ACCC view on Australia Post's draft price notification

January 2024

Acknowledgement of country

The ACCC acknowledges the traditional owners and custodians of Country throughout Australia and recognises their continuing connection to the land, sea and community. We pay our respects to them and their cultures; and to their Elders past, present and future.

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Land of the Ngunnawal people
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ACCC 01/24
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Executive summary

Australia Post has submitted a draft price notification to the ACCC which proposes to increase the price of its reserved ordinary letter services from early 2024. The ACCC's preliminary view on the draft price notification is to not object to the proposed price increase. This decision is based on our finding that, even with the proposed price increase, Australia Post is unlikely to recover revenue in excess of its costs for reserved letter services over the period 2023–24 to 2025–26.

Australia Post is proposing to increase the price for reserved ordinary small letters delivered to the regular timetable by 25% (from $1.20 to $1.50).[1] It also proposes to increase the prices for the delivery of reserved ordinary large letters delivered to the regular timetable by 25% (from $2.40 to $3.00 for letters up to 125 grams, and from $3.60 to $4.50 for letters over 125 grams and up to 250 grams). Australia Post's proposed price increase does not affect the price of concession stamps ($3 for 5) or stamps for seasonal greeting cards (65 cents).

Australia Post cannot increase the prices of these letter services without notifying the ACCC and the Minister for Communications of its intentions. The ACCC must decide whether to object to the proposed price increase, or to not object to the proposed price increase, or to not object to a specified price increase which is lower than the proposed increase.

Why is Australia Post seeking to increase the prices of these letter services?

Letter services, and other services offered by Australia Post such as access to post offices, are highly valued by the Australian community. Australia Post is also required by law to provide a service that is reasonably accessible to all people across Australia (which is referred to as Australia Post's community service obligation).

Australia Post has a statutory monopoly over certain letter services, known as reserved services, which means that no other businesses are legally able to offer these. The statutory monopoly was introduced to support Australia Post in meeting its community service obligations, because Australia Post does not receive direct funding from the Government to provide its services.

Australia Post has become less profitable in recent years, with letter services, including the reserved services, making a significant loss. Letter revenue has continuously declined by an average of 6.3% per annum between 2018–19 and 2022–23 which has been driven by a decline in letter volumes. The volume of letters being delivered is expected to continue to decrease by 11.3% annually from 2023–24 to 2025–26. At the same time, the number of premises needing to be served continues to grow by around 200,000 per year. The increased costs of delivery combined with reduced revenue puts pressure on the financial sustainability of Australia Post's letter services.

Further, the profits earned in Australia Post's other services were not high enough to cover the losses of the reserved services, so Australia Post made its first overall loss for 8 years in the 2022–23 financial year. This illustrates that the viability of the reserved letter services impacts Australia Post's services more broadly, including their availability to the Australian public.

1 We note the 'regular timetable' is likely to change in 2024 as a consequence of the postal service modernisation review.

Australia Post is now seeking to reach a more financially sustainable position by increasing the prices of its reserved ordinary letter services. Australia Post considers that implementing the proposed price increase will contribute to achieving a pricing structure that better aligns stamp prices with Australia Post's efficient costs.

The Government is also taking steps to reduce the operating costs to Australia Post of delivering the reserved services in its postal services modernisation review.

The ACCC has carefully assessed the price notification given the importance of Australia Post's services

When assessing a price notification, the ACCC must balance the interests of mail users with the financial sustainability of the basic postal service provided by Australia Post.

We take a cost-based approach to assessing proposed price increase. That is, we assess the extent to which the prices proposed by Australia Post are commensurate with the efficient costs of providing those services.

To do this, we examine Australia Post's costs in providing reserved services, its efficiency in incurring these costs, and its expected rate of return or profit on its investment. We assess whether Australia Post is able to recover revenue from the reserved services sufficient to cover the efficient costs in providing them, without generating excessive profits.

Overall, we have come to the view that Australia Post is not likely to recover revenue in excess of its costs for the reserved services for the period 2023–24 to 2025–26 even if the proposed price increase is implemented.

With that said, we acknowledge that the vast majority of consumers and businesses who responded to our consultation on the draft price notification were opposed to the proposed price increase. As detailed in this report, consumers and businesses were particularly concerned about the price increase in the context of broader current cost-of-living pressures, with some businesses considering they have no other option except to pass the price increase on to their customers. While the ACCC has considered this feedback throughout our assessment process, we note the limitations of our regulatory role, with a cost-based approach being the primary metric for assessing price notifications for reserved services.[2] We do, however, consider that Australia Post should explore methods to ameliorate the affordability issues identified for small to medium business customers under the proposed price increase.

We note the information Australia Post has presented in support of its draft price notification has raised concerns about revenue allocation. In particular, stakeholders identified potential inconsistencies in the way costs and revenue are allocated by Australia Post. We recognise these concerns have the potential to give rise to broader competition impacts and recommend that Australia Post review its revenue allocation processes. However, for the purposes of this assessment process and our statutory role, we accept the approach used by Australia Post to determine forecast revenue in the assessment model.

The ACCC considers that both cost and revenue allocation are important because of the competition issues that could arise if Australia Post used the revenue generated from its monopoly letter services to subsidise the parts of its business that operate in competitive markets. The ACCC will continue to monitor developments in this area, including the

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[2] ACCC, *Statement of regulatory approach to assessing price notifications under Part VIIA of the CCA*, March 2017, p.13.

appropriateness of Australia Post's allocation of costs and revenue across the reserved and non-reserved services.

The ACCC is recommending that Australia Post make improvements to the way it models, allocates and recovers costs

Further, in conducting this review, we have identified a number of recommendations for improvements to ensure the ACCC can undertake a robust assessment process in future price notification processes.

We consider that a transparent and consultative process based on accurate and fulsome information is essential for delivering good outcomes for consumers. A fundamental element of a cost-based assessment is a rigorous assessment of forecast efficient costs. We note that Australia Post's cost allocation methodology is based on actual costs (not necessarily efficient costs), and is not integrated with a forecasting tool. Therefore, we have identified some recommendations to improve the forecast cost information provided by Australia Post to inform any future price notification assessments.

We also recognise the critical importance of cost allocation as Australia Post's business changes from focusing primarily on letters to parcel delivery. This is relevant because the proposed price increase for the reserved letter services should be commensurate with the costs associated with those services only, and should not be used to cross-subsidise other services that are provided by Australia Post in competitive markets. We have set out some recommendations for Australia Post to improve its cost allocation model to more accurately separate the costs attributable to its reserved and non-reserved services.

We further raise in this report and our recommendations a number of other issues with Australia Post's cost allocation model. These include issues with Australia Post's transfer price arrangements with StarTrack, the basis on which subsidies paid to local post offices are allocated within the model, and the absence of short-run and long-run incremental costs within the model, the latter of which are critical for effective regulatory decision making.

We acknowledge that this assessment has been particularly complex because the outcomes of the postal services modernisation review were uncertain when Australia Post submitted its draft price notification(s). However, the ACCC considers that improved information and processes will be increasingly important if Australia Post moves towards a long-term price path approach in the future, and the cost-based assessment becomes more finely balanced as operating costs are reduced following the implementation of modernisation reforms. We note that in the absence of improvements to the information provided by Australia Post in support of any future price notifications, the ACCC may not be in a position to not object to future proposed price increase.

Process

Australia Post's reserved ordinary letter services are part of the services for which Australia Post has a statutory monopoly and are declared as 'notified services' for the purposes of section 95Z of Part VIIA of the *Competition and Consumer Act 2010* (CCA). The current declaration expires on 30 June 2025.

As the reserved ordinary letter services are 'notified services',[3] Australia Post cannot increase its prices without notifying the ACCC and the Minister for Communications of its intentions.

Australia Post's obligations in this regard relate only to its notified services. Australia Post is not subject to any obligation to notify the ACCC in relation to a decision to increase the price of any non-notified service, such as parcel services.

The ACCC must consider Australia Post's proposal to increase the price of the notified services and decide to:

- not object to the price increase, or
- not object to a price that is less than the proposed increase, or
- object to the price increase.

The decision set out in this ACCC view paper relates to Australia Post's draft price notification only. Following consultation on this view, we will invite Australia Post to submit a formal price notification.

Australia Post is not permitted to increase the price of the notified services until:

- 21 days have elapsed since the formal notification to the ACCC, or the ACCC has decided to not object to the proposed increase, and
- 30 days have elapsed since the notification to the Minister, and the Minister does not disapprove the proposed increase.

Australia Post intends to implement the proposed price increase in early 2024, subject to the ACCC's consultation on this view paper, Australia Post's formal notification of the price increase to the ACCC, and the Minister not disapproving the increase.

[3] If the price of priority stamped letters is more than 1.5 times the price for an equivalent ordinary letter, it also falls into the scope of notified letter services. At this time, the price of priority stamped letters is less than 1.5 times the price for an equivalent ordinary letter, and therefore priority stamped letters are not currently notified letter services.

Findings and recommendations

Findings

The ACCC's view, based on the draft price notification, is that it proposes to not object to Australia Post's proposed price increase for its notified services.

The ACCC has found that Australia Post is unlikely to earn revenue in excess of its costs for reserved services even with the proposed increase in prices.[4]

In making this assessment, the ACCC has observed that:

- Australia Post is expected to continue to under-recover its costs for its reserved letter segment under scenarios where alternative values for key inputs, such as cost of capital, are adopted
- from a high-level, top-down view, WIK Consult found that, despite its weaknesses, Australia Post's cost allocation model broadly generates a relatively fair allocation of costs to services
- while Australia Post lags behind its international peers in relation to operational efficiency, we expect its efficiency to improve as its new delivery model is implemented
- the number of new delivery addresses that Australia Post is expected to service continues to grows by around 200,000 per year,[5] while the volume of domestic addressed letters delivered by Australia Post continues to decline
- the unit costs of domestic reserved letters have increased with the decline in volume and will continue to do so if letter volumes decline further
- while Australia Post's ordinary letter prices have increased significantly over the past decade, they remain below the average price of an ordinary letter in other OECD nations
- the proposed price increase may present challenges for some small businesses, and are likely to cost the average consumer approximately $4.50 to $13.50 per year.

Recommendations

While assessing Australia Post's draft price notification, we have identified a number of recommendations for improvements to support any future price notification process. These recommendations are discussed further in Chapter 9.

The ACCC recommends that in future price notifications:

- Australia Post provide a base case scenario for analysis
- Australia Post provide improved forecast data
- Australia Post further improve its cost allocation model, particularly with:
  - multiple forecast scenarios, including ones without proposed price increase, that show the incremental effects of individual cost change factors
  - a new delivery time standard update

4 We note that the cost forecasts provided for input into the post-tax revenue model refer to the actual costs Australia Post is expected to incur, which are not necessarily the same as the efficient costs.

5 Australia Post, *Draft price notification*, November 2023, p. 5.

  - short-run and long-run incremental costing of individual services and products
  - a review of the allocation of licenced post office subsidy costs, electric delivery vehicle costs, restructuring costs and other unattributable costs, and
  - an ex-ante contractual transfer pricing arrangement with StarTrack.
- Australia Post amend its approach to the cost of capital
- Australia Post amend its approach to calculating its present value calculations in its post-tax revenue model
- Australia Post ensure its regulatory accounting procedures manual aligns with the classifications of reserved and non-reserved services under the relevant legislation
- record-keeping rule data be supported by responsibility statements
- the price notification process should be as transparent and consultative as possible.

We also consider that Australia Post should explore methods to ameliorate affordability issues identified for small to medium business customers under the proposed price increase.

1. Introduction

Australia Post's draft price notification

On 23 August 2023, Australia Post submitted a draft price notification to the ACCC, proposing to increase the prices charged for delivering reserved ordinary small and large letter services to its regular timetable by 25% from early 2024.[6]

Australia Post proposes to raise the price of delivery of:

- small letters from $1.20 to $1.50
- large letters up to 125 grams from $2.40 to $3.00
- large letters between 125 grams and 250 grams from $3.60 to $4.50.[7]

On 7 November 2023, Australia Post provided the ACCC with an updated version of the draft price notification, which reflected revised financial information and forecasts. Australia Post provided a further price notification in December 2023, which corrected certain outputs from the post tax revenue model. The revised draft price notifications did not propose to alter the magnitude of the proposed 2024 stamp price increase.

Australia Post's legislative obligations

Reserved and notified services

Under s 29 of the *Australian Postal Corporation Act 1989* (Cth) (the Postal Act), Australia Post has exclusive rights over the provision of 'reserved services' in Australia. These services include the domestic carriage of letters weighing no more than 250 grams and the issue of postage stamps.

Australia Post's reserved letter services for ordinary letters are 'notified services' under s 95X of the CCA (the notified letter services).[8] Where Australia Post proposes to increase the price of a notified letter service, it must notify the ACCC of any such proposal.

Australia Post is not permitted to increase its prices until 21 days have elapsed since the notification or the ACCC has decided to not object to the proposal.

In addition to the ACCC's assessment, Australia Post must give written notice to the Minister for Communications of its intent to vary the postage rate for reserved ordinary letters. Australia Post may increase the rates only if the Minister does not disapprove the proposed rates within 30 days of receiving notification from Australia Post.[9]

Parcel services and ordinary large letters weighing more than 250 grams are not reserved or notified, and their prices are not subject to ACCC review.

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6 Australia Post, *Draft price notification*, August 2023.

7 Australia Post, *Draft price notification*, August 2023, p. 13.

8 *Price Notification Declaration (Australia Post Letter Services) (No. 2) 2015*. Letter services which involve the supply by Australia Post of a special service for which a special charge or additional fee is payable (as described in the Price Notification Declaration) or letter services under an incoming overseas mail service to which a convention applies are not notified services.

9 Section 33 of the Postal Act.

Community service obligation and delivery standard

Australia Post is subject to a range of obligations under the Postal Act and the *Australian Postal Corporation (Performance Standards) Regulations 2019* (the Postal Regulations).

Key to the delivery of ordinary letters, under s 27(4) of the Postal Act, Australia Post must ensure:

(a) that, in view of the social importance of the letter service, the service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business

(b) that the performance standards (including delivery times) for the letter service reasonably meet the social, industrial and commercial needs of the Australian community.

The obligation under s 27(4)(a) to provide a service that is reasonably accessible to all people is also referred to as Australia Post's community service obligation. A community service obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices.[10]

The Postal Regulations set out several performance standards Australia Post must currently meet, such as delivery timeframes. For example, under s 7(1) of the Postal Regulations, Australia Post must service:

(a) 98% of all delivery points daily (except on weekends or public holidays)

(b) 99.7% of all delivery points at least 2 days each week.

Section 8 of the Postal Regulations sets out the time for expected delivery of reserved service letters at different types of addresses, distinguishing between priority and non-priority mail.

We note that Australia Post met its community service obligation and delivery standards for the 2022–23 financial year.[11]

Operating environment

Modernisation review

Subsequent to Australia Post's most recent price notification in 2022, the Australian Government announced the commencement of the postal services modernisation review. In March 2023, the Department of Infrastructure, Transport, Regional Development, Communications and the Arts (the Department) released a discussion paper[12] outlining the Government's intentions to modernise postal services, including:

- providing appropriate coverage of the post office network, particularly in regional and rural areas, and supporting local post office and community postal agents' financial sustainability

10 Steering Committee on National Performance Monitoring of Government Trading Enterprises, 1994, p. 8.

11 Australia Post, *Annual Report 2023*, p. 158.

12 Department of Infrastructure, Transport, Regional Development, Communications and the Arts, *Postal Services Modernisation Discussion Paper*, March 2023.

- letter pricing arrangements that support Australia Post to recover the actual costs of providing its services, while retaining appropriate Government oversight and maintaining subsidised social mail pricing (for example, for concession card holders)
- relaxing letter delivery frequency requirements, while maintaining appropriate maximum letter delivery speed regulations
- deregulating the priority letter service, while maintaining a commercial bulk priority letter service to meet the needs of Australian businesses.[13]

The ACCC recognises the importance of Australia Post's services, and particularly the significant role that post offices play in regional and remote communities throughout Australia. We are supportive of the modernisation review to ensure that Australia Post continues to meet the needs of consumers and businesses into the future.

December 2023 Government announcement

On 6 December 2023, the Australian Government announced the initial outcomes of the postal services modernisation review. These include a plan to amend the Postal Regulations to allow Australia Post to reduce letter delivery frequency to every second business day for 98% of locations, whilst parcels, priority, and express mail will be delivered daily. To reflect the new delivery frequency, Australia Post will have an extra day to deliver regular letters across Australia. We note the consequential amendments to the Postal Regulations are subject to further consultation in 2024.[14]

Other announcements include that Australia Post may change the way it manages priority mail, and that the geographical classification of some post offices will change. The classification of post offices is relevant for determining where post offices must be located. Under the current Postal Regulations, Australia Post must maintain 4,000 post offices in Australia, with no fewer than 2,500 in rural and remote areas. At least 90% of residences in metropolitan areas must be within 2.5km of a post office, and at least 85% of residences in non-metropolitan areas must be located within 7.5km of a post office. The Government is not proposing to change the prescribed minimum numbers of post offices that Australia Post must retain, including in regional Australia.

While not relevant to this 2023 price notification, the Government also announced that it will work with Australia Post to develop a pricing oversight mechanism that will give Australia Post and its customers greater certainty over a longer-term price path for basic postage.

Australia Post has advised the ACCC that the Government's announcement is closely aligned with the outcomes that were anticipated when the November 2023 forecasts were prepared. There are some cost saving measures that Australia Post included in its forecasts that it will not be able to implement, but these are likely to be immaterial within the forecast period for this assessment. Further, some of the modernisation reforms will be implemented later and more slowly than anticipated in the November 2023 forecasts. As a result, Australia Post submits that the November 2023 forecasts are likely to be optimistic when compared to the cost savings Australia Post will be able to implement over the coming years. That is, Australia Post considers that the under-recovery associated with its reserved letter services will be even larger than is set out in the November 2023 draft price notification.

13 Department of Infrastructure, Transport, Regional Development, Communications and the Arts, *Postal Services Modernisation Discussion Paper*, March 2023, p. 17.

14 M Rowland, *Ensuring Australia Post can deliver more for Australians* [media release], Minister for Communications, 6 December 2023, accessed 5 January 2024.

Draft price notification iterations

Australia Post submitted its initial draft price notification in August 2023.[15] This draft price notification was based on various assumptions by Australia Post, which included potential outcomes from the Government's postal services modernisation review. The ACCC consulted on this draft price notification throughout September 2023.

In November 2023, Australia Post provided the ACCC with a revised draft price notification.[16] The revised draft included end of financial year updates, such as updating some forecast data with actual figures. The November 2023 draft also included updated forecasts based on Australia Post's most recent corporate plan (FY24) and revised assumptions regarding the likely outcomes of the postal services modernisation review. The forecasts in the November 2023 draft price notification were less optimistic regarding the implementation of changes following the postal services modernisation review and the performance of the business more broadly.

The August 2023 and November 2023 scenarios differ significantly in terms of the overall results in the post-tax revenue model. In the assessment set out in this ACCC view paper, we have focused on the November 2023 forecasts as they represent Australia Post's best estimates at the time of undertaking this assessment.[17]

Assessing a price notification in a time of uncertainty

While we welcome the Government's review of postal services modernisation, we note that undertaking a price notification assessment during a period of regulatory reform is challenging.

The accuracy of Australia Post's demand, revenue and cost forecasts is critical to our analysis, but preparing forecasts in an environment of policy reform and uncertainty is inherently difficult. Factors such as delivery network design, the speed and frequency of letter delivery, as well as the size of the post office network, have a significant influence on Australia Post's forecasts and all these factors are subject to the modernisation review.

We also note that due to the uncertainty and sensitivities around proposed reforms, Australia Post has not provided the ACCC with all of the information we have requested to assess the current draft price notification. In some instances, Australia Post has provided information confidentially to the ACCC, but we note this information is not available for public comment. As a result, undertaking this price notification assessment process has presented significant challenges for the ACCC.

Broader economic environment

Australia Post's proposed price increase comes amid a range of cost-of-living pressures for consumers. Over the 12 months to September 2023 as a reference period, the Consumer Price Index (CPI) as tracked by the Australian Bureau of Statistics (which measures household inflation) rose 5.4%.[18] The proposed 25% stamp price increase within a 12-month span is well above this average growth in consumer costs, and thereby reflects an additional cost to consumers.

15 Australia Post, *Draft price notification*, August 2023.

16 Australia Post, *Draft price notification*, November 2023.

17 Australia Post provided a further update to the November 2023 draft price notification in December 2023 to correct for some errors. For simplicity, we have referred to the November 2023 draft price notification throughout this report.

18 Australian Bureau of Statistics, *Consumer Price Index, Australia*, September 2023, accessed 9 January 2024.

While postal services account for a small share of the goods and services that make up the CPI basket[19] and are often considered a small expense on an annual basis, in light of the current economic climate, we have considered the affordability impacts of the proposed price increase on consumers and small businesses in Chapter 3.

ACCC approach to assessment

Australia Post's provision of letter services for carriage of reserved ordinary letters at the regular timetable have been declared as a notified service under Part VIIA of the CCA.[20]

In response to a price increase notification for a notified service, the ACCC must consider the proposal and decide to:

- not object to the price increase, or
- not object to a price that is less than the proposed increase, or
- object to the price increase.[21]

In considering whether to object to a proposed price increase for Australia Post's notified letter services, the ACCC must have particular regard to:[22]

- the need to maintain investment and employment, including the influence of profitability on investment and employment
- the need to discourage a person who is in a position to substantially influence a market for goods and services from taking advantage of that power in setting prices
- the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.[23]

The ACCC's approach to interpreting s 95G(7) of the CCA is set out in our *Statement of regulatory approach to assessing price notifications under Part VIIA of the CCA*.[24]

Broadly, the ACCC considers that the matters in s 95G(7) require an assessment of the efficiency of a regulated firm's cost base and the rate of return that it is seeking. The proposed price increase is then assessed having regard to the firm's ability to recover revenue sufficient to cover the efficient cost of providing a service, including a rate of return commensurate with the risks faced by the firm, without generating excessive or monopoly profits.

In accordance with ministerial directions issued under s 95ZH of the CCA,[25] the ACCC must also give special consideration to the functions and obligations of Australia Post as set out

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19 Postal services account for 0.10% of the 'all group' CPI basket. Australian Bureau of Statistics, *Annual weight update of the CPI and Living Cost Indexes*, December 2022, accessed 9 January 2024.

20 *Price Notification Declaration (Australia Post Letter Services) (No. 2) 2015*.

21 Section 95Z of the CCA.

22 Subsection 95G(7) of the CCA.

23 As set out in our statement of regulatory approach, the ACCC considers the third criterion is now less relevant to its consideration of price notifications given there has been a movement away from centralised wage fixing to agreements negotiated at the enterprise level. ACCC*, Statement of regulatory approach to assessing price notifications under Part VIIA of the CCA*, March 2017, p.12.

24 ACCC, *Statement of regulatory approach to assessing price notifications under Part VIIA of the CCA*, March 2017.

25 The relevant ministerial directions are General Direction 8 and Direction 11 made under section 20 of the *Prices Surveillance Act 1983*. The *Prices Surveillance Act 1983* is no longer in force, but the directions under apply as directions given under subsection 95ZH(1) of the CCA by virtue of Schedule 2, Part 2, Item 45(2) of the *Trade Practices Legislation Amendment Act 2003.* A number of sections of the *Australian Postal Corporation Act 1989* that are referred to in Direction 11 have been repealed or amended.

in ss 14–16, 25–26, 27(1), 27(3)–(5), and 28 of the Postal Act, and to directions or notifications given to Australia Post by the Minister under that Act. The ACCC considers these matters in its assessment of Australia Post's cost and revenue forecasts below.

As set out in Figure 1 below, Australia Post's notified letter services are a subset of Australia Post's broader reserved letter services monopoly. The notified letter service includes the domestic carriage of letters weighing no more than 250 grams, while the broader reserved letter service also includes small and large letters up to 250 grams which incorporate special services, such as seasonal greeting cards, and business letter services. Australia Post also provides non-reserved letter services, for which Australia Post does not have the exclusive right to carry. These include express post services and registered post.

Only the notified letter services are subject to ACCC review when a price increase is proposed. However, when assessing the appropriateness of the proposed price increase for the notified letter services, the ACCC also considers the forecast costs and revenues of all reserved letter services.[26] This is necessary as the notified letter services share most of the same processing and delivery facilities as other reserved letter services. Consequently, Australia Post's cost recovery for the notified letter services is affected by the amount of shared and direct costs allocated across reserved services.

Consultation and review process

In considering Australia Post's draft price notification, the ACCC has carried out a public consultation process. On 5 September 2023, we published Australia Post's August 2023 draft price notification and supporting materials on the ACCC's website.

We also opened a public survey via the ACCC's Consultation Hub, seeking stakeholder views on the proposed price increase. Through the Consultation Hub, respondents were invited to provide comments in support of their views. Respondents were also able to submit both public and confidential versions of a written submission. Some stakeholders also contacted the ACCC directly to provide their written submission via email.

The ACCC received 240 responses over the consultation period. A summary of the survey responses and the public versions of written submissions are available on the ACCC's website. 164 survey responses were from members of the public, whose personal details have not been disclosed publicly. Content from these submissions has been referred to anonymously in breakout boxes throughout this report. Most stakeholders opposed the proposed price increase.

We welcome submissions from interested parties on this ACCC view on Australia Post's draft price notification by 15 February 2024.

We expect to receive Australia Post's formal price notification in late February 2024. We then intend to publish the ACCC's final decision in March 2024. Our anticipated timeline is outlined in Table 1.

[26] Reserved services include all of Australia Post's statutory monopoly letter services under section 29 of the Postal Act, including business mail services that are not notified services but are provided at a discount to notified 'ordinary' letter services prices.

Table 1. Timeline for assessing Australia Post's price notification

Date	Event
5 September 2023	Consultation survey opened
29 September 2023	Consultation survey closed
25 January 2024	ACCC view on draft price notification released
15 February 2024	Consultation on ACCC view closes
Late February 2024	Australia Post lodges formal price notification
Mid-March 2024	ACCC decision

Figure 1. Categorisation of Australia Post product groups, revenues and costs (2022–23, revenue and costs in $ millions, costs *italicised*)

Australia Post – Whole Corporation ($8,937) (*$9,137*)

Postal ($3,175) (*$3,518*)

Letters ($1,780) (*$2,160*)

Reserved ($1,450) (*$1,668*)

Notified letter services ($98) (*$166*)

Ordinary (stamped) letters:

Sent at the regular delivery timetable and involves no special service. Comprises:

- Small Letters (up to 250g) – the basic postage rate
- Large Letters;
  - up to 125g
  - over 125g up to 250g

Exceptionally,

Priority (stamped) letters if the price is more than 1.5 times the price for an equivalent Ordinary Letter and that rate is not on account of the supply of any special service other than priority delivery.

Other reserved letters ($1,352) (*$1,502*)

Small and Large Letters up to 250g that incorporate a special service (i.e. not Ordinary letters). Includes:

- Concession stamps,
- Seasonal greeting cards,
- Prepaid Envelopes / cards
- **Business letter services:**
  - Metered/Imprint
  - PreSort (incl Charity Mail, Promo Post, Acquisition Mail, Impact Mail)
  - Clean Mail
  - Local Country
  - Reply Paid
  - Print Post
- Stamped letters sent to the priority delivery timetable if price is not greater than 1.5 times the Ordinary price

Non-reserved letters ($330) (*$493*)

- Letters (large ordinary and Print Post) over 250g
- Letters charged at more than 4 times the basic postage rate
  - e.g. Express Post, Registered Post
- Unaddressed Mail
- International outward letters
- International inward letters * and packets <2kg

Other postal ($1,395) (*$1,358*)

- Mail related e.g. PO boxes, digital communications
- Retail
  - Sale of stationery and merchandise
  - Financial and Agency services – banking, Insurance, travel cards, bill payment, money transfer

Parcels ($5,762) (*$5,619*)

- Delivery of parcels (Parcel and Express)
- Freight forwarding
- International parcels
- Courier

Notes: * International inward letters and international inward parcels weighing less than 250g are formally non-reserved services but are subject to Universal Postal Union (UPU) regulation.

Key:

- Notified letters (part of Reserved) – subject to price notification to ACCC
- Reserved letters – overall cost recovery considered by ACCC in deciding whether to object to price increases for notified services

Source: Australia Post.

2. Australia Post's proposed price increase

Australia Post's proposal

Australia Post proposes to increase the prices charged for its notified letter services delivered according to the regular timetable. Table 2 summarises the proposed price changes for the affected letter service.

Table 2. Prices of ordinary letter services ($ nominal)

Letter service	Current price	Proposed price	Increase
Small letters	1.20	1.50	25 %
Large letters up to 125 grams	2.40	3.00	25 %
Large letters >125 grams <250 grams	3.60	4.50	25 %

Source: Australia Post, *Draft price notification*, November 2023, p. 13.

Australia Post proposes to implement the new prices from early 2024.[27]

Australia Post is not proposing to increase the price of concession stamps ($3 for a booklet of 5, equivalent to 60 cents each) or seasonal greeting stamps (65 cents for a small letter).[28]

Prices for reserved letter services not subject to the price notification regime are also increasing, including prepaid envelopes, reply paid envelopes, and business letter prices.[29] Further, priority labels are increasing by 27.3%, from 55 cents to 70 cents.[30] Under the *Price Notification Declaration (Australia Post Letter Services) (No. 2) 2015*, the price of priority stamped letters does not fall under the scope of notified letter services unless it is supplied at more then 1.5 times the price of an equivalent ordinary letter. Since Australia Post's proposed increase in the price of priority stamped letters is less than 1.5 times the price of an equivalent ordinary letter, the ACCC is not required to separately consider this increase in the current price notification assessment.

While not noted in the draft price notification, Australia Post's related media release announced that Australia Post reported a $384.1 million loss in its letters business in 2022–23.[31] Australia Post considers that implementing the proposed price increase will contribute to achieving a pricing structure that better aligns stamp prices with Australia Post's efficient costs.[32]

27 Australia Post, *Draft price notification*, November 2023, p. 13.
28 Australia Post, *Draft price notification*, November 2023, p. 13.
29 Australia Post, *Draft price notification*, November 2023, pp. 48-50.
30 Australia Post, *Draft price notification*, November 2023, pp. 48.
31 Australia Post, *Australia Post proposes increase to stamp price, concessional and seasonal rates unchanged* [media release], Australia Post, 5 September 2023, accessed 9 January 2024.
32 Australia Post, *Draft price notification*, November 2023, p. 5.

Previous price increase

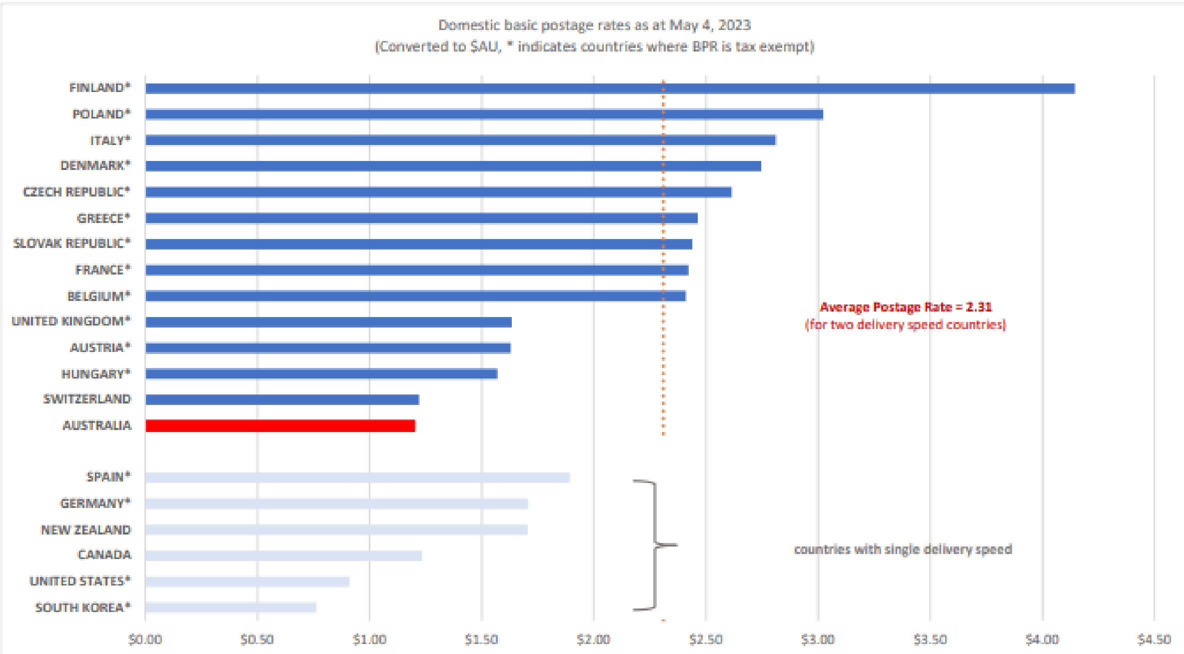
Australia Post last raised stamp prices in January 2023, after submitting a price notification to the ACCC in August 2022. Following an assessment process, the ACCC did not object to a 9.1% increase in the price of the notified services on the basis that Australia Post was not likely to recover revenue in excess of efficient costs for reserved and notified postal services over the period to 2023–24.

We note that the forecasts provided by Australia Post in support of its 2022 notification did not refer to the 25% increase proposed for 2024, and thus this was not considered in the ACCC's assessment of Australia Post's forecast revenue in our 2022 ACCC view paper.

Price increase in an international context

As per Figure 2, Australia Post's draft price notification sets out that even with a 25% increase, stamp prices will remain low in Australia in comparison to many other OECD countries that also offer two speed letter delivery.[33]

Figure 2. Basic postage rates in OECD countries with choice of delivery speed



*countries where basic postage rate is tax exempt

Source: Australia Post, *Draft price notification*, November 2023, p. 16.

Australia Post also provided a table, set out as Table 3, which shows that at the current small letter postage rate of $1.20, Australia Post's stamp price growth since 2018 is one of the lowest in the OECD.[34]

However, this table does not reflect the current draft price notification's proposal to increase stamp prices by a further 25%. Once the proposed 2024 increase is factored in, when compared to other OECD countries listed in the table, Australia Post will have the equal third highest basic postage rate growth since 2018.

33 Australia Post, *Draft price notification*, November 2023, p. 16.

34 Australia Post, *Draft price notification*, November 2023, p. 15.

Table 3. Basic postage rate growth in OECD countries (prices converted to $AUD using OECD purchasing power parities)

Country	2018	2023	Growth
Slovak Republic	$1.36	$2.44	80%
Finland	$2.52	$4.15	64%
Poland	$2.01	$3.02	50%
Hungary	$1.08	$1.57	46%
France	$1.67	$2.42	45%
Spain	$1.33	$1.89	42%
New Zealand	$1.20	$1.70	42%
Greece	$1.78	$2.46	38%
Belgium	$1.76	$2.41	37%
Denmark	$2.06	$2.75	33%
South Korea	$0.59	$0.76	30%
United Kingdom	$1.26	$1.63	29%
Italy	$2.23	$2.81	26%
United States	$0.72	$0.91	26%
Germany	$1.41	$1.71	21%
Czech Republic	$2.16	$2.61	21%
Australia	$1.00	$1.20	20%
Austria	$1.37	$1.63	19%
Canada	$1.15	$1.23	7%
Switzerland	$1.15	$1.22	6%

Source: Diversified Specifics, *Australia Post Letter Volume Demand Update*, July 2023, p. 13.

ACCC view

The basic postage rate remains lower than many international comparators

The ACCC considers that even following a 25% increase, the Australian basic postage rate will remain relatively low when compared to international comparators.

Table 4 illustrates the ACCC's analysis of Australia Post's basic postage rate rises over the past decade compared to other OECD nations. In 2013, Australia's ordinary domestic letter price of $0.60 ranked 26th out of 32 countries, and below the average price of $0.87. By 2018, Australia's letter rate of $1.00 became comparatively somewhat more expensive – ranking 21st out of 32, though still below the average for this year, which was $1.40.

In 2023, an ordinary stamp price of $1.20 saw Australia improve in terms of comparative affordability – moving back down to 25th on the list out of 32, below the average rate of $2.04. The proposed 2024 increase to $1.50 would take Australia up to 19th most expensive out of the 32 countries, but still below the projected average price for 2024 of $2.08.

In summary, while Australia's stamp price growth between 2013 and 2024 appears relatively high, this is off a low base, and Australia's nominal stamp price remains below the average price for comparable countries within this time span.

Table 4. Comparison of international ordinary letter postage rates ($AUD, nominal), ranked by price growth 2013-24

	2013	2018	2023	2024 (proposed)	Growth 2013-24
Iceland	$1.73	$8.20	$11.84		584%
Estonia	$0.67	$1.43	$2.16		222%
Finland	$1.19	$2.21	$3.82		221%
Slovenia	$0.40	$0.63	$1.25		213%
New Zealand*	$0.63	$1.12	$1.84		192%
Poland	$0.56	$0.94	$1.48		164%
Czech Republic	$0.71	$1.15	$1.84		159%
Ireland	$0.89	$1.57	$2.24		152%
Australia	$0.60	$1.00	$1.20	$1.50	150%
Greece	$0.81	$1.13	$1.99		146%
Belgium	$0.99	$1.36	$2.31	$2.43	145%
France	$1.26	$2.02	$2.76	$2.98	137%
Spain*	$0.55	$0.86	$1.30		136%
Latvia	$0.86	$0.89	$1.99		131%
Netherlands	$0.80	$1.30	$1.68	$1.81	126%
Denmark	$1.19	$1.27	$2.68		125%
USA*	$0.50	$0.69	$1.01	$1.04	108%
Slovak Republic	$0.74	$0.78	$1.50		103%
Italy	$1.04	$1.49	$2.08		100%
Portugal	$0.53	$0.83	$1.01		91%
Luxembourg	$0.89	$1.10	$1.66		87%
Sweden	$1.17	$1.62	$2.18		86%
Canada*	$0.65	$1.04	$1.19		83%
Austria	$0.92	$1.10	$1.58		72%
Switzerland	$1.02	$1.18	$1.55	$1.72	69%
UK	$0.89	$1.03	$1.43		61%
Germany*	$0.89	$1.10	$1.41		58%
South Korea*	$0.33	$0.40	$0.50		52%
Norway	$2.15	$2.83	$2.97	$3.25	51%
Lithuania	$0.67	$0.71	$0.91		36%
Japan	$0.86	$1.00	$0.86	$1.12	30%
Hungary	$0.84	$0.93	$0.92		10%

Price below 10th percentile for given year   Price above 90th percentile for given year

* Countries with single-delivery speed only.

Notes: Ordinary letter postage rate refers to the base price of the cheapest available domestic letter product sent at the regular timetable. The ordinary letter products offered vary between countries in terms of maximum weight, dimensions, and delivery speed, and thus the table should be treated as an indicative guide only. The table compares OECD nations, excluding those with a current GDP per capita below AUD$25,000 (Chile, Colombia, Costa Rica, Mexico, Turkey) according to World Bank data. The table does not include Israel, as the Israel Post website was unavailable at the time of writing. Prices accurate as of 24 November 2023. Local prices have been converted into $AUD using currency exchange rates published by the Reserve Bank of Australia as of 23 November 2023 (for 2023 and 2024 prices), 23 November 2018 (for 2018 prices), and 22 November 2013 (for 2013 prices). Growth rate refers to nominal price growth – local rates of inflation would impact price growth in real terms.

Sources: Respective operator and regulator websites, annual reports.

3. Consumer and business impacts

Draft price notification

In relation to the impact of the proposed price increase on consumers, Australia Post commissioned KPMG to undertake community sentiment research in 2022. We note that this research was conducted in advance of the 2022 price notification, and that community sentiment has not been tested in relation to the currently proposed 25% increase.

The KPMG research estimated that 57% of Australians send letters, with those aged 55 and over more likely to send letters than younger Australians. KPMG found that of consumers who do send letters, the average person sends around 15 per year. This means the 30 cent stamp price increase would amount to an increased cost of around $4.50 per consumer per year, if consumers send only small letters.[35]

In relation to the impact on small businesses, the KPMG community sentiment research from July 2022 estimated that the average small business sends 68 letters per year.[36] This is vastly below the volume which is eligible to access Australia Post's bulk business rates, which are only offered to businesses sending at least 300 letters per occasion.[37] Consequently, based on the KPMG research, for the average small business, a 30 cent stamp price increase would amount to an average extra cost of $20.40 per small business per year.

As part of its draft price notification, Australia Post provided an additional forecast for how the price increase would impact small to medium businesses.[38] Australia Post categorised small to medium businesses across the following tiers to estimate an average additional cost per year:

- 77% of small to medium business customers spend less than $1,000 per year, and would incur an average annual increase of $38
- 15% of small to medium business customers spend between $1,001 and $5,000 per year, and would incur an average annual increase of $562
- 7% of small to medium business customers spend between $5,001 and $50,000 per year, and would incur an average annual increase of $3,356
- 1% of small to medium business customers spend more than $50,000 per year. Australia Post did not provide data on the average annual increase for this group. [39]

[35] KMPG, *Community Sentiment Research - Exploring reactions to a potential stamp price increase*, July 2022, p. 8.
[36] KMPG, *Community Sentiment Research - Exploring reactions to a potential stamp price increase*, July 2022, p. 8.
[37] Australia Post, *Bulk Mail Options*, accessed 9 January 2024.
[38] Australia Post, *Draft price notification*, November 2023, p. 14.
[39] Australia Post, *Draft price notification*, November 2023, p. 14.

Submissions received

Survey responses

The ACCC received 235 survey responses to the consultation on Australia Post's draft price notification. Of these, 164 (70%) responded as individuals and 71 (30%) as representatives of businesses. Most respondents (219, or 93%) opposed the proposed price increase. They consisted of 154 responding as individuals and 65 as representatives of businesses.

13 respondents (6%) supported the proposed price increase, consisting of 9 responding as individuals and 4 as representatives of businesses. The remaining 3 respondents (1%) neither supported nor opposed the proposed price increase.

Among surveyed individuals who opposed the price increase, the most common reason given – by 108 (70%) of respondents – was that the proposed price increase was excessive. Respondents raised concerns including cost-of-living pressures and the increase being above the current rate of inflation. Some typical comments from individuals in this group were as follows:

> *"I think the increase is too high in one jump."*
>
> *"25% increase for postage stamps is way too high and is not in line with current inflation."*
>
> *"With the cost of living increasing so rapidly, the last thing we need is an increase in postage."*
>
> *"A 25% increase in postage is too much in one go. I would not be so upset by a smaller increase."*
>
> *"The proposed 25 per cent increase could impose an excessive financial burden on Australian consumers."*
>
> *"Cost of living pressures are increasing in all areas, this does not need to be included."*[40]

Among representatives of businesses who opposed the stamp price increase, 41 (61%) argued that the proposed increase is excessive. Some typical comments from representatives of businesses in this group were as follows:

> *"This is a HUGE increase and should NOT be allowed given the cost of living crisis that consumers & businesses are going through."*
>
> *"The increase is far greater than CPI (over the last 12 months to June 2023 the increase was 6%)."*
>
> *"There has been too many increases in recent years. 25% increase as suggested here is outrageously high."*
>
> *"It seems that the price increase is higher than the rate of inflation and it is also higher than the price increases of similar services."*[41]

Further, 37 (55%) business respondents argued that the proposed stamp price increase would be detrimental to small business. Respondents referred to the negative impact the increase would have on company budgets, and indicated that they would have no choice but

[40] ACCC, *Australia Post draft price notification 2023 survey response summary*, October 2023.
[41] ACCC, *Australia Post draft price notification 2023 survey response summary*, October 2023.

to pass the increased costs on to consumers. This was particularly so for small businesses who engage in e-commerce. Some typical comments from representatives of businesses in this group were as follows:

> *"This cost cannot be absorbed by a business sending out small items and so it will be passed on to the unsuspecting, already financially-stretched consumer."*
>
> *"A 25% increase in cost would be an enormous strain on our budget."*
>
> *"As a small business that sends 90% of their items to customers by letter rate this will impact us very much."*
>
> *"Postage already affects our margins and this would put many small business out of business."*[42]

Among those who supported the price increase were representatives of several local post office businesses. Some comments we received from such businesses via our survey include:

> *"The extra revenue for us as Licensees would be a great help in increasing our revenue and helping us to remain economically viable."*
>
> *"This increase will help our Licensed Post Office's bottom-line and make our business more viable. The extra revenue will enable us to reinvest the funds back into business. Please approve this increase."*[43]

Written submissions

The ACCC also received 7 written submissions in response to our consultation. Six of these submissions (86%) opposed the proposed price increase, noting, among other things, the detrimental impact the increase could have on small businesses. Hunter Water particularly noted that they would be required to pass the increase directly onto consumers.[44]

The 1 written submission which supported the increase was received from Post Office Agents Associated Limited (POAAL). POAAL argued in favour of the increase, for reasons including that post office licensees have adjusted their business plans to take into account the decline in stamp sales, the reduction in bulk mail volumes, and variations in foot traffic.[45]

ACCC view

The proposed price increase will affect different consumers differently

We acknowledge the large number of survey respondents who opposed the price increase on the basis that the magnitude of the increase was too high, creating affordability issues. On the basis of the KPMG research, the proposed increase may result in an average annual

42 ACCC, *Australia Post draft price notification 2023 survey response summary*, October 2023.
43 ACCC, *Australia Post draft price notification 2023 survey response summary*, October 2023.
44 Hunter Water, *Submission to ACCC consultation on Australia Post draft price notification*, September 2023.
45 Post Office Agents Association Limited, *Submission to ACCC consultation on Australia Post draft price notification*, September 2023.

increased cost of $4.50 for consumers who send only small letters. If consumers also send larger letters, the cost impact will be higher. For example, if a consumer sent 15 large letters up to 125 grams, this would be an increased annual cost of $9 per year, and if a consumer sent 15 large letters between 125 grams and 250 grams each year, this would be $13.50 extra.

We also highlight that the increase in ordinary letter prices is likely to disproportionally affect consumers who send larger volumes of mail, including older Australians. KPMG found that Australians aged over 55 were more likely to buy stamps than younger Australians.[46] Affordability issues for older Australians and concession card holders may be ameliorated to a large extent by Australia Post's retention of current concession and seasonal greeting card stamp prices, which remain at $3 for 5 concession stamps and 65 cents for seasonal greeting card stamps.

Concession card holders[47] are entitled to purchase 50 concession stamps annually. The ACCC acknowledges that some concession card holders may send more than 50 letters per year. However, the KPMG research provides some assurance that most consumers are unlikely to send letters in such quantities, and any impact from the proposed increase would only have an effect on concession card holders after sending 50 letters at the concession rate.

The ACCC considers that the proposed price increase is likely to affect consumers differently, depending on the number, size, and type of letters sent by the consumer, and the consumer's ability to access concession options.

Ordinary letter prices may present challenges for some small businesses

We acknowledge that many small businesses will be unable to utilise discounted bulk business mail services offered by Australia Post, which, as noted above, are only offered to businesses sending at least 300 letters per occasion.[48]

These businesses may also send large (up to 250 grams) rather than small letters, and in both cases the financial impact will be greater. For example, following the ordinary letter price increase, a small business that sends 295 small letters per year would face an additional annual cost of $88.50. For a small business who sends 295 large letters per year, the additional cost could be up to $265.50.

Further, as noted above, Australia Post's own analysis of small to medium business spend on mail services indicates that the average annual impact of the proposed price increase will range from $38 to $3,356, with 15% of business customers (spending between $1,001 and $5,000 per year) expected to incur an average annual increase of $562, and 7% (spending between $5,001 and $50,000 per year) expected to incur an average annual increase of $3,356.[49] Facing these additional expenses, some small to medium businesses may elect to use electronic forms of communication instead of post, but others are reliant on physical letter mail to carry out their business.

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46 KPMG found that 62% of those aged over 55 bought stamps, 63% of retirees and pre-retirees bought stamps, and 51% of those holding a pensioner concession card bought stamps. In contrast, only 20% of those aged 16-24 bought stamps. KMPG, *Community Sentiment Research - Exploring reactions to a potential stamp price increase*, July 2022, p. 13.

47 Holders of a Pensioner Concession Card, Health Care Card, Commonwealth Seniors Health Card, Department of Veterans' Affairs Card or Veterans' Repatriation health Card. Source: Australia Post, *Concession stamps*, accessed 17 January 2024.

48 Australia Post, *Bulk Mail Options*, accessed 9 January 2024.

49 Australia Post, *Draft price notification*, November 2023, p. 14.

We note the ministerial direction requiring the ACCC to give special consideration to certain sections of the Postal Act when assessing a price notification,[50] particularly the Postal Act requirement that Australia Post should ensure the letter service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business.[51] In this context, we highlight that the proposed price increase may disproportionally affect the small to medium businesses who will be subject to an average annual impact of $563 to $3,356 (or more) as a consequence of the increase and who are not able to rely on electronic communication as an alternative to post.

The ACCC considers that Australia Post should explore methods to ameliorate the affordability issues identified for these small to medium business customers under the proposed pricing. For example, this could take the form of a discount or rebate based on an annual spend beyond a certain threshold – in addition to the relatively modest concessions provided for sending bulk business mail.[52]

With regard to the survey responses and written submissions detailed above, we consider it likely that businesses will pass on the price increase directly to their customers, which may have impacts for consumer willingness to purchase from these businesses. It also means that the average consumer impact is likely to be greater than $4.50 to $13.50 as described above.

The ACCC considers that the impact of the proposed price increase is likely to affect small businesses differently, depending on how each business operates. For some small businesses, particularly those who engage in e-commerce delivered using letter products or who send bills or information via post due to consumer needs, the increase is likely to have a more significant effect than on others.

Australia Post does not appear to be taking advantage of its market power in setting prices

Under section 95G(7)(b) of the CCA, when assessing a proposed stamp price increase, the ACCC must have particular regard to the need to discourage a person who is in a position to substantially influence a market for goods and services from taking advantage of that power in setting prices. Given Australia Post's reserved ordinary letter service represents a statutory monopoly for the purposes of section 95Z of the CCA, it is appropriate to consider whether Australia Post is taking advantage of this market power with the magnitude of price increase proposed.

As outlined in the *Statement of regulatory approach to assessing price notifications under Part VIIA of the CCA*, the ACCC considers that the matters in section 95G(7) require an assessment of the efficiency of a regulated firm's cost base (addressed in Chapter 5 of this report) and the rate of return that it is seeking. The proposed price increase is then assessed having regard to the firm's ability to recover revenue sufficient to cover the efficient cost of providing a service, including a rate of return commensurate with the risks faced by the firm, without generating excessive or monopoly profits.

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50 General Direction 11 made under section 20 of the *Prices Surveillance Act 1983*.

51 Section 27(4) of the Postal Act.

52 Australia Post currently offers bulk discounts to businesses sending a minimum of 300 articles at once, including PreSort (8.3% discount for sending to same state, 5.83% discount for sending to other state) and Clean Mail (1.25% discount). Comparisons refer to small letters up to 125g, sent at the regular timetable, which meet the lodgement requirements of the above services.

As expressed in Chapter 8 of this report, the ACCC has come to the view that revenue produced following the proposed stamp price increase is unlikely to result in an excess above efficient costs for the period 2023–24 to 2025–26.

While the ACCC acknowledges that Australia Post's proposed price increase may present affordability issues, particularly for some small businesses, we do not consider the price increase proposed suggests that Australia Post is taking advantage of its market power in setting the price of the notified letter services.

4. Letter volumes

Australia Post's letter volume demand forecasts are used to assess whether its proposed price increase is expected to achieve sufficient revenue to recover costs, without providing excessive returns. This forecast is also relevant to assessing Australia Post's cost forecasts, as the volume of letters sent impacts on estimated future operational costs.

Draft price notification

In the draft price notification, Australia Post has noted that letter volumes have been declining in Australia and internationally for several years. This has largely been driven by e-substitution, which has resulted in a migration away from traditional letters to digital communication platforms. Australia Post expects that this trend of declining letter volumes will continue for the duration of the assessment period of this draft price notification.[53]

Letter volume forecasts

Australia Post submitted 3-year demand forecasts in its draft price notification, which are based on volume decline forecasts by Diversified Specifics. Australia Post then applied augmentation to these base rates to derive the decline rates it uses for the volume forecasts (see below section 'Australia Post's forecasting method').

Table 5 below shows Diversified Specifics' base rates of volume change, before Australia Post's augmentation. It estimated an average volume decline of 11.3% annually from 2023–24 to 2025–26 with the proposed price rises, and 8.7% without the proposed price rises.

Australia Post's forecasting method

Australia Post's approach to forecasting letter demand is broadly consistent with the approach that it has used in its price notifications since 2010. The approach to letter demand forecasting comprises two key parts:

- Australia Post engaged Diversified Specifics to construct baseline volume forecasts for each of its key letter volume segments
- Australia Post then undertook in-house augmentation of the baseline forecasts, using management intelligence and insights about emerging market trends.

Diversified Specifics uses econometric models to forecast domestic letter volumes by segment for the 3-year period from 2023–24 to 2025–26 across five letter segments. The econometric methods used vary by letter segment given econometric testing of the actual data. Vector error correction modelling (VECM) and dynamic ordinary least squares (DOLS) represent the primary modelling techniques. The VECM framework nests the structural and cyclical components of letter volume trends into a methodology that allows an examination of short and long-run fluctuations in letter volumes and their relevant drivers. DOLS techniques are also employed to improve the precision of the long-run parameter estimates for some letter segments because of data availability or the presence of structural breaks.

53 Australia Post, *Draft price notification*, November 2023, p. 17.

Table 5. Australia Post letter volume rates of change – base forecasts by Diversified Specifics (%)

Segment[54]	2023-24	2024-25	2025-26	Average[55]
Projected percentage change in volume with price rises				
Other small	-12.3	-13.0	-13.1	-12.8
PreSort small	-14.3	-10.1	-6.3	-10.3
Other large	-9.7	-10.0	-9.3	-9.7
PreSort large	-10.0	-13.0	-10.5	-11.2
Print Post	-21.1	-22.1	-12.3	-18.6
Total letters	**-13.9**	**-11.5**	**-8.4**	**-11.3**
Projected percentage change in volume without price rises				
Other small	-12.1	-12.0	-12.1	-12.1
PreSort small	-8.9	-6.5	-6.3	-7.2
Other large	-9.6	-8.8	-8.1	-8.8
PreSort large	-8.7	-6.5	-7.6	-7.6
Print Post	-16.9	-12.7	-12.3	-14.0
Total letters	**-10.1**	**-8.1**	**-8.0**	**-8.7**

Source: Australia Post, *Draft price notification*, November 2023, p. 18.

To derive the final volume forecasts, Australia Post augmented Diversified Specifics' baseline forecasts using internal management and market insights. According to Australia Post's draft price notification, these management and market insights were derived from:

- input from the salesforce, account managers regarding customer behaviour
- market intelligence from participants in the mail value chain
- information in the public domain
- interpretation of qualitative and quantitative reports commissioned by Australia Post and external sources
- underlying market changes including consolidation of mailings, changes in cycles e.g. monthly to quarterly, potential targeted activities or events
- information about changes in use of communication media – moving customers to online, digital communication, paying online, and large mass communication activities e.g. the federal election, the census.[56]

Table 6 presents Diversified Specifics' and Australia Post's letter volume demand forecasts for the period 2023–24 to 2025–26.

54 Other small letters comprise full-rate ordinary small letters.
PreSort small letters comprise bulk (300+) lodgements with small letter category size and weight requirements, e.g., bills, statements, share notices; public sector notifications and correspondence e.g., welfare, elections; promotional mail e.g., direct mail, brochures and other addressed advertising materials; charity mail for e.g., fundraising. To be accepted as PreSort, letters must have been been machine-addressed, barcoded, and sorted into postcode ranges.
Other large letters comprise full-rate large letters up to maximum size 360x260mm, thickness 20mm and weight 500g.
PreSort large letters comprise bulk (300+) lodgements with large letter category size and weight requirements. To be accepted as PreSort, letters must have been been machine-addressed, barcoded, and sorted into postcode ranges.
Print Post comprises lodgements with Print Post category size and weight requirements e.g., magazines, periodicals and catalogues.

55 3-year geometric average.

56 Australia Post, *Draft price notification*, November 2023, pp. 52-55.

Table 6. Diversified Specifics and Australia Post demand forecasts, 2023-24 to 2025-26[57]

Period	2023/24				2024/25				2025/26			
	Diversified Specifics		Australia Post		Diversified Specifics		Australia Post		Diversified Specifics		Australia Post	
	$m	Δ%	$m	Δ%	$m	Δ%	$m	Δ%	$m	Δ%	$m	Δ%
Ordinary Small	299	-12.3	291	-14.7	253	-13.0	260	-10.7	226	-13.1	230	-11.5
Ordinary Large	45	-9.7	43	-14.0	39	-10.0	37	-14.0	34	-9.3	33	-10.8
Total Ordinary	344	-12.0	334	-14.6	292	-12.6	297	-11.1	259	-12.6	263	-11.4
PreSort Small	810	-14.3	819	-13.3	736	-10.1	737	-10.0	691	-6.3	652	-11.5
PreSort Large	34	-10.0	33	-13.2	29	-13.0	29	-12.1	26	-10.5	27	-6.9
Total PreSort	844	-14.1	852	-13.3	765	-10.2	767	-10.0	717	-6.5	679	-11.5
Print Post	80	-19.2	81	-18.2	66	-18.5	69	-14.8	63	-8.7	63	-8.7
Total Letters	**1,268**	**-13.9**	**1,267**	**-14.0**	**1,124**	**-11.3**	**1,133**	**-10.6**	**1,039**	**-8.3**	**1,006**	**-11.2**

	3-year average	
	Diversified Specifics	Australia Post
	Δ%	Δ%
Ordinary Small	-12.8	-12.3
Ordinary Large	-9.7	-12.9
Total Ordinary	-12.4	-12.4
PreSort Small	-10.3	-11.6
PreSort Large	-11.2	-10.8
Total PreSort	-10.3	-11.6
Print Post	-18.6	-14.0
Total Letters	**-11.2**	**-11.9**

Note: Diversified Specifics' change rates for Print Post are not applied to Large Member Associations Print Post. The rates shown here are derived from forecast demand figures for all Print Post, including Large Member Associations.

Source: Australia Post, *Draft price notification*, November 2023, pp. 53-55.

Historical trends

Table 7 presents year-on-year percentage changes in total addressed domestic letter volumes for the last three years covered by Australia Post's draft price notification.[58] The table also shows the overall decline in volume in the period 2007–08 to 2021–22 for each letter segment. Australia Post explains that letter volume reductions differ across each segment because the impact of the key volume driver, e-substitution, differs depending upon the unique communication and content characteristics of each letter service.

Australia Post's draft price notification noted that total letter volume declines in 2021–22 were softer than usual due to transitory demand stimulus flowing through the PreSort small letter service. Additional mail was attributable to factors including the federal election and increases in the Reserve Bank of Australia's official cash rate which triggered lending

[57] Australia Post, *Draft price notification*, November 2023, pp. 53-55.

[58] Australia Post, *Draft price notification*, November 2023, p. 17.

institutions into sending letters to alert customers of changes to their mortgage commitments.[59]

Table 7. Total addressed domestic letter volumes, 2007-08 to 2021-22[60]

	Percentage change (%)				Share of total letters
Segment	**2019-20**	**2020-21**	**2021-22**	**2007-08 to 2021-22**	**2021-22**
Other small	-12.5	-13.6	-9.6	-78.0	25%
PreSort small	-11.0	-10.1	-1.0	-55.4	62%
Other large	-10.5	-12.4	-2.9	-74.7	4%
PreSort large	-20.1	-15.2	8.7*	-76.0	3%
Print Post	-21.3	-12.9	-1.9	-66.2	6%
Total letters	**-12.3**	**-11.4**	**-3.2**	**-66.5**	**100%**

*Australia Post explains that this figure is impacted by the August 2021 Australia census.

Source: Australia Post, *Draft price notification*, November 2023, p. 17.

Price elasticity of demand

As set out in Table 8, Australia Post estimates that the price elasticity of demand for each segment of letters is inelastic. This means that the decline in volume of letters is not explained by price increase. According to Australia Post, the volume erosion is largely driven by accelerated e-substitution and a relatively stable letter rate. Diversified Specifics' econometric baseline projections emphasise minimal long-term demand effects resulting from the proposed 2024 price rises. Instead, total letter volume erosion is expected to be primarily driven by e-substitutive pressures by 2025–26, irrespective of any price increase.[61]

Table 8. Price elasticity of demand

		2022 update	2023 update
Small letter	Ordinary/other	-0.15	-0.38*
	PreSort	-0.55*	-0.45*
Large letter	Ordinary/other	-0.18	-0.38
	PreSort	-0.47*	-0.65
Print Post		-0.06*	-0.65

* *denotes statistically insignificant*

Source: Australia Post, *Draft price notification*, November 2023, p. 18.

Submissions received

We received 1 submission regarding Australia Post's letter volume demand, from Post Office Agents Associated Limited (POAAL). POAAL argued that e-substitution of letters has been occurring for some years, and that digital is the first choice of communications channel for a

59 Australia Post, *Draft price notification*, November 2023, p. 17.
60 Australia Post, *Draft price notification*, November 2023, p. 17.
61 Australia Post, *Draft price notification*, November 2023, p. 17.

growing number of Australians. POAAL considers the downward trend in letter volumes is clear, and that Australia Post's forecast rate of letter volume decline seems realistic.[62]

ACCC view

Assessment of Diversified Specifics' baseline forecasts

The econometric modelling approach adopted by Diversified Specifics to generate the baseline demand forecasts is very similar to its previous approach for the 2022 price notification. In the 2022 price notification, several refinements were made to account for the impact of COVID-19 and variable specification.

Diversified Specifics has continued this process of refinement in 2023. In particular, Diversified Specifics has embedded a provision for cost-of-living increases into the PreSort small letter volume model, to address the link between the general level of inflation, interest rate rises, and the increase in banking customers who are notified by mail when their mortgage repayments rise.

However, the ACCC remains concerned about Diversified Specifics' use of principal component analysis to construct an electronic substitution variable, particularly in relation to the source data used. This includes whether they represent alternative e-communications technologies, and whether the combined series, using principal component analysis, properly measure online connectivity for bill payment and presentation.

While principal component analysis is useful as a means of combining different series into a single summary measure, it offers no real insight into the individual effects of any of its components. In Australia Post's 2023 draft price notification and the Diversified Specifics report, no decomposition of this measure is provided, and it may well be that only 1 or 2 of the data series account for most of the variation.

Assessment of Australia Post's augmentations

In response to previously expressed concerns by the ACCC about the transparency, justification, and consistency of the augmentation by Australia Post of the Diversified Specifics forecasts, Australia Post has provided more detail on its post-modelling adjustments in the 2023 draft price notification. The adjustments are separated into transactional[63] and promotional[64] adjustments, and each in turn into underlying market changes and changes in communications medium.

However, there is no explanation of the reasons for these adjustments, and insufficient clarity to assess whether the adjustments double count effects already captured in Diversified Specifics' modelling. Nonetheless, Australia Post's adjustments are mostly small in magnitude, including against the 2022 price notification, and we consider they will therefore not materially affect the forecasts.

62 Post Office Agents Association Limited, *Submission to ACCC consultation on Australia Post draft price notification*, September 2023.

63 Transactional adjustments are for utility, phone and internet bills, bank account and credit card statements, etc., being -0.4%, -1.2% and -1.3% of Diversified Specifics' volume forecasts for 2023–24, 2024–25 and 2025–26, respectively.

64 Promotional adjustments are for brochures and other addressed advertising material, being 0.3%, 2.0% and -1.9% of Diversified Specifics' volume forecasts for 2023–24, 2024–25 and 2025–26, respectively.

Comparison of historical forecasts against actual demand

Over the four years from 2019–20 to 2022–23, Diversified Specifics' forecasts for volume demand for each of the five letter segments was closer to the actual volumes observed compared to Australia Post's augmented forecasts. Both Diversified Specifics and Australia Post tend to over-forecast ordinary small letter volumes. Diversified Specifics slightly over-forecasts ordinary large letters, while Australia Post slightly under-forecasts ordinary large letters. Both Diversified Specifics and Australia Post significantly under-forecast PreSort large and small letter volumes. Over time, the tendency has been for all letter forecasts to move from over to under forecasting.

Price elasticity of demand

The forecasted price elasticities of demand are considerably larger in magnitude in this update when compared to the previous update. However, neither of the small letter (ordinary and PreSort) estimates are statistically significant. The significantly larger price elasticity of demand in the 2023 update could be a consequence of the increase in the number of observations and inclusion of additional variables. They could also be because consumers are increasingly realising that sustained price increase in recent years have become permanent, and are therefore looking for alternatives.

ACCC views on demand forecasts

The ACCC recognises that there is inherent uncertainty when trying to determine forecasts for letter volume demand, particularly considering the significant rise of e-substitution and changes to the way postal services are used. It is also unclear how Australia Post's letter volume demand forecasts will be impacted by anticipated operational changes (including proposed changes to Australia Post's delivery model).

The ACCC remains concerned about Australia Post's augmentation of Diversified Specifics forecast results because there is limited transparency and justification of these adjustments. We encourage Diversified Specifics and Australia Post continue to refine their modelling process in line with the ACCC's comments, including improving the transparency of their post-modelling adjustments.

Having said that, the ACCC accepts the volume demand forecasts provided by Australia Post for the purposes of this draft price notification.

5. Costs and operational efficiency

The ACCC has adopted a cost-based approach to assessing whether Australia Post's proposed price increase for its notified letter services are justified.

Under this approach, the ACCC seeks to compare the revenue earned by Australia Post through the proposed price increase with an efficient cost base. An efficient cost base in this context reflects those costs which would be incurred by a hypothetical efficient operator supplying letter services and operating to maximum efficiency in line with world's best practice.

To inform this assessment, the ACCC engaged consultancy firm WIK Consult to assess the efficiency of Australia Post's letter operations and compare this with international postal operators.

Draft price notification

Australia Post's forecast costs

As set out in Table 9, Australia Post forecasts that its costs for the reserved letter services will decline by 13%, from $1.67 billion in 2022–23 to $1.46 billion in 2025–26. This reduction in costs is largely driven by efficiency measures and expected changes to Australia Post's letter delivery model following the postal services modernisation review.

Table 9. Costs (nominal, $m) of Australia Post's reserved letter services

	2021–22 (actual)	2022–23 (actual)	2023–24	2024–25	2025–26
Total reserved services ($m)	1,599	1,668	1,685	1,497	1,456

Source: Australia Post, *Draft price notification*, November 2023, p. 39.

Australia Post's draft price notification sets out Australia Post's costs by major category. These comprise:

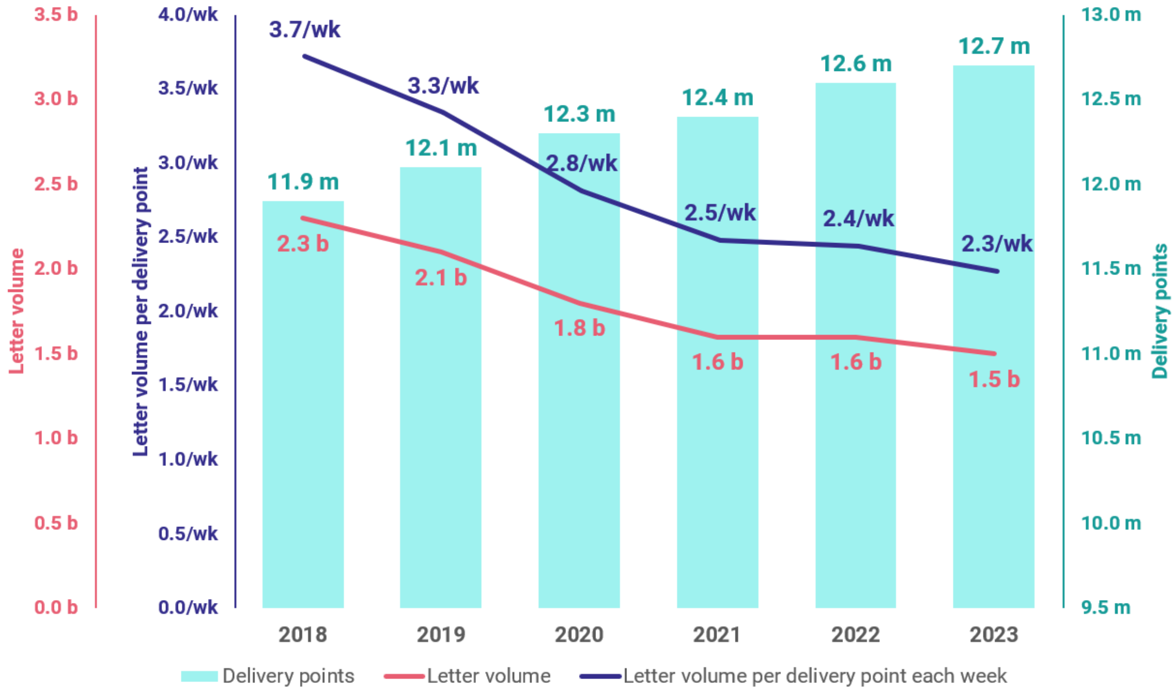
- labour and oncosts
- superannuation
- goods and services for sale
- accommodation
- depreciation
- carriage of mail
- licensed post office (LPO) and franchising expenses
- other.[65]

65 Australia Post, *Draft price notification*, November 2023, p. 32.

Labour and oncosts and carriage of mail make up the largest share of Australia Post's overall costs.

For reserved letter services, delivery is the cost function with the highest share of costs. As set out in Figure 3, letter volume has declined against a concurrent and consistent increase in delivery points. Australia Post is now delivering only 2.3 addressed letters to each delivery point per week on average, which can be compared to 3.7 in 2018.[66] This decrease of volume-to-delivery point ratio has implications for Australia Post's ability to reduce overall costs.

Figure 3. Australia Post addressed letter volumes and delivery points



Source: Australia Post, *Annual Report 2023*, p. 15; ACCC analysis.

To address this challenge, Australia Post has proposed a new delivery model. We understand that this proposed change to Australia Post's delivery model is the most significant driver of forecast future cost reductions.

Australia Post's efficiency measures

Australia Post's draft price notification explains that it operates an organisation-wide business efficiency program, covering aspects such as retail, network operations, customer experience, and support functions.

Some examples of specific efficiency measures that have been implemented between 2019–20 to 2022–23 include:[67]

- streaming of small parcels to posties, which Australia Post notes has resulted in a benefit of $49 million, but raises revenue and cost allocation issues as detailed in Chapter 6

[66] 2023: volume of 1.5 billion ÷ 12.7 million delivery points ÷ 52 weeks = 2.3 letters per delivery point per week
2018: volume of 2.3 billion ÷ 11.9 million delivery points ÷ 52 weeks = 3.7 letters per delivery point per week.

[67] Australia Post, *Draft price notification*, November 2023, pp. 20-21.

- a restructure of corporate metropolitan postie rounds to reduce the overall number of rounds, and which has resulted in a benefit of $26.5 million
- the introduction of electric delivery vehicles (eDVs) which enable posties to carry more items than the motorcycle fleet, which has resulted in a benefit of $10.6 million
- increased automation via the deployment of small parcel processing machines, resulting in a benefit of $8.8 million
- a variety of initiatives rolled out in letter processing, including:
  - improvements to machine processing and mail movements within facilities
  - the consolidation of metropolitan mail processing in Queensland
  - a reduction in the processing footprints in mail centres across Sydney, Melbourne, Newcastle, Adelaide, and Darwin.

  Cumulatively, these letter processing efficiency measures have resulted in a benefit of $49.7 million across 2019–20 to 2022–23.

In addition to these individual initiatives, Australia Post reports that the changes it is proposing to implement as a consequence of the postal services modernisation review will have a significant impact on its operational efficiency.

These changes are expected to include the reduction in letter delivery frequency to every second business day for 98% of delivery points,[68] which will be operationalised via a new delivery model, comprising 'light' and 'heavy' alternate day delivery rounds.[69] We note that these changes will affect Australia Post's efficiency and are subject to consultation in early 2024.[70]

Submissions received

We received 1 submission regarding Australia Post's cost forecasts, from Post Office Agents Associated Limited (POAAL). POAAL argued that Australia Post's costs are driven by the growing number of delivery points. POAAL considers that while most delivery points are in urban areas, there remain significant costs associated with regional and rural mail delivery, and that while delivery point density continues to be low in these areas, fuel costs continue to rise, which in turn increases delivery costs.[71]

POAAL's submission also addressed Australia Post's operational efficiency. POAAL argued that Australia Post may be able to drive efficiencies in its post office network by converting corporate post offices to LPO operations. POAAL also considers there are opportunities for Australia Post to further outsource its mail carriage operations, including mail pickup, line haul, and delivery. In this context, POAAL noted that Australia Post has used mail contractors to perform letter and parcel delivery for decades. In rural areas, many post office licensees also hold the local mail contract. Contracts are awarded following a competitive

68 M Rowland, *Ensuring Australia Post can deliver more for Australians* [media release], Minister for Communications, 6 December 2023, accessed 5 January 2024.

69 Australia Post, *Draft price notification*, November 2023, p. 22.

70 M Rowland, *Ensuring Australia Post can deliver more for Australians* [media release], Minister for Communications, 6 December 2023, accessed 5 January 2024.

71 Post Office Agents Association Limited, *Submission to ACCC consultation on Australia Post draft price notification*, September 2023.

tender process. POAAL considers that urban and suburban delivery in major metropolitan and regional centres could also be outsourced to contractors to drive further efficiencies.[72]

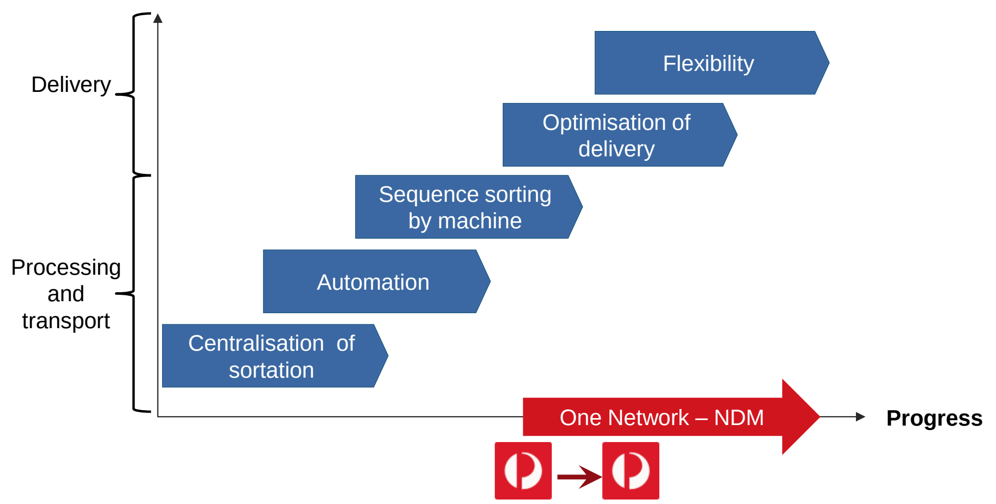
WIK Consult's findings on Australia Post's operational efficiency

The ACCC engaged WIK Consult to assess the efficiency of Australia Post's letter operations and to compare this with postal operators internationally. WIK Consult used the same international benchmark comparators as during its 2015 and 2019 efficiency reviews: Deutsche Post (Germany), La Poste (France), PostNL (The Netherlands), PostNord Denmark and PostNord Sweden.

WIK Consult observed that Australia Post's One Network Program – launched in FY2017 – helped Australia Post to gain ground on its international peers in terms of parcel operations efficiency over recent years.

In contrast, WIK Consult found Australia Post's efficiency gains in its letter operations to be limited. This lack of progress is largely attributed to a stagnation of letter automation, as well as capacity limitations associated with staffed delivery rounds. Figure 4 provides an overview of Australia Post's letter operations efficiency progress over recent years.

Figure 4. Australia Post efficiency progress in letter operations (2019-2023)



Source: WIK Consult, *Assessment of Australia Post's operational efficiency*, December 2023. p. iii.

Automation

During its previous 2019 review, WIK Consult found that in comparison to Australia Post, most of the international benchmark operators were far more advanced in terms of letter automation. Given all benchmark operators (apart from La Poste) had achieved high levels of automation up to 2019, WIK Consult observed during the current 2023 review that these operators have not needed to make further significant investments in automation. In contrast, WIK Consult found that Australia Post continues to trail its comparators by a wide margin on automation. As shown in Figure 5, WIK Consult assigned Australia Post's 2023

[72] Post Office Agents Association Limited, [Submission to ACCC consultation on Australia Post draft price notification](), September 2023.

automation levels the same ratings as in 2019 – highlighting the lack of progress made in this area.

Figure 5. Comparison of Australia Post automation levels in letter operations

	Australia Post (2019)	Australia Post (2023)	Deutsche Post (2018)	La Poste (2018)	PostNL (2018)	PostNord Denmark (2018)	PostNord Sweden (2018)
Sorting of large letters to rounds by machine	◕	◕	●	◕	●	●	●
Sorting of small letters into walk order by machine	◕	◕	●	◕	●	●	●
Minimising mail preparation in delivery centres	◔	◔	◕	◑	●	●	●
Separate manual sequence sorting from outdoor delivery (different persons)	○	○	◕	◔	●	●	●
Centralise manual sequence sorting	○	○	◕	◔	●	●	◕

Note: The assessment of international benchmark operators refers to the year 2018, noting that these operators have not required significant further investments since this time.

Source: WIK Consult assessment.

○ not implemented/applied
◔ implementation/application started
◑ ongoing implementation
◕ mostly implemented/applied
● largely implemented/applied

Machine sorting

WIK Consult found that Australia Post's proportion of small letters sequenced by machine stagnated between 2018 and 2023. According to WIK Consult, this share of letters sequence sorted by machine would have been expected to increase, given declining total letter volumes and the declining share of priority letters.

This means that in each of its 2015, 2019, and 2023 reviews of efficiency standards, WIK Consult regarded Australia Post's sequence sorting of small letters to be below international benchmarks. WIK Consult also noted that Australia Post has not achieved its self-defined targets in this area.

Optimisation of delivery

WIK Consult found that Australia Post slightly reduced its time share of indoor activities[73] between 2018 and 2023 – attributing this reduction to overall letter volume decline, as well as slight increases in parcel deliveries and efficiency measures (most notably, an increase in delivery points per round). WIK Consult identified the significant share of non-sequenced

73 Australia Post's delivery operation involves activities that are broadly categorised as 'indoor' (e.g. sorting procedures in a delivery centre) and 'outdoor' (e.g. a postal delivery officer delivering a letter to an address). A key performance measure is the amount of time spent on each type of activity.

items, as well as the streaming of parcels to posties, as the main barriers to Australia Post further reducing indoor activity time.

WIK Consult noted that the international benchmark operators had already achieved lower time shares for indoor activities in 2018, primarily thanks to high rates of letter sequence sorting. These operators also realised efficiency gains by separating manual mail preparation from outdoor activities, and the further centralisation of mail preparation in delivery centres.

Flexibility

WIK Consult found that while Australia Post's recent flexibility improvements have helped to improve efficiency, for example through an increase in the number of delivery points per round, they have not resulted in a reduced number of delivery rounds.

In response, Australia Post has argued that the total number of delivery rounds is driven by the growth in total delivery points (as discussed above), the increased number of packets and parcels delivered by posties, and the ongoing switch from motorcycles to 3-wheel eDV vehicles (which provide the capacity for more parcels, yet often result in a slower overall round speed). WIK Consult observed that many of the benchmark operators employ vans for joint letter and parcel delivery, which has resulted in improved delivery flexibility in the respective countries.

With specific regard to trials of its proposed new delivery model under the modernisation reforms, WIK Consult noted the demonstrated ability of Australia Post to increase flexibility by working closely with its employees.

Modernisation reforms

With regard to Australia Post's forthcoming modernisation reforms, WIK Consult acknowledged that the changes represent a way for Australia Post to realise efficiency savings by capitalising on the combined delivery of letters and parcels.

WIK Consult characterised the planned new delivery model as combining increased flexibility, while still maintaining traditional delivery methods ('one postie, one round'). WIK Consult also noted that the model is specific to Australia and represents a 'softer' solution than the alternate-day delivery employed during the COVID-19 temporary regulatory relief period, or models implemented by international comparators.

Australia Post expects productivity benefits from the new delivery model to include an increased number of delivery points per round, an increased number of mail items (volume density) per stop for heavy rounds, and an increased delivery travel speed for light rounds.[74]

Overall, WIK Consult considered Australia Post's proposed delivery model to be in line with international practice, while being less comprehensive than the models adopted by several overseas comparators.

However, compared to these international peers, WIK Consult found that Australia Post continues to lag in terms of implementing a delivery model which is responsive to the speed of letter volume decline in Australia.

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74 Australia Post, *Draft price notification*, November 2023, p. 22.

ACCC view

Australia Post has implemented a range of standalone efficiency measures over recent years, but the ACCC agrees with WIK Consult's overall assessment that Australia Post's operational efficiency lags its international peers.

That said, the ACCC considers that Australia Post's proposed delivery model changes (subject to 2024 consultation), including the shift to an every-second-day new delivery model, will have a significant impact on its costs and operational efficiency. We also note that international peers have adopted different operating models to respond to the unique characteristics in each market.

While the ACCC considers that the new delivery model and other business reforms should enable Australia Post to achieve further cost savings over the next 3 years, which could potentially reduce Australia Post's efficient costs, it is likely that Australia Post will continue to under-recover the costs of providing reserved services over the coming years. This is due to the ongoing predicted letter volume decline and concurrent continued increase in delivery points across Australia.

6. Cost allocation

Australia Post's draft price notification relates to its notified services (i.e. reserved ordinary letters delivered to the regular timetable). These, as noted above, are the only letter services which are declared and therefore subject to ACCC review of price increase.

In assessing Australia Post's justification for the proposed price increase, the ACCC has regard to the revenue required to support Australia Post's notified letter services. However, the notified letter services are a subset of the wider segment of reserved letter monopoly services.

The reserved letter services also share the use of some resources (for example, post offices and postal delivery officers) with non-reserved services such as the growing segment of parcels. Growth in the parcel delivery segment and e-commerce have been key contributors to revenue for Australia Post in recent years. The way in which shared costs are allocated between the various product groups is important for analysis of how Australia Post is recovering the costs of supplying monopoly notified and reserved letter services.

The ACCC requested that WIK Consult assess Australia Post's cost allocation model for the purposes of this draft price notification. We asked WIK Consult to consider the reasonableness of the allocation of Australia Post's direct and shared costs between reserved and non-reserved services, the appropriateness of the cost allocation model given the trend of declining letter volumes and increasing parcel volumes delivered by Australia Post, and potential improvements that could be made to the cost allocation model, building on the previous reviews and work undertaken by WIK Consult in 2015 and 2019.

Previous assessments of Australia Post's cost allocation model

For the ACCC's most recent price notification assessment in 2022, we reviewed Australia Post's cost allocation model internally, noting that a comprehensive review had last been undertaken by WIK Consult in 2019.[75] In 2019, the key findings included that while Australia Post's cost allocation model, as it then stood, had a number of weaknesses, it overall provided an adequate measure of Australia Post's historic costs for reserved letters, including the notified letter services.[76]

Draft price notification

Australia Post uses an Enterprise Profit Model (EPM) to allocate costs, assess profitability and support commercial pricing decisions. This incorporates a cost allocation model which allocates costs across the business between the various products and services, and between reserved and non-reserved services.

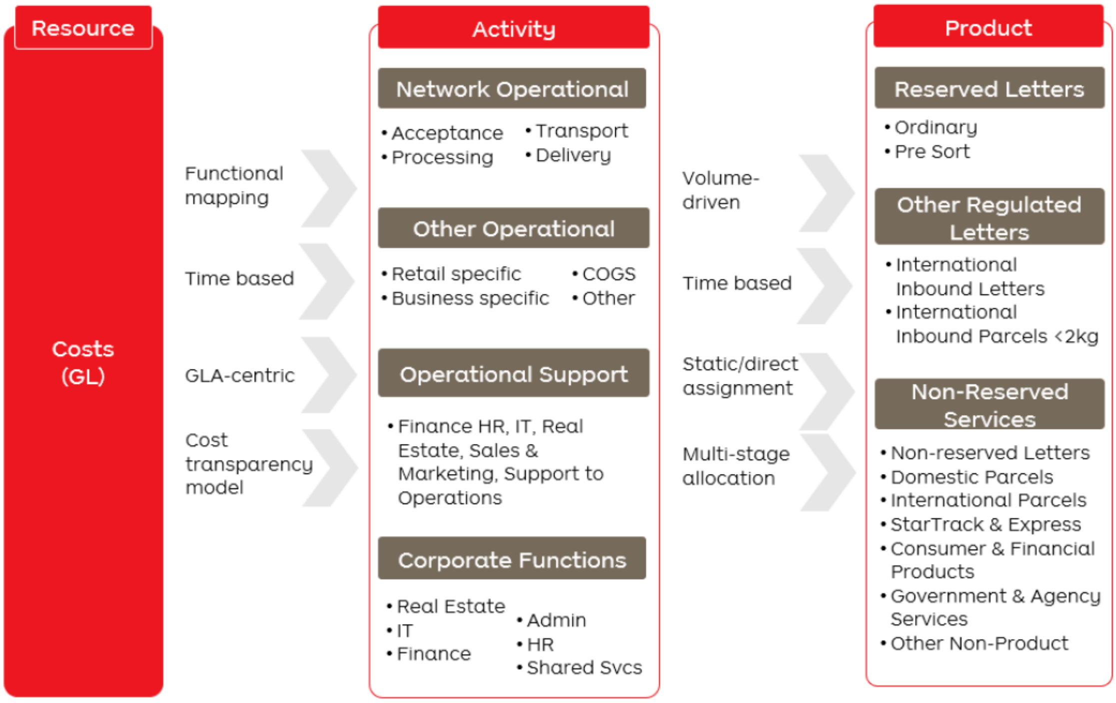
According to the draft price notification, Australia Post's costs are allocated using an 'activity-based costing' model. This approach identifies resource costs from the general ledger and assigns them to activities. These activities are then assigned to products and services primarily according to consumption. Wherever possible, costs are directly attributed to products.[77] Figure 6 illustrates Australia Post's current Enterprise Profit Model.

75 WIK Consult, *Assessment of Australia Post's cost allocation methodology and operations' efficiency – Executive Summary*, November 2019.

76 ACCC, *ACCC view on Australia Post's draft price notification*, November 2019, pp. 26-28.

77 Australia Post, *Draft price notification*, November 2023, p. 28.

Figure 6. Australia Post Enterprise Profit Model



Source: Australia Post, *Regulatory Accounting Procedures Manual*, July 2023.

Consistent with previous price notifications, this cost allocation methodology reflects a 'dual till' approach. Under this approach, Australia Post separates costs and revenues of its reserved services from its non-reserved services.

Submissions received

A small number of stakeholders responded through our survey and via written submission regarding Australia Post's cost allocation methodology. Of the survey respondents, 6 consumers (4%) and 3 business representatives (4%) expressed concerns around Australia Post's allocation of costs between the letter and parcel sides of the business, and encouraged the ACCC to consider whether any cross-subsidisation issues exist.

Some comments from business representatives include:

> *"[T]heir claim of publishing letter loss raises significant doubts about the transparency and accuracy of their financial assessment. It is imperative that the ACCC scrutinizes these claims with unwavering diligence. I believe an examination is required of whether Australia Post's financial reporting truthfully reflects the dual responsibilities of letter carriers who simultaneously handle small parcels."*
>
> *"[I]t is likely that there a discrepancies in financial reporting between the letter and parcel divisions, which are used as an attempt to justify the price increase - namely, that the letter division incurs costs against revenue (or lack thereof) from the parcel division."*
>
> *"[I query] the appropriate allocation of common costs."*[78]

[78] ACCC, Australia Post draft price notification 2023 survey response summary, October 2023.

Comments from individual survey respondents include:

> *"Have Australia Post's parcel delivery arm been taken into account when assessing these proposed cost increases?"*
>
> *"I think it might be prudent for Aust Post to call in Auditors to examine there business to look at their overall costs"*
>
> *"A comprehensive review of the cost of running Australia Post should be undertaken prior to approving an increase in postage."*
>
> *"I must insist on a rigorous examination of whether Australia Post's financial reporting truthfully reflects the dual role of letter carriers who simultaneously handle small parcels. Failing to account for this pivotal aspect of their operations could lead to a financial miscalculation that would unjustly burden consumers."*[79]

We also received written submissions expressing similar concerns. For example, Matthew Cummins argued that "there are substantial concerns about the financial transparency of Australia Post, especially concerning their claim of losses in the letter division. When analysing their assertions, it's pivotal to consider the dual role of letter carriers who not only deliver letters but also handle small parcels. The revenue from these parcel deliveries substantially benefits the parcel division, but it appears that the associated costs are disproportionately attributed to the letter division ... The ACCC must ensure that these financial claims are based on accurate and transparent data, not influenced by any artful accounting practices."[80]

Similarly, the Water Services Association of Australia submitted that "many of Australia Post's services are in competitive markets, while the letter service is a reserved monopoly service. As a firm, Australia Post must earn a reasonable return on its investment across its operations. However, this does not imply that genuinely common costs should simply be pro-rated against each product line. Indeed, in a declining segment it would be unusual in commercial markets for that segment to contribute the same amount to common costs as growing segments. The Water Services Association of Australia makes the point that so long as the letter service covers the incremental costs of its provision it cannot be said to be making a loss (incremental cost includes direct operating costs and directly attributable capital costs) ... Australia Post's submission suggests that it has adopted a version of fully distributed costs where costs are pro-rated across products by the level of activity: *"Australia Post uses an Enterprise Profit Model (EPM) to calculate the operational cost of 'reserved' and 'non-Reserved' services provided by Australia Post. The model is a fully absorbed costing model."* Water Services Association of Australia suggests the ACCC closely examine this practice in light of the above discussion."[81]

WIK Consult's findings

As noted above, the ACCC last undertook a comprehensive review of Australia Post's cost allocation model in 2019. Given the time that has now passed since that review, we asked

[79] ACCC, Australia Post draft price notification 2023 survey response summary, October 2023.

[80] Matthew Cummins, *Submission to ACCC consultation on Australia Post price notification*, September 2023.

[81] Water Services Association of Australia, *Submission to ACCC consultation on Australia Post price notification*, September 2023.

WIK Consult to comprehensively examine the cost allocation model to assist us in forming our view on this 2023 price notification.

Strengths of the cost allocation model

At a high level, WIK Consult found that the overall structure of Australia Post's cost allocation model has remained unchanged since 2019. WIK Consult found that Australia Post's model retains its previous strengths, such as:

- consistency with the ACCC's Record Keeping Rules for Australia Post
- consistency with Australia Post's financial accounts, General Ledger and externally audited accounts
- fully allocated costing, ensuring costs are fully accounted for
- its use as an internal management tool as well as for regulatory reporting.

WIK Consult also found that the relative proportional development of revenues and costs indicates, from a high-level top-down view, that Australia Post's cost allocation model broadly generates a relatively fair allocation of costs to services.

Changes to the cost allocation model since 2019

WIK Consult noted that Australia Post has implemented several significant updates to its business since its cost allocation model was last reviewed in 2019, and that these updates are now reflected in changes to the model.

WIK Consult found that it is appropriate for Australia Post to reflect major business changes to the cost model to ensure that the cost model accurately and prudently reflects the current structure of costs and allocation of costs to various services. WIK Consult also identified that an increasing number of products are differentiated in Australia Post's Enterprise Profit Model. WIK Consult considers these changes to be generally positive as these changes tend to make the outputs of the Enterprise Profit Model more precise.

WIK Consult also identified two major changes which have occurred since FY2019 and which affected the cost allocation to service categories, namely the implementation of Australia Post's delivery time standard update[82] and the increase in parcel and express volumes juxtaposed against the decline in letter volumes.

In relation to the delivery time standard update, WIK Consult found that this resulted in a structural shift from variable to fixed costs, which was reinforced for the domestic letter services due to the decline in letter volumes. As more than three quarters of the fixed costs were allocated to domestic reserved letters (before and after the delivery time standard update), this change resulted in a significant increase in activity costs for domestic letters. Conversely, the reduction in letter volume correspondingly reduced the variable cost allocated to domestic letters.

WIK Consult also identified that between FY2019 and FY2023 the share of fixed costs allocated to parcel and express services increased. However, this increase was too small to compensate for the structural shift following the delivery standard time update.

[82] The delivery time standard provides the delivery cost structure for the allocation of delivery costs to services. In the update, Australia Post undertook a field-based review of the time standards associated with the indoor and outdoor activities performed by postal delivery officers. For example, it considered travel, stop and delivery times across a sample of delivery addresses and modes (e.g. motorbikes, eDVs, electric bicycles) for different products.

WIK Consult considers this discrepancy is likely due to a shortcoming in the implementation of the delivery time standard update within the cost allocation model, specifically the research that Australia Post had undertaken to understand the effects of the delivery time standard update on the business.

According to WIK Consult, Australia Post has only undertaken limited research on the impact of the update on operations. WIK Consult notes that the research was undertaken in the pre-COVID-19 environment, has not been repeated since, used a small sample, and was only conducted through studies in the Melbourne metropolitan area.

Therefore, WIK Consult considers that the changes flowing from the delivery time standard update may not be representative of the delivery cost structure today for the business and corresponding allocation of delivery costs to services.

In addition to the above, WIK Consult has observed that the unit cost of domestic reserved letters has increased over recent years. This is due to the decline in letter volume and the mechanism with which Australia Post's model allocates fixed costs, such as those for delivery activities. Continued volume decline of reserved services will result in further increases in unit costs, in the absence of changes to Australia Post's operations.

Potential issues with the cost allocation model

Despite the strengths of the cost allocation model as listed above, WIK Consult also identified several weaknesses within the model:

- it is based on actual and not (necessarily) efficient costs
- it presents an ex-post cost allocation to products and services incurred at the corporation level
- it is not an integrated tool, so it does not allow an external user to calculate the impact of parameter changes and scenario calculations
- it does not generate forward-looking cost forecasts and is not integrated into a forecast model
- it does not provide the short or long-run incremental cost of a service.

Furthermore, WIK Consult's analysis raised concerns about the approach taken by Australia Post on cost allocation in some areas. These include:

- the sharing of the additional fixed cost of electric delivery vehicle (eDV) delivery between letter and parcel services
- the transfer pricing arrangements with StarTrack for using Australia Post's network
- the allocation of unattributable costs
- the allocation of linehaul cost
- the allocation of LPO subsidies only to reserved services.

According to WIK Consult, the above allocation issues indicate that higher costs have been allocated to reserved services than what would be appropriate under efficient cost causation principles.

Because the cost allocation model does not allow an external user of the model to simulate the financial impact of such structural changes on the cost allocated to a particular service, WIK Consult was not able to quantify the impact of these distortions on the overall costs of reserved services.

However, WIK Consult also found that correcting the cost allocation model to account for these issues would not likely make Australia Post's reserved services profitable in the absence of the proposed stamp price increase.

WIK Consult's recommendations

WIK Consult has recommended several enhancements to Australia Post's cost allocation model, for both management and regulatory purposes. These include:

- Australia Post should share the calculation of different forecast scenarios with the ACCC, which will allow the ACCC to better deal with uncertainties associated with Australia Post's forecasts
- relatedly, to allow the ACCC to properly assess the price notification, Australia Post should provide an analysis of the financial impact in the factual and the counterfactual (i.e. a base case versus different forecast scenarios)
- Australia Post should provide the absolute value of cost changes related to input price changes, volume changes, economies of scale, changes in the production process, and changes in economies of scope. The financial effects of each cost change factor should be provided for each product individually. This would be an extension of the decomposition of volume and price change effects which Australia Post provides for major cost input factors
- for major updates to the cost allocation model, Australia Post should analyse the impact of the update by comparing the profitability of the service in a year with the update applied against the previous corresponding period without the update applied
- currently, Australia Post provides financial impact calculations of model updates for reserved letters, non-reserved letters, and for total domestic letters. Australia Post should also provide this data for parcel post, express services, and StarTrack services
- currently, Australia Post allocates unattributable costs in a way which implies that these ought to be allocated to activities and to services, but WIK Consult considers this is not appropriate. Australia Post should allocate these costs at a high level according to an equi-proportionate mark-up rule to products or service groups
- restructuring costs should be separately identified, treated as unattributable costs, and allocated by an equi-proportionate mark-up rule
- Australia Post should provide the short-run and long-run incremental cost of certain loss-making reserved services. This information is necessary to assess the profitability of reserved and other services
- the StarTrack business is integrated within the cost allocation model in two different tracks. StarTrack firstly forms a separate product group within the model. Secondly, StarTrack services are integrated in the main body of the cost allocation model for activities which share common resources. Resources of the letter and parcel networks consumed by StarTrack are then allocated in a transfer price regime to StarTrack ex-post. WIK Consult recommends a contractually specified transfer price system to better enable the ACCC to control for competitive distortions
- Australia Post should make clear whether there are direct and indirect benefits for non-reserved services from the existence of a larger LPO outlet network. The cost allocation model currently allocates all subsidies paid by Australia Post to LPOs to reserved services only. This allocation is only correct under the assumption that non-reserved services do not benefit, either directly or indirectly, from having the larger number of LPO outlets that are supported by subsidisation

- Australia Post should conduct a new delivery time standard survey to update its delivery model, as detailed further above
- Australia Post should ensure that incremental costs are allocated according to cost causation. In particular, WIK Consult points out that Australia Post has increased the use of eDVs for delivering parcels and letters. eDVs cause higher fixed costs for delivery than motorcycles, but the increased costs of eDVs should be attributable only to parcel delivery.

ACCC view

The ACCC considers that it is appropriate for Australia Post's cost allocation model to be primarily driven by product volume. The use of volume as a key driver means the methodology by Australia Post correctly allocates increasing costs for products experiencing volume growth and less costs for products in decline.

We agree with WIK Consult that Australia Post's continued use of its cost allocation model to calculate the operational cost for reserved and non-reserved services is beneficial, given the strengths inherent in the model.

The ACCC notes that Australia Post has responded to and implemented recommendations made by WIK Consult in 2019 in relation to improvements to be made to the cost allocation model. We also recognise that Australia Post made several significant updates to its cost allocation methodology to reflect the various changes to its business since 2019. We consider that continually revisiting and updating the cost allocation model to ensure it reflects current conditions is positive, and that Australia Post should continue doing so.

However, it is vital that updates made by Australia Post to its cost allocation model are implemented accurately and based on sufficient evidence. The ACCC is concerned about WIK Consult's finding that Australia Post has not undertaken sufficient research to fully understand the impact of the delivery time standard update on operational costs and that the changes made to the cost model to reflect the impact of the update may not be representative of current business conditions. To ensure that the cost model produces accurate results, the ACCC agrees with WIK Consult's recommendation that Australia Post should conduct a more comprehensive study on the impact of the delivery time standard update.

The ACCC is also concerned about WIK Consult's finding that Australia Post's cost allocation method has the effect of inflating the costs allocated to reserved services, which increases the value of the estimated under-recovery. We have concerns that the method of allocating unattributable costs, such as from corporate overheads, may have the effect of disproportionately increasing costs allocated to reserved services. Further, we consider that Australia Post should more accurately capture the incremental costs of eDVs according to cost causation. In addition, it is particularly concerning that WIK Consult found Australia Post's current methodology provides it the flexibility to distort the cost allocation in favour of StarTrack to support its position in the parcel market. We acknowledge that WIK did not argue that the cost allocation system is strategically distorted, but nevertheless, the potential for it to be distorted raises concerns.

To better support our regulatory process, the ACCC considers that Australia Post should implement the changes recommended by WIK Consult. We repeat these and other recommendations in Chapter 9.

The ACCC notes WIK Consult's finding that correcting the cost allocation model to account for these issues would not likely make Australia Post's reserved services profitable in the absence of the proposed stamp price increase. In light of this finding, notwithstanding the above, we have accepted Australia Post's cost allocation model for the purposes of this draft price notification assessment.

7. Cost of capital

In assessing Australia Post's draft price notification, the ACCC has had regard to whether the estimated revenue generated is required to recover the efficient costs of providing its reserved services,[83] including a return on capital.

The weighted average cost of capital (WACC) is a commonly used approach for calculating the return on capital. It reflects the opportunity cost to investors and lenders of choosing to finance a firm's operations. The WACC estimates the expected rate of return on assets by combining the return on debt and equity weighted by the amount of debt and equity held by the firm.

To attract capital to fund activities, investors and lenders expect a business to earn at least a sufficient profit or cash flow to meet a required return in proportion to the risk of the business, while preserving the base capital provided.

While the WACC formula is simple to apply, the analysis that goes into determining each parameter can be contentious. Any assessment of WACC needs to consider the assumptions underlying the choice of values for key parameters, as they will impact the WACC calculation.

Draft price notification

In 2023, Australia Post again provided the 2022 report prepared by Deloitte Financial Advisory Pty Ltd (Deloitte), which contained an independent assessment of the WACC for the Australia Post reserved letters business.

ACCC view

The ACCC has reviewed the parameters proposed by Australia Post and compared these with parameters that the ACCC considers more reasonable based on its historical approach to calculating WACC for Australia Post price notifications. The ACCC's reasoning for adjusting each of the parameters proposed by Australia Post is set out in Appendix A.

The ACCC does not agree with Australia Post's value of gamma, the gearing ratio, and the value of the asset and equity betas.[84] The ACCC's lower value of nominal vanilla WACC is the result of lower asset and equity beta, and higher gearing ratio, offset by a higher market risk premium.

Table 10 compares the WACC input parameters proposed by Australia Post to the ACCC's view.

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83 The ACCC considers Australia Post's cost recovery for all reserved services, as the notified letter services share most of the same processing and delivery facilities as other reserved letter services.

84 Each of these variables is explained and discussed in Appendix A.

Table 10. Australia Post's weighted average cost of capital

WACC parameter	Australia Post proposal	ACCC view
Risk-free rate	3.92%	4.71%
Market risk premium	5.75%	6.20%
Corporate tax rate	30.00%	30.00%
Gamma (imputation factor)	0.00	0.57
Asset beta (β_a)	1.00	0.54
Equity beta (β_e)	1.04	0.90
Debt beta (β_d)	0.00	0.00
Gearing ratio (D/V)	5.00%	40.60%
Cost of equity	9.88%	10.32%
Cost of debt	6.89%	6.68%
Nominal vanilla WACC	**9.73%**	**8.84%**

Source: Australia Post, ACCC analysis.

Based on the ACCC's adjusted parameters, the ACCC considers that an alternative WACC of 8.84% is more appropriate than the 9.73% WACC proposed by Australia Post.

The impact on required revenue (discussed in Chapter 8 of this report) when the ACCC's alternative parameters are used is a reduction of approximately:

- $12 million, $11 million and $11 million for reserved services in 2023–24, 2024–25 and 2025–26 respectively.
- $1 million in each year for reserved ordinary letters in 2023–24, 2024–25 and 2025–26 respectively.[85]

The effect of this reduction in required revenue is relatively small and would not materially improve Australia Post's under-recovery for reserved services. This is because the return on capital accounts for approximately 1.2% of Australia Post's total required revenue for reserved services.

The ACCC notes that it sets the cost of capital in reference to an efficient comparable firm operating in Australia rather than the regulated business' actual financial statements. The ACCC considers that this approach balances the need for a firm to earn an investment grade rate of return, but not lead to monopolistic pricing, and provides an incentive to improve overall performance.

85 Further to the updated WACC parameters, these estimates include updated inflation estimates based on the Reserve Bank of Australia's November 2023 Statement on Monetary Policy.

8. Cost recovery

The ACCC's key consideration in assessing the proposed price increase is whether revenue generated by the proposed increase is sufficient to allow Australia Post to recover its efficient costs, without generating excessive or monopoly profits.

The ACCC typically considers a building block model provided by Australia Post to aggregate its full costs. The cost components of the building block model are:

- operating costs
- return of capital, representing depreciation of fixed assets
- return on capital, representing the required rate of return on the asset base
- tax allowances.

The sum of these building block elements represents the 'required revenue' to recover the costs of providing the reserved letter services. Required revenue represents a return covering the full economic costs of providing the services, as distinct from Australia Post's operating costs, which are a subset of full economic costs.

The type of building block model provided by Australia Post is a post-tax revenue model (referred to in this paper as the revenue model), meaning that the corporate tax allowance is a separate cost block in the model, so the rate of return is the return required after tax has been paid.

Draft price notification

In support of the draft price notification, Australia Post has provided the ACCC with the latest version of its revenue model, which sets out its forecast costs, revenue, and other inputs used to estimate its expected cost recovery and required revenue for the period 2023–24 to 2025–26.

The draft price notification emphasises that 'as a Government Business Enterprise, the expectation is that Australia Post will operate and price efficiently and earn a commercial rate of return.'[86] The required revenue Australia Post will need to achieve this objective for reserved ordinary letters, domestic reserved letters, and domestic letters, are set out in Table 11. Both nominal values and present values[87] are shown, the latter being useful for summation across years.

The revenue recovery figures in Australia Post's model include the additional revenue expected from the currently proposed price increase for both notified and non-notified reserved services, as forecast by Australia Post in this draft price notification. They rely on Australia Post's assumptions around factors such as future letter volumes, costs, inflation, and the rate of return on capital. These forecasts do not include future possible price increases to ordinary reserved letter services beyond those proposed in this draft price notification.

[86] Australia Post, *Draft price notification*, November 2023, p. 6.

[87] Australia Post calculated the present values using forecast inflation rates as the discount factors.

Table 11. Australia Post's revenue model summary ($ million)

		2023/24	2024/25	2025/26	Total
A: Ordinary reserved letters					
Required revenue	*Nominal*	*167*	*144*	*137*	
	Present Value	161	135	125	421
Revenue at proposed prices	*Nominal*	*95*	*89*	*78*	
	Present Value	92	84	71	247
Over(under) recovery	*Nominal*	*(72)*	*(55)*	*(59)*	
	Present Value	(70)	(51)	(54)	(175)
As percentage of required revenue		(43%)	(38%)	(43%)	(41%)
B: Domestic reserved letters					
Required revenue	*Nominal*	*1,722*	*1,536*	*1,498*	
	Present Value	1,663	1,441	1,365	4,469
Revenue at proposed prices	*Nominal*	*1,476*	*1,442*	*1,284*	
	Present Value	1,426	1,353	1,170	3,948
Over(under) recovery	*Nominal*	*(246)*	*(94)*	*(214)*	
	Present Value	(238)	(88)	(195)	(521)
As percentage of required revenue		(14%)	(6%)	(14%)	(12%)
C: Domestic letters					
Required revenue	*Nominal*	*1,979*	*1,769*	*1,705*	
	Present Value	1,912	1,660	1,553	5,124
Revenue at proposed prices	*Nominal*	*1,619*	*1,580*	*1,400*	
	Present Value	1,565	1,482	1,275	4,321
Over(under) recovery	*Nominal*	*(360)*	*(189)*	*(305)*	
	Present Value	(347)	(177)	(278)	(803)
As percentage of required revenue		(18%)	(11%)	(18%)	(16%)

Source: Australia Post, *Draft price notification*, November 2023, Table 43, p. 47.

According to the draft price notification, even with the proposed price changes, by 2025–26 Australia Post's:

- reserved ordinary letter service is forecast to generate $175 million less than the required revenue
- domestic reserved letter service is forecast to generate $521 million less than the required revenue
- domestic letter service is forecast to generate $803 million less than the required revenue.[88]

Underpinning these estimated revenue shortfalls is Australia Post's calculation of the required revenue for each service. The building block components for Australia Post's reserved letter services comprise:

- operation and maintenance cost, which makes up over 90% of required revenue for the three letter services
- return of capital, representing depreciation of fixed assets
- return on capital, representing the required rate of return on the asset base
- tax effects.

88 Australia Post, *Draft price notification*, November 2023, pp. 5, 47.

The operation and maintenance costs incurred by Australia Post are the largest cost component for its reserved letter services, reflecting the nature of Australia Post's operations. This is different to providers of other infrastructure such as energy, telecommunications, transport and water, which have a greater share of capital costs. As a result, the required revenue is less sensitive to changes in the rate of return than may be observed in some other regulated industries.

Australia Post has been profitable with the exception of 2022–23, but its letter services run at a loss

The ACCC notes that although until 2022–23 Australia Post has been a profitable business overall, its letter segment has continuously incurred losses due to declining letter volumes and increasing delivery points.[89] Without a price increase, the losses will be even greater for the forecast period.

Table 12 presents an extract from Australia Post's annual report for the 2022–23 financial year, showing its business performance in the last 5 years.

Although Australia Post's revenue for its non-letter segment has increased continuously over those 5 years, its letters segment revenue has continuously declined, with letter revenue in 2022–23 lower than in 2018–19 by 22.8% (an average decrease of 6.3% per annum). Non-letter revenues have increased by 52.0% (an average increase of 11.0% per annum) in the same period. Australia Post's expenditure over the period has also increased, by 31.9% (an average increase of 7.2% per annum).

Table 12. Australia Post's business performance trends from financial years 2019 to 2023

Five-year trends

	2019	2020	2021	2022	2023
Revenue – letters ($m)	2,216.3	1,996.4	1,794.4	1,783.1	1,710.4
Revenue – non-letters ($m)	4,773.5	5,502.8	6,479.3	7,190.8	7,254.8
Expenditure (including finance costs) ($m)	6,950.3	7,447.5	8,174.4	8,918.7	9,167.4
Profit/(loss) before tax ($m)	41.1	53.6	100.7	55.3	(200.3)
Profit/(loss) after tax ($m)	40.6	42.9	69.6	49.5	(134.6)
Total assets ($m)	5,542.7	6,785.3	7,064.9	6,293.4	6,353.5
Shareholder return on equity (%)	1.7	1.9	3.0	2.0	(5.5)
Return on average operating assets (%)	1.6	2.1	2.6	1.7	(3.1)
Debt to debt plus equity (%)	23.6	24.6	15.7	12.0	18.9
Dividends declared ($m)	25.4	27.9	44.3	32.1	–
Dividends paid ($m)	42.2	21.0	46.2	36.3	21.8
Estimated cost of Community Service Obligations ($m)	392.2	393.3	348.3	348.5	442.2
Total taxes and government charges ($m)	529.4	480.6	571.0	660.6	547.8
Capital expenditure ($m)	423.9	316.1	450.0	427.2	343.1

Source: Australia Post, *Annual Report 2023*, p. 17.

Table 12 shows that Australia Post's overall profits (excluding capital costs, before tax) have been positive during the 4 years from 2018–19 to 2021–22, before the loss incurred in 2022–23.

Table 13 presents a comparison between Australia Post's letter and non-letter services. It shows that the letter segment's contribution to overall revenue and expenditure for Australia

[89] All references to profits and costs in this part refer to accounting profit and loss, not economic profit and loss.

Post has remained similar in 2023 (19.1% and 23% respectively) when compared with 2022 (19.9% and 23% respectively).

Profits before tax and finance costs for the non-letter segment have fallen significantly from $348.8 million in FY 2021–22 to $228.7 million in 2022–23. This is due to the increase in expenditure ($184 million, or 2.7%) being greater than the increase in revenue ($64 million, or 0.9%).

The letter segment loss increased from $255.7 million in 2021–22 to $384.1 million in 2022–23. This results from a reduction in revenue ($72.7 million, or 4.1%) combined with an increase in expenditure ($55.7 million, or 2.7%).

Table 13. Comparison between Australia Post's letters and non-letter services

	Letters[1]		Non-Letters		Total	
2023	$m	%	$m	%	$m	%
Revenue	1,710.4	19.1%	7,254.8	80.9%	8,965.2	100.0%
Expenditure	2,094.5	23.0%	7,026.1	77.0%	9,120.6	100.0%
Profit/(loss) before income tax, finance costs and share of net profits of equity-accounted investees	**(384.1)**	**247.2%**	**228.7**	**(147.2%)**	**(155.4)**	**100.0%**
Finance costs					(46.8)	
Share of net profits of equity-accounted investees					1.9	
Profit/(loss) before income tax					**(200.3)**	
Income tax (expense)/benefit					65.7	
Net profit/(loss) for the year					**(134.6)**	

	Letters		Non-Letters		Total	
2022	$m	%	$m	%	$m	%
Revenue	1,783.1	19.9%	7,190.8	80.1%	8,973.9	100.0%
Expenditure	2,038.8	23.0%	6,842.0	77.0%	8,880.8	100.0%
Profit/(loss) before income tax, finance costs and share of net profits of equity-accounted investees	**(255.7)**	**(274.7%)**	**348.8**	**374.7%**	**93.1**	**100.0%**
Finance costs					(37.9)	
Share of net profits of equity-accounted investees					0.1	
Profit before income tax					**55.3**	
Income tax (expense)/benefit					(5.8)	
Net profit for the year					**49.5**	

1 Letters includes reserved letters (Revenue $1.5 billion (2022: $1.5 billion) and loss before income tax expense and share of net profits of equity-accounted investees of $213.8 million (2022: loss before income tax expense and share of net profits of equity-accounted investees of $95.8 million)), non-reserved letters (including unaddressed mail), international letters and small packets (i.e. regulated packets less than 2kg).

Source: Australia Post, *Annual Report 2023*, p. 167.

ACCC view

The estimated under-recovery reflects assumptions in the revenue model

The under-recovery forecast by Australia Post's revenue model reflects assumptions made by Australia Post on a number of key factors. The ACCC has discussed these factors in the preceding parts of this report, namely: letter volumes (Chapter 4), costs (Chapters 5 and 6) and cost of capital (Chapter 7).

The ACCC considers that Australia Post has generally suggested reasonable values for these parameters, but in some instances considers alternative values may be more appropriate.

To test the revenue model's conclusion that Australia Post will continue to under-recover revenue if its proposed pricing is implemented, the ACCC has conducted sensitivity analysis on cost recovery assumptions. That is, we have considered whether under-recovery is still likely to occur, assuming the proposed price increase is accepted, after updates to the assumptions considered appropriate by the ACCC.

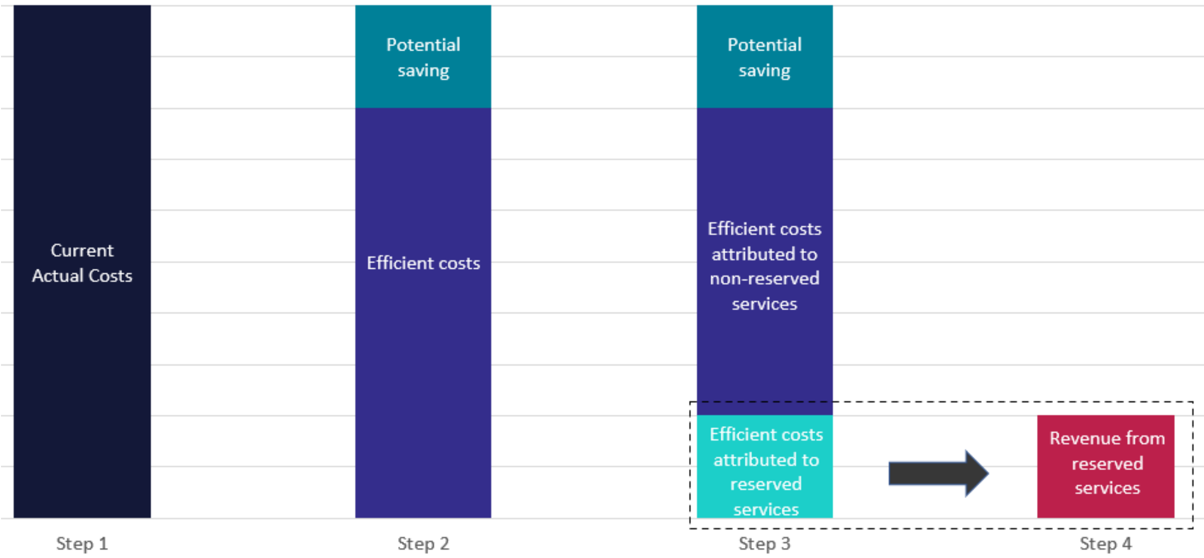
Forecast revenue

The revenue model essentially compares the required revenue (that is, the economic costs attributable to the reserved letter services) with the revenue expected to be received at the proposed prices. The difference between the two is the amount of expected under or over recovery.

To determine the amount of revenue to include in the revenue model, the ACCC considers the quantity of reserved letters that are likely to be sent at the proposed prices. That is, revenue is the product of the proposed prices and the expected volume of reserved letters. For the purposes of this assessment, we only need to consider the revenue attributable to the reserved letter services in this way.

At a high level, we are seeking to ensure that the revenue received for reserved letter services is commensurate with the efficient economic costs of providing the reserved letter services. Figure 7 is a conceptual illustration of this comparison.

Figure 7: Conceptual illustration of revenue relevant to our assessment



Notes: Step 1: Australia Post submits its current actual costs and cost forecasts.

Step 2: We consider the efficiency of Australia Post's operations. Only efficient costs should be included in the forecasts in the revenue model.

Step 3: The ACCC uses a 'dual till' approach where we assess the efficient costs allocated to reserved letter services. We do not consider the costs allocated to non-reserved services in this assessment.

Step 4: We compare the efficient costs for the reserved letter services (including a reasonable return) with the revenue Australia Post is expected to earn from the reserved letter services.

We recognise that some stakeholders have noted potential inconsistencies in the way cost and revenue allocation is applied in Australia Post's financial reporting. While revenue allocation is not relevant for the narrowly defined scope of this assessment, we do note that these issues raise the potential for competition concerns more broadly, including concerns about cross-subsidisation. We consider that Australia Post should review its revenue allocation processes for consistency purposes.

Proposed prices

In its assessment, the ACCC has used the proposed prices for reserved letter services provided by Australia Post.

We note that Australia Post does not provide a base case scenario of the revenue model without the proposed price increase. We consider that a base case would provide a useful counterfactual for a 'with and without' assessment in future price notification processes.

We also note that the forecasts do not include future possible price increases to ordinary reserved letter services beyond those proposed in this draft price notification.

Volumes

As discussed in Chapter 4, while the ACCC considers the letter volume forecasting approach adopted by Diversified Specifics generally reasonable, we have reservations over the electronic substitution variables constructed. Furthermore, there is uncertainty around how the outcome of the postal services modernisation will affect letter volume in future years.

The ACCC has compared actual volumes to the forecasts Australia Post provided for its 2022 price notification. We found Australia Post tend to over-forecast ordinary small letter volume and under-forecast PreSort large and small letter volumes. Overall, the tendency for all letter volume forecasts changed from over to under-forecasting.

However, the ACCC considers that addressing these modelling and forecasting issues is unlikely to result in an alternative set of volume forecasts that are materially higher. Therefore, improved volume forecasts, in combination with changes to other parameters, are not likely to substantially improve the under-recovery.

Forecast economic costs (required revenue)

The required revenue in the revenue model represents the full economic costs to Australia Post of its reserved letter services. These include efficient costs plus a reasonable return on capital.

Operating costs

In Chapter 5, the ACCC considers the efficiency of operational costs in the forecast data provided in the draft price notification. While the ACCC shares WIK Consult's view that Australia Post's operational efficiency in relation to letter delivery lags behind its international peers, there will likely be improvements from expected changes to its business operations.

The ACCC notes that there is inherent uncertainty in the forecasting of costs. As an illustration, the forecast costs in the draft price notification Australia Post provided in November 2023 are significantly different to those in the August 2023 version. This is due to, among other factors, changes in Australia Post's corporate plan and forecasts in relation to the postal services modernisation reform.

The ACCC's analysis of the November 2023 revenue model indicates that to break even Australia Post would require an average reduction in operations and maintenance costs of 16% in 2023–24, 7% in 2024–25, and 16% in 2025–26 compared to the current forecasts by Australia Post, across all reserved letters. Such magnitude of cost reduction is unlikely to be achieved within this time period, even with further improvements in efficiency.

The ACCC also considered the August 2023 version of Australia Post's revenue model as an alternative scenario. Even with the more optimistic assumptions in this scenario, the proposed price increase is unlikely to result in an over-recovery of costs over the forecast period.

WACC

For the reasons set out in Chapter 7 and Appendix A, the ACCC has adjusted a number of the WACC input parameters proposed by Australia Post. The combined effect of adjusting the parameters is to reduce the nominal WACC from Australia Post's proposed 9.73% to 8.84%. This results in a decrease in required revenue through the return on capital component.

The estimated reduction on required revenue is approximately $12 million, $11 million and $11 million per annum for reserved services in 2023–24, 2024–25, and 2025–26 respectively. It is approximately $1 million per annum for reserved ordinary letters in 2023–24, 2024–25 and 2025–26 respectively. The effect is relatively small, as the return on capital accounts for approximately 1.2% of Australia Post's total required revenue for its reserved letters, and would not substantially affect the under-recovery.[90]

Other cost elements

In addition to the above factors, the ACCC has assessed Australia Post's calculations for the following items in its revenue model:

- regulatory asset base
- depreciation (return of capital)
- tax

The ACCC did not find any issues that would materially affect the outcome of Australia Post's revenue model, although notes the comments on inflation and present value below.

Inflation and present value

The ACCC has updated the inflation rates used in the model to the latest forecasts from the Reserve Bank of Australia. Table 14 shows the inflation rates applied by Australia Post in the revenue model up to financial year 2025–26 and the Reserve Bank of Australia's November 2023 estimates.

[90] The ACCC has also conducted sensitivity analysis on some of the individual WACC parameters to observe the difference in PTRM outputs.

Table 14. Comparison of inflation rates applied in Australia Post's revenue model

Financial Years	2023/24	2024/25	2025/26
Inflation rate applied by Australia Post	3.5%	3.0%	3.0%
Reserve Bank of Australia's forecasts	3.9%	3.3%	2.9%

Australia Post's revenue model utilises an inflation factor in 3 ways:

1. it is used for indexing the value of Australia Post's regulated asset base (that is, the value of the assets for which it is seeking a return) and for converting depreciation from a historic cost basis to a current cost basis
2. inflation is used as the discount factor to calculate present value of revenues and costs
3. inflation is used as an input to calculate the real WACC (discussed in Chapter 7 and Appendix A).

Australia Post has calculated present value based on future values discounted by inflation and considers that present value is not impacted by the WACC.

Firstly, we note that the rate of return used in the present value formula should be compounded to reflect the time value of the return.

Secondly, while the inflation rate is one measure of rate of return, we consider a more appropriate value to use is the nominal vanilla WACC. Australia Post uses 'current cost accounting' values for its required and proposed revenue. Australia Post derives these current cost accounting by increasing 'historic cost accounting' values by inflation.[91] Hence, if inflation is used as the rate of return in the present value formula, this is in effect reversing this calculation.

We consider that the nominal vanilla WACC is a more appropriate value to use in the present value calculation as it accounts for the value of Australia Post's debt and equity, and hence is a better reflection of the rate of return than the inflation rate.

Changes to the inflation rate will have an impact in relation to real WACC. A lower projected inflation factor will increase real WACC, thus increasing the calculated return on capital and ultimately the required revenue.

These adjustments reduce the estimated under-recovery, though do not change the finding that an under-recovery is likely to result.

Time horizon

Australia Post has provided its revenue model for 2023–24 to 2025–26, a time horizon of 3 years. The ACCC considers this to be a reasonable length of time for the purpose of assessing Australia Post's proposed price increase on this occasion. Financial forecasts beyond this timeframe would involve significant additional uncertainty.

This is in the context of the declaration of Australia Post's notified services expiring on 30 June 2025.[92] Most of the 3-year forecast horizon, 2023–24 and 2024–25, falls within the declaration period.

[91] Note that the current cost accounting values are still nominal values as the historic cost accounting figures have been multiplied by the inflation rate. These are not real values (which would result from dividing by the inflation rate).

[92] *Price Notification Declaration (Australia Post Letter Services) (No. 2) 2015*.

Using the ACCC's recommended parameters results in a smaller shortfall

As outlined in this chapter and in Chapter 7, the ACCC recommends changes to inflation and WACC parameters, as well as to the approach to calculating present value. The combined effect of these adjustments is a decrease in required revenue.

Table 15 summarises the forecast revenue shortfall for domestic reserved letters in Australia Post's revenue model using Australia Post's approach relative to the parameters and approach proposed by the ACCC.

Table 15. Effect of alternative parameters on forecast revenue shortfall for domestic reserved letters

Financial Years	2023/24	2024/25	2025/26	Total
Present value of shortfall as per Australia Post's model ($ million)	238	88	195	521
Present value of shortfall with the ACCC's parameters ($ million)	215	70	158	443

It is significant to note that even when all the ACCC's alternative parameters and approach to estimating present value are used, the model continues to predict a material under-recovery in revenue for Australia Post's reserved services in the future under its proposed pricing.

Impact of modernisation outcomes

Australia Post's cost forecasts in the draft price notification were made prior to the Government releasing the outcomes of the postal services modernisation review on 6 December 2023. As a consequence of the modernisation outcomes, certain factors in the forecasts provided by Australia Post in the November 2023 draft price notification are likely to be optimistic, including the timing of the roll-out of the every-second-day delivery model.

Consequently, some of Australia Post's forecasted cost savings, reflected in the draft price notification, are unlikely to fully eventuate within the time horizon encompassed by the draft price notification. As such, we expect a greater under-recovery than forecast, even after accounting for the ACCC's parameter adjustments.

Under-recovery will likely continue with the proposed price increase

The ACCC considers that based on past trends, the letter segment of Australia Post is likely to continue to incur losses in the next 3 years. In forming this view, the ACCC considers:

- actual letter volumes in the future years are unlikely to be substantially higher than Australia Post's forecasts
- any reduction in actual cost in future years, in comparison with Australia Post's forecasts, is unlikely to be sufficiently large to close the forecast revenue shortfall, even after considering potential efficiency measures
- the ACCC's recommended adjustments to the model do not eliminate the estimated under-recovery

- Australia Post's costs will likely be higher than forecast over the next 3 years due to the timing of implementation of the postal services modernisation reforms being slower than anticipated in the November draft price notification
- the under-recovery of cost will likely continue during the assessment period, mainly due to declining letter volume.

In light of these factors, the ACCC considers that a break-even of costs and revenue is unlikely to arise for reserved services. This is the case even if Australia Post is permitted to increase its prices as it has proposed. The ACCC is also mindful that Australia Post's ability to earn revenue sufficient to cover its efficient costs is necessary to maintain investment and employment.

9. ACCC recommendations for future price notification processes

While assessing Australia Post's draft price notification, the ACCC has identified some deficiencies in the materials upon which Australia Post has relied in support of its notification. In this chapter, we set out our recommendations for improvements to support any future price notification process.

The ACCC recommends that Australia Post provide a base case scenario for analysis

In support of the draft price notification, Australia Post has provided forecast demand, revenue and cost calculations that include the proposed stamp price increase. However, Australia Post has not isolated and calculated the financial impact of the proposed price increase in comparison to a scenario where stamp prices are not increased.

To allow the ACCC to more easily assess the impact of a proposed stamp price increase, Australia Post should provide in support of future price notifications a base case scenario, to illustrate for comparison the forecast outcomes should stamp prices remain unchanged.

The ACCC recommends that Australia Post provide improved forecast data

Australia Post has provided forecast data to support the draft price notification. The significant differences in forecast numbers between the August 2023 draft price notification and November 2023 revised draft price notification demonstrate the difficulty of generating accurate forecasts in an uncertain environment, and the sensitivity of forecasts to changes in underlying assumptions.

To allow the ACCC to better assess forecasts, Australia Post should provide the ACCC with the underlying assumptions employed in its forecasts. We also recommend that Australia Post provide the ACCC with forecasts under alternative scenarios that can be compared with the base case.

We also recommend that Australia Post provides forecast data which contains a decomposition of cost changes related to input price changes, volume changes, economies of scale, economies of scope, and any changes in the production process. This decomposition should be provided for major product groups such that the forecast data are consistent with the cost allocation model data.

The ACCC also notes that Australia Post's costs and other financial reporting are not disaggregated by geographic region. In recognising the importance of postal services for regional and remote Australia, the ACCC recommends that such a disaggregation of Australia Post's reporting between urban and rural areas would be beneficial – both for the assessment of Australia Post's provision of its community service obligations under section 27(4)(a) of the Postal Act, and for government policy setting into the future.

Further, we consider that Australia Post should review its revenue allocation processes to ensure consistency with its approach to cost allocation.

Cost forecasts

In the case of cost forecasts, the ACCC considers that cost forecasts should be based on efficient costs rather than actual costs. The allowance for operating costs in the revenue model should be based on the costs that would be expected to be incurred in providing the reserved services, assuming that Australia Post is acting efficiently and prudently. This is not necessarily the same as the actual costs that are expected to be incurred.

Letter volume demand forecasts

The outcomes of the 2023 postal services modernisation review will (subject to further consultation in 2024) lead to changes to the Postal Regulations which allow Australia Post to adopt an every-second-day delivery model and to consequently take a longer time to deliver letters without being in breach of their performance standards.

To allow the ACCC to assess the impact of a proposed stamp price increase, Australia Post should provide in support of future price notifications letter volume demand forecasts which consider the impact of the new delivery model. Further, Australia Post should refine its modelling process in line with the ACCC's comments set out in Chapter 4, including improving the transparency of its post-modelling adjustments.

Planned price changes

In this 2023 draft price notification, Australia Post expresses its intention to develop a longer-term price path for stamp price increases.[93] However, these planned price increases have not been incorporated into the assumptions underpinning the demand, revenue and cost forecasts provided in this notification.

To allow the ACCC to assess the impact of a proposed stamp price increase, the ACCC considers that Australia Post should clearly identify planned future price increases and the impact on demand, revenue, and cost forecasts in future price notifications. This should be disaggregated in such a way that allows the ACCC to conduct sensitivity testing, with and without each of the proposed price increases.

The ACCC recommends that Australia Post further improve its cost allocation model

As set out in Chapter 6, WIK Consult has identified several potential improvements to Australia Post's cost allocation model. We recommend that Australia Post carefully consider these recommendations.

Importantly, we note that Australia Post's cost allocation model is an ex-post tool that is based on actual costs, which are not necessarily the same as efficient costs. For the purposes of our assessment, it is important that we have accurate forecasts of efficient costs. The model is not integrated with a forecasting tool, so it does not generate forward-looking cost forecasts and does not allow an external user to calculate the impact of parameter changes or alternative scenarios. Further, the model does not provide the short-run or long-run incremental cost of service.

93 Australia Post, *Draft price notification*, November 2023, pp. 5, 10.

We acknowledge that Australia Post is continually reviewing and updating inputs to the cost allocation model. We recommend that Australia Post undertake further work to address the issues raised by WIK Consult, such as:

- providing short-run and long-run incremental costs of individual services and products, including loss-making reserved services
- separately identifying restructuring costs as unattributable costs
- conducting a new delivery time standard survey
- more closely considering incremental cost in cost causation and allocation regarding eDVs
- undertaking a program of work to assess whether there are direct and indirect benefits for non-reserved services that arise as a result of having a larger post office network and, accordingly, adjust the method of allocating LPO subsidy costs, and
- changing to a contractually specified transfer price system for cost allocations to StarTrack.

The ACCC recommends that Australia Post amend its approach to the cost of capital

As set out in Chapter 7, the ACCC recommends that Australia Post apply alternative assumptions to its WACC inputs. These include:

- applying a gamma value which reflects a competitive capital market that is supporting investment in real assets
- applying a gearing ratio which reflects comparable listed companies
- applying raw equity and asset betas (and associated gearing assumptions) rather than adjusted betas
- estimating the cost of debt based on a forward-looking expected cost of debt to the firm, set with reference to a benchmark business facing similar risks to Australia Post's reserved services.

The ACCC recommends that Australia Post amend its present value formula in its post-tax revenue model

Australia Post's post-tax revenue model uses inflation rather than the rate of return (WACC) as the discount factor to calculate the present value of the estimated under-recovery.

The ACCC recommends that Australia Post use the WACC as the discount factor in their present value calculations for the following reasons.

Firstly, we note that the WACC used in the present value formula should be compounded to reflect the time value of money.

Secondly, while the inflation rate is one measure of the rate of return, we consider a more appropriate value to use is the nominal vanilla WACC. Australia Post uses 'current cost accounting' values for its required and proposed revenue. Australia Post derives these current cost accounting values by increasing 'historic cost accounting' values by inflation. Hence, if inflation is used as the rate of return in the present value formula, this is in effect reversing this calculation.

The nominal vanilla WACC is a more appropriate value to use in the present value calculation as it accounts for the value of Australia Post's debt and equity, and hence is a better reflection of the rate of return than the inflation rate.

The ACCC recommends that Australia Post ensure their regulatory accounting procedures manual aligns with the classifications of reserved and non-reserved services under the Postal Act

The Australia Post regulatory accounting framework Record Keeping Rules[94] provide that Australia Post must establish and maintain a regulatory accounting procedures manual which records the procedures to be followed within the company in preparing regulatory accounts.

Under these Record Keeping Rules, details from several schedules are required to be incorporated into Australia Post's regulatory accounting procedures manual. This includes service group definitions for reserved and non-reserved services. The Record Keeping Rules categorise inward international mail, apart from international inward letters, as non-reserved rather than reserved services. This is consistent with the definition of services which are not reserved under s 30 of the Postal Act. However, we have identified that Australia Post's 2023 regulatory account procedure manual currently lists international inward packets as reserved services.

The ACCC recommends Australia Post review their regulatory accounting procedures manual to ensure that the services classified as reserved or non-reserved are consistent with the Postal Act, and that revenue and costs are attributed accordingly.

The ACCC recommends that Record Keeping Rules data be supported by responsibility statements

Australia Post is subject to Record Keeping Rules issued by the ACCC under section 50H of the *Australian Postal Corporation Act 1989*.[95] Under these rules, when Australia Post provides the ACCC with the regulatory accounts, Australia Post must also submit a responsibility statement signed by its Chief Executive Officer and Chief Financial Officer.

The ACCC considers that Australia Post should submit the required responsibility statement when providing the ACCC with regulatory accounts, both of which should be provided in support of any future price notifications. Failure to do so may mean that Australia Post is in breach of the Record Keeping Rules.

The ACCC recommends a transparent and consultative price notification process

The ACCC considers that transparency and consultation are important for an effective price notification assessment process. We encourage Australia Post to be as transparent as possible with the information it provides. We note the ACCC will continue to consider public consultation to be a critical step in any future price notification process.

94 ACCC, *Record keeping rules for Australia Post*, June 2016.

95 ACCC, *Record keeping rules for Australia Post*, June 2016.

Appendix: ACCC approach to cost of capital parameters

Australia Post has adopted the mid-point of the assessed range of the weighted average cost of capital (WACC), as prepared by Deloitte in August 2022. These are the same parameters as used in Australia Post's 2022 price notification, with the exception of an updated risk-free rate and consequent flow on to the calculated cost of equity capital.

Risk free rate

Deloitte uses the 5-day average of the 10-year Australian Government Bond yield as the proxy for the risk-free rate.[96] For this price notification, Australia Post has updated the risk-free rate to be 3.92% as at June 2023.

The ACCC agrees that a 10-year Australian Government Bond yield is a good proxy for the risk-free rate. However, the ACCC uses a 20-day average to calculate the risk-free rate. As at 31 October 2023, the risk-free rate is 4.71%.[97]

Market risk premium

The market risk premium (MRP) is the expected return over the risk-free rate that investors require to invest in a well-diversified portfolio of assets. It represents the risk premium that investors can expect to earn for bearing only non-diversifiable (systematic) risk.

The MRP is common to all businesses in the economy and is not specific to an individual business or industry.

Australia Post has proposed to apply the same MRP as used in its 2022 price notification (5.75%). Deloitte notes that its estimate is based upon analysis of both historic and prospective estimates of the MRP, with a greater weight on current and prospective approaches.[98]

Consistent with the approach taken in 2022 and its historical approach to estimating MRP, the ACCC favours using historical excess returns as there is difficulty in estimating the conditional MRP.[99] The ACCC considers that historical excess returns provide the better estimate of MRP because they are directly observable, easily replicable and transparent.

The ACCC's and Australian Energy Regulator's (AER's) MRP estimates typically range between 6.1 and 6.6.[100]

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96 Deloitte, *Australian Postal Corporation – Assessment of WACC for Australia Post's Reserved Letters Business*, 1 August 2022, p. 7.

97 Using Bloomberg ticker BV100127.

98 Deloitte, *Australian Postal Corporation – Assessment of WACC for Australia Post's Reserved Letters Business*, 1 August 2022, pp. 7-8.

99 MRPs informed or conditional on information from the time of the estimate.

100 ACCC, *Public inquiry on the access determination for the Domestic Mobile Terminating Access Service – Final Report*, October 2020, p. 82; Australian Energy Regulator, *Rate of Return Instrument – Explanatory Statement*, February 2023, p. 17.

Given the ACCC's and AER's previous estimates of the MRP, the ACCC's view is that an MRP estimate of 6.2% should be applied in determining the nominal vanilla WACC. This is consistent with using a 10-year term for the risk-free rate.

Gamma

In general, the ability of a listed company to pay imputation credits with dividends is considered in determining the WACC to avoid over-compensation of a regulated business.

Since Australia Post's revenue model applies a vanilla WACC, gamma is used to capture all tax effects in the estimation of cash flows and tax liabilities. The revenue allowance to cover Australia Post's expected tax liability is reduced in a manner consistent with the value of gamma.

Australia Post has proposed a gamma value of zero. This is consistent with its 2022 price notification where Deloitte, on behalf of Australia Post, did not include a value of gamma, which effectively assumed a value of zero.

As noted in previous price notification assessments, the ACCC has historically set gamma with reference to a benchmark for an efficient firm operating in Australia rather than the regulated business' actual financial statements. This is on the premise that the cost of capital should be independent of the regulated firm's ownership structure, and it should instead reflect a competitive capital market that is supporting investment in real assets. The ACCC considers that this approach allows the firm to earn a competitive rate of return to encourage investment but not lead to monopolistic pricing while providing an incentive to improve overall performance.

For this price notification, the ACCC considers it appropriate to use a gamma value of 0.57, consistent with the AER's final 2022 Rate of Return Instrument.[101] The AER slightly revised the value of gamma from its 2018 Instrument, reflecting a revised rounding approach using updated empirical estimates of the distribution rate and the utilisation rate.[102]

The ACCC's view is that a gamma of 0.57 should be applied in estimating Australia Post's tax liabilities.

Equity beta

The equity beta measures the 'riskiness' of a firm's returns compared with that of the market. Equity beta measures how sensitive a firm might be to the systematic risk that affects the overall market. A firm's exposure to these risks depends on its activities and level of financial leverage.

Australia Post has proposed an equity beta of 1.04, consistent with its 2022 price notification. This equity beta was estimated with reference to betas for comparable listed companies operating in the postal and logistics industries that collectively reflect the range of operations of Australia Post. It calculated the betas based on weekly and monthly returns, over a 2 and 4-year period, compared to the relevant domestic index.[103]

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101 Australian Energy Regulator, *Rate of Return Instrument – Explanatory Statement*, February 2023, p. 12.

102 Australian Energy Regulator, *Rate of Return Instrument – Explanatory Statement*, February 2023, p. 240.

103 Deloitte, *Australian Postal Corporation – Assessment of WACC for Australia Post's Reserved Letters Business*, 1 August 2022, pp. 11-13.

The ACCC accepts the eight international postal companies and eight logistics/transport providers used by Deloitte as comparable companies, and included four Australian logistics companies: CTI, K&S, Lindsay and Qube. As transport and logistics are estimated to consist of only 5% of the reserved services' operating cost,[104] in calculating the average beta of comparable companies, the ACCC proposes the Australian logistics group should be weighted accordingly.

However, the ACCC considers several aspects of Deloitte's approach to estimating Australia Post's equity beta to be inappropriate. This includes the approach to estimating the equity and asset betas (and associated gearing assumptions) to arrive at a final estimate. The ACCC does not accept Deloitte's argument for using adjusted equity betas over raw equity betas.[105]

The ACCC gives weight to empirical estimates from comparable listed companies to construct a benchmark beta for Australia Post's reserved services. The ACCC sources an average of weekly equity betas over a 5-year period. The ACCC considers that this approach represents a trade-off between a shorter period with most recent data that is reflective of current systematic risk, and a longer period with more data that improves accuracy of estimates.

The ACCC has also identified concerns with Deloitte's approach of using a 'mean of means'[106] for selection of a total reserved services beta, noting that this approach attributes equal weights to each of the comparable sectors. As noted above, the transport and logistics sector reflect a relatively low share of the reserved service's total operating cost. The ACCC therefore applies a weighted average across the 2 groups to reflect the comparable companies' contribution more accurately to the reserved services' cost structure. The ACCC assigns a weight ratio of 0.95:0.05 to the international postal group and logistics group.[107] Having regard to the analysis above, the ACCC's view is that it would be appropriate to apply an equity beta of 0.90 to Australia Post's reserved services.

Gearing

Gearing is the proportion of capital funding sourced through debt as opposed to equity. The gearing level weights the return on equity and cost of debt in the WACC formula. Where the firm is highly geared (that is, the firm has a high level of debt) and holding all else equal, this implies greater financial risk for the firm and therefore a greater required rate of return for equity holders.

Australia Post has proposed a gearing ratio of 5%, as used in its 2022 price notification. The ACCC considers it is the long-term gearing that an efficient firm in the industry would target.[108] The ACCC adopted a gearing ratio of 40.6% in its decision for the 2023 price notification, by observing comparable companies' gearing. We consider that the gearing ratios of the comparable listed companies will most closely reflect the range of operations

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104 From Australia Post's revenue model.

105 The raw equity beta measures the 'riskiness' of a firm's returns compared with that of the market as a whole and compares the historical returns of the firm against that of the overall market. The adjusted beta is derived from historical data but modified by the assumption that a security's beta moves toward the market average of one over time (i.e. the Blume adjustment).

106 The 'mean of means' approach uses a simple average within each group, and then a further simple average across the 2 groups.

107 From Australia Post's revenue model.

108 Using a firm specific gearing exposes the possibility of firms manipulating their leverage levels to improve their allowed revenues or prices (for example, raising its leverage to increase its allowed revenues or prices). The ACCC considers that a benchmarking approach incentivises a firm to efficiently finance its operations.

of Australia Post and propose the same value for this price notification. We note, however, that the gearing level has increased since our 2022 decision. The increase in gearing from 28.3%[109] to 40.6% reflects a significant increase in the gearing levels for the international postal corporations.

Cost of debt

Australia Post has used a cost of debt of 6.89% based on Deloitte's advice for its 2022 price notification. This reflects:

- Australia Post's weighted average cost of debt of 3.84%. Deloitte notes that this includes 2 fixed medium-term notes with weighted average interest of 4.74%
- the borrowing capacity of the letter business on a standalone basis. Deloitte considers the yield on 10-year non-financial BBB-rated corporate bonds as of 30 June 2022.[110]

The ACCC holds the view that the cost of debt should be estimated based on a forward-looking expected cost of debt to the firm, with the cost of debt set with reference to a benchmark business facing similar risks to Australia Post's reserved services. The ACCC considers Deloitte's method of using an actual cost of debt to be inconsistent with this approach.

We consider it appropriate for Australia Post to achieve an investment grade credit rating. Using a benchmarking approach, we estimate the cost of debt using average yields on 10-year investment grade bonds over a 20-trading-day average period. This would represent an appropriate trade-off between the long asset lives of regulated assets and the better quality of available data for shorter maturities.

109 ACCC, *Decision on Australia Post's 2022 price notification*, December 2022, p. 54.

110 Deloitte considers a 10-year maturity of the observed corporate bonds appropriate notwithstanding the shorter duration of the Regulatory Period, on the basis that a commercial enterprise would not seek to refinance its entire debt portfolio every 2 years, but rather would rationally seek to refinance a portion of its debt every year.