolved very quickly and fairly by the independent regulator. Provided that the competitors are treated no less favourably than an equivalent customer then this should be an adequate safeguard to prevent discrimination against competitors. As this is covered by the applicable provisions of general competition law, no specific regulation would be required but the requirement for a speedy form of resolution in the case of complaint remains important.

<u>Compensation fund payments</u>
In principle, a compensation fund payments by all operators providing services falling within the universal service area are preferable to full monopoly because it is a less restrictive measure. This must not be excessive. Two examples demonstrate this point:

- **Finnish compensation fund** - The experience in Finland has shown that the imposition of an excessive compensation fund payment (in that case, 20% of turnover) has had the effect of maintaining a de facto monopoly. With profitability often in single figures (and then only after sufficient volumes have been achieved), such a high compensation fund contribution guaranteed no market entry.

- **Greek compensation fund** - In Greece, the compensation fund obligations would have rendered the entire Greek express industry loss making overnight and would have imposed a fee which represents a sum greater than the entire annual turnover than some of the operators who are obliged to pay it! The Greek law is the subject of a pending complaint to the EC Commission who have recently confirmed in writing that the compensation fund payments may not be applied to non universal services (such as express services). Compensation fund payments, which can only ever be imposed on providers of services falling within the universal service area, must be proportionate and rigorously controlled to ensure that they act only to compensate the universal provider to

[2] "The Post Office is said to be the best known brand in the United Kingdom after Coca-Cola. It is also the country's biggest retail chain." *The Times,* 14 November 2000, Christine Buckley

the extent that liberalisation of the relevant market has increased the cost of meeting the universal service obligation but only to the extent that the universal service obligation could not be more efficiently provided by other operators.

Proposed solution: provided that a suitable economic model is established which proves the cost of the universal service obligation and that the data to run the model are reliable, publicly available and confirmed by an independent party, this could be a workable solution. It is also essential that the extent of the contribution is known in advance, in order to enable contributors to budget properly. However, since prices must be geared to costs, no such fund should be necessary as the universal service provider has the means to preserve its viability. In any event, the EC Directive 97/67/EC provides that such a fund must never be used to fund the provision by the universal service provider of special services (as compared with the standard postal service as provided on the date that Directive came into effect i.e. 10 February 1998) – such as express services. Furthermore, such a fund must never be used to subsidise the inefficiency of the universal service provider.[3]

Investment

The investment to provide a local mail delivery service is not significant and does not, in itself, present a major barrier to entry. The experience in Germany has shown that several hundred operators have been willing to enter the market. However, wider scale investment will be dependent upon sufficient volumes being available to give the private operator the necessary return on investment. Where the regulatory situation limits the mail volumes which are open to free competition, it is likely that market entry will be limited. Furthermore, it is to be expected that the universal service provider will react to market entry by reducing its prices, thus making the viability of the new entrant's business more difficult.

Proposed solution: ensure that new entrants have a long enough period to recover any investment they have made. Interim licences and uncertainty over licence conditions will severely hamper investment.

Licensing procedures

Burdensome licensing procedures can deter market entry and, in extreme cases, can even force existing competition out of the market. This latter situation was witnessed in Greece where every express provider (including subcontractors) was obliged to apply for a licence The administrative complexity was beyond the capability of many small operators and the turnover-related application fee was wholly disproportionate.

Proposed solution: use simple, general authorisation procedures wherever possible with easy to understand rules and procedures.

[3] In Germany, this issue is addressed in the following way: if the universal service provider shows prima facie evidence of financial prejudice arising from the universal service obligation, the service shall be put out to tender and awarded to a viable operator requiring the least financial assistance. Postgesetz of 22 December 1997, Article 14.

Market features which need to be considered include the following:

- **Work force and know how** – Hiring qualified delivery staff and establishing a network which provides a suitable service quality can be a very time consuming exercise. Furthermore, without substantial volumes, the ability to recruit full time employees is often considered to risky for a market entrant. Flexible working conditions are, therefore, an important factor in affecting market entry.

- **Data protection legislation** - Where a country has very restrictive data protection legislation, the development of database related marketing will be limited.

- **Printing and fulfilment services** - The availability of good printing and publishing industries will have an impact on the ability to stimulate growth for certain mail volumes (such as direct mail). The lack of such facilities will act as a barrier to entry.

- **Culture** - A cultural resistance to the use of databases or receipt of direct mail can act as a barrier to entry into a direct mail market.

Section 6: Impact of price and weight reduction on market entry

While large amounts of time and money are spent on price and weight limit discussions, it is - from the point of view of our members – wasted time and money.

The formal reduction of the maximum price threshold to five times the basic tariff in Directive 97/67/EC attracted little concern from our members since their express services are typically priced in excess of this amount. This is also the case because only a very small amount of traffic carried in an express network weighs under 350g. The differentiation, however, lies not in the pricing but the network and infrastructure necessary to provide an express service. Guaranteeing sufficient capacity to ensure express delivery at any given time involves high capital investment and a constantly available network. The service levels are what distinguish the services, not the price. Therefore, the Directive 97/67/EC had no appreciable beneficial effect on the provision of express services.

A further reduction of the weight limit would still have little impact unless it realistically offered the customers and private operators a practical opportunity to separate the reserved and non-reserved material.

In those countries where weight limits have been reduced below the 350g level but without full liberalisation (Netherlands to 100g, Germany to 200g and Denmark to 250g) there has been no appreciable market entry in the mail market in the non reserved weight bands. Even where full liberalisation has occurred, the loss of market share has been insignificant.

The reasons for this can be predicted as being:

- Insufficient mail volumes to launch a business (mail over 350g represents only 3% of volumes and mail over 50g represents 19% of volumes)[1]
- Inability of operators and/or customers to sort mail by weight
- Hassle to have to separate out mail flows and rely on more than one supplier
- Unpredictable volumes based on weight limits
- Identifying (and being able to target) customers with volumes over a given weight is very difficult, without inside information of the their mailing profile
- Natural inertia to remain with universal service provider
- Achieving savings in postage costs has low commercial priority in most companies
- General satisfaction with the price and service level provided by universal service provider
- Discounts offered by the incumbent universal service provider in reaction to competing services

As most letters fall in the category of 9-20g, unless there were liberalisation to allow these letters to be carried (and at any price) the further discussion of a further reduction of weight and price limits is likely only to result in more lost time and money.

[1] See §1.2.5 and §2.2 of Explanatory memorandum of the Commission Proposal of 30 May 2000.

Section 7: Conclusions

AICES believes the arguments put forward in this paper provide a cogent case for the accelerated liberalisation of the postal sector. We look forward to working with other interested bodies to ensure that the UK's postal system provides choice, efficiency and good value for all consumers. We conclude:

- **The benefits of competition are clear.**
- **From the examples in the market where liberalisation has occurred, there is a net benefit to the industry and a clear benefit to customers.**
- **In no situation has the universal service been compromised by the introduction of competition.**
- **The benefit of full liberalisation is succinctly summarised by the EC Commission in the case of Sweden thus: "*any objective analysis shows that consumers, as well as businesses, have benefited from market opening through higher quality. In addition, prices have been substantially reduced for business customers while households have been protected from price increases*"[1].**
- **The market is a growth market and now would be good time to liberalise, before substitution by other media starts to accelerate.**
- **Employment rationalisation will take place, liberalisation or not. The long term preservation of employment lies in making the industry efficient and competitive with other media.**
- **The key barriers to entry are regulatory.**
- **There is no natural monopoly on delivery**
- **Entry at the collection level exists; entry at the collection stage could be a viable entry strategy with final delivery being provided by the universal service provider; this is dependent upon a fair access pricing regime being in place**
- **The universal service provider is likely to retain a dominant or even super-dominant market position even after full liberalisation.**
- **Diverse entry strategies are possible and small and medium sized operators are likely to represent the vast majority of market entrants.**
- **Reduction of weight limits to anywhere above 20g is likely to have no appreciable impact on market entry.**

[1] http://europa.eu.int/comm/internal_market/en/postal/evloframe/docs/ficheen06.pdf at page 21/32