

4 April 2008

**Ms Margaret Arblaster**  
**General Manager – Transport and Prices Oversight**  
**Australian Competition and Consumer Commission (ACCC)**  
GPO Box 520  
MELBOURNE VIC 3001

Also via email: [transport.prices-oversight@acc.gov.au](mailto:transport.prices-oversight@acc.gov.au)

**Dear Ms Arblaster**

The Australian Direct Marketing Association (ADMA) welcomes the opportunity to make this submission in response to the ACCC's Issues Paper (IP) addressing Australia Post's draft price notification.

ADMA is the peak body of the Australian direct marketing industry and represents over 500 member organisations including major financial institutions, telecommunication companies, energy providers, travel service companies, major charities, statutory corporations and specialist suppliers of direct marketing services.

According to recent CEASA<sup>1</sup> research, 715,385 Australians were employed in the direct marketing industry in 2006 and it had revenues of \$12.8 billion pa.

These figures provide an insight into the importance and potential impact of any increase in the cost of Australia Post's products or services, as the majority of ADMA members rely heavily on Australia Post's mail delivery system. In fact, it is fair to say that it is the lifeblood of their business.

In this submission, ADMA will respond to specific issues raised by the ACCC and is uniquely placed to do so.

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<sup>1</sup> Commercial Economic Advisory Service of Australia report Direct Marketing in Australia 2006.

## Preamble

ADMA's membership includes organisations that represent the entire mail marketing supply chain from paper manufacturers and suppliers to creative agencies, printers, mail houses, fulfillment companies, major users of mail marketing and postal service providers including Australia Post itself.

Given ADMA's role in advocating on behalf of the full spectrum of organisations involved in the direct mail marketing 'channel', we believe we can assist the ACCC by providing a balanced view.

From the outset, it is important to recognise that ADMA understands the need for Australia Post to provide a reasonable rate of return to the taxpayers of Australia for the significant investment that they have made in the nation's postal system and that as a corporatised government monopolistic provider Australian Post has community service obligations to provide goods and services to disadvantaged sectors of the community that may not otherwise be commercially viable.

However, ADMA also strongly believes that a high quality, low cost postal system is essential to the growth and prosperity of the entire Australian economy, the business and not-for-profit sectors in particular, and the broader Australian community.

Given that position, ADMA, in principle, is not opposed to modest price increases in Australia Post's 'reserved' mail products and services provided that they are both fair and reasonable.

In determining what is fair and reasonable, ADMA notes that the ACCC has three specific responsibilities in regard to the regulation of postal services, namely:

1. monitoring for the presence of cross subsidies between Australia Post's reserved and non-reserved services;
2. assessing proposed price increases for Australia Post's reserved services; and
3. inquiring into certain disputes regarding the terms and conditions under which Australia Post supplies bulk-mail services.

Further, ADMA notes that the ACCC has specific obligations imposed by the *Trade Practices Act 1974* in that it must have regard to:

- (a) the need to maintain investment and employment, including the influence of profitability of investment and employment;
- (b) the need to discourage Australia Post which is in a position to substantially influence a market for goods and services from taking advantage of that power in setting prices;
- (c) the need to discourage cost increases arising from increases in wages and changes in the conditions of employment inconsistent with principles established by relevant industry tribunals.

## Submission structure

For ease, ADMA has numbered the issues raised by the ACCC (see appendix 1), however, this submission will not address Australia Post's econometric forecasts or modeling in regard to Australia Post's Weighted Average Cost of Capital, beta risk, forecast capital expenditure or tax rates.

ADMA will also not pronounce specific judgments on the reasonableness of Australia Post's forecasts for outputs and inputs and trend growth rates. However, ADMA will address these issues more broadly and will respond to the more pressing issues in detail.

Given that approach, ADMA would be pleased to discuss all matters in more detail with the ACCC at a later date and would like to reserve the right to further address relevant specific matters as the consultation process unfolds.

## Recent history

In addressing the mail pricing issue in general and its impact on the direct marketing industry in particular, ADMA notes Australia Post's statement in its *Draft Notification of Change in Domestic Letter Pricing and Introduction of New Letter Categories*.

*"The proposed increases are the first for the BPR and other Ordinary Letters since January 2003 and the first general increase to PreSort Letters since January 1992: overall they represent an average increase of 8.1%.*

*Considering the Consumer Price Index (CPI) is estimated to have increased by over 15% (over the period January 2003 to June 2008), the proposed prices represent a real reduction of around 6%."*

While this is the case, it should be read in context with the importance of price increases that specifically affected mail marketing between 1999 and 2003, specifically in regard to an Australia Post product called Ad Post.

Ad Post commenced in 1976 as a discounted price incentive for advertising mail and its original purpose was to foster the use of direct mail advertising.

In March 1999, Australia Post lodged a notification to reduce the Ad Post discount from 26.5% to 21%. This change came into effect in April 2000.

In December 2001, Australia Post lodged a notification of its intent to eliminate the Ad Post discount for all customers except charities, the effect of which was to increase the cost to direct marketers by 19%. This significant increase was phased in over two tranches six months apart, with a 10% increase in the price of Ad Post from 1 July 2002 and a further 9% increase from 1 January 2003.

ADMA would like to make it clear that these price rises did have a significant impact upon the cost base of organisations using mail marketing and the direct marketing industry in general.

## Issues raised

- 1. The period over which the reasonableness of Australia Post's proposed prices should be considered by the ACCC.**
- 2. The implications of more frequent price notifications for cost efficiency.**
- 3. The impact of future price increases on customers' planning (including the impact on the investment decisions of customers).**

As noted by the ACCC in a preliminary view of an earlier price notification in 2002 there was no fixed regulatory period for assessments under the former *Prices Surveillance Act*, however, five years was a common period for review.

ADMA agrees with the statement made by the ACCC at that time.

*"The appropriate regulatory period is a balance between competing demands. A short period, such as one year, generates excessive costs for frequent notifications and regulatory inquiries, and perhaps administrative costs for adjustment of prices."*

It is also ADMA's view that a five year timeframe is appropriate for industry planning purposes and to provide certainty for organisations undertaking significant capital and business investment.

- 4. The factors identified by Australia Post that influence letter volumes.**
- 5. The underlying assumptions in Australia Post's forecasts of future volumes regarding consolidation, rationalisation and substitution.**
- 6. The impact of price increases on Australia Post's reserved service profitability in the context of forecast declining letter volumes.**
- 7. The impact that the proposed price changes will have on volumes for each of the products for which Australia Post is intending to increase its prices.**
- 8. The extent to which the level and the timing of price changes has an impact on mail volumes.**

In ADMA's view, the imposition of increased letter postal prices is highly likely to result in a corresponding reduction in future letter volumes across all three 'letter segments' identified by Australia Post, namely: transactional, promotional, and social mail. ADMA is also concerned that these likely reductions in volumes may in themselves form the basis for future increased postal prices.

Improving technologies like email, instant messaging and web based applications have provided both businesses and consumers with substitutes to communication via letters and the willingness of Australians and Australian companies to adopt and exploit these technologies is certainly affected by the analysis of their relative benefits, value and cost.

ADMA does not hold empirical evidence to support any view of the demand and price elasticity of the transactional, promotional, and social mail segments, however, strong anecdotal evidence of billing and payment communications migrating to the online environment along with the rising use of email and SMS, would suggest that both business and empowered consumers are optimising their utility and are increasingly choosing which communication 'channels' they prefer to conduct relationships through.

Of course there are regulatory schemes created by the Commonwealth *Spam Act 2003* and *Do Not Call Register Act 2007*, that arguably advantage the mail channel, yet as technologies continue to improve, ADMA believes that higher mail prices may increasingly correlate with reduced letter volumes across all segments.

- 9. The key drivers of the costs of the collection, sorting and delivery services provided by Australia Post, and how these drivers could be used to inform an assessment of the allocation of costs between the different letter services provided by Australia Post.**
- 10. The forecast growth in outputs and inputs for the reserved and non-reserved services.**
- 11. The of the trend growth rate for the period 2002-2007 and for the forecast period 2007-11.**
- 12. The economic efficiency of Australia Post's operating costs (including labour costs, contractor costs, accommodation and depreciation).**
- 13. Changes in Australia Post's cost structure over time.**

ADMA does not possess any greater insight than the ACCC into the economic efficiency of Australia Post's operating costs, however, we do have a strong interest.

In ADMA's view, we strongly encourage the ACCC to ensure that all monopolistic providers of products and services, that have significant market power and set prices in the absence of pure competition, are operating efficiently and effectively.

- 22. Whether the difference between the pre-sort letter service rates is appropriate.**

It is important to note that differing rates of price increase across different letter categories will disproportionately disadvantage direct marketers using promotional mail products/ services.

The trend for mail marketers is to use larger mail pieces to generate greater visual impact and Australia Post's proposed price rises for larger mail pieces is disproportionately higher than that for smaller letters.

- 23. Whether the Acquisition Mail service has been priced appropriately in comparison with other mail services.**
- 24. The likely impact of the introduction of the new Acquisition Mail service on the other types of promotional mail.**

ADMA understands that Acquisition Mail is a specialist product/ service and is priced accordingly. In ADMA's view, Acquisition Mail in itself is highly unlikely to account for large letter volumes and is also unlikely to have a significant impact on the volumes of other types of promotional mail.

### **Important conclusions**

Any balanced view would conclude that Australia Post's proposal to implement modest price rises for letters for the first time in five years would not appear unreasonable or unfair, however, this is a matter, rightly, for the ACCC to determine.

However, that is not to say that these proposed increases will not impact significantly on ADMA member companies, particularly large mail users. To the contrary, it will increase their cost bases by many thousands and, in some cases, many hundreds of thousands of dollars.

ADMA has not provided details of those impacts in this submission as they are commercial in confidence, however, we would be happy to arrange discussions between these organisations and the ACCC to explain these impacts in detail.

It is also important to note that these proposed price increases for letters are also likely to have far wider ramifications for other businesses and Australia Post itself.

Mail marketing, or the promotional letter segment, is a very effective way of generating sales and economic activity throughout the national economy. Those sales and relationships between companies and consumers usually lead to the creation of transactional letters and often involve the shipment of products by parcel post or other delivery systems. As a result, any reduction in promotional letter volumes due to the imposition of higher prices may have a negative impact on volumes and/or profitability of other postal products and services.

### **ADMA's strongest objection**

ADMA's strongest objection to Australia Post's draft price notification is the proposed timing of its implementation.

The notification states that the price changes are to be effective "no later than" the 1<sup>st</sup> of July 2008 and that 2008/09 is "the first full financial year that the proposed prices would apply".

ADMA believes that this timeframe is simply unacceptable.

Given that the notification was only provided to the ACCC on the 5<sup>th</sup> of February 2008 and that many of ADMA's member companies and not-for-profit organisations have already established their marketing and other budgets for the 2008/09 financial year, ADMA would urge the ACCC to postpone any price rises until the 1<sup>st</sup> of July 2009.

This lead time would allow businesses to take proper account of these added costs as part of their rigorous budgeting processes.

In conclusion, ADMA again thanks the ACCC for the opportunity to make this submission and we would be pleased to discuss any aspect of it and Australia Post's draft price notification in more detail.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Rob Edwards', with a flourish underneath.

Rob Edwards  
Chief Executive Officer

## Appendix 1

### Issues raised by the ACCC's Issues Paper addressing Australia Post's draft price notification.

1. The period over which the reasonableness of Australia Post's proposed prices should be considered by the ACCC.
2. The implications of more frequent price notifications for cost efficiency.
3. The impact of future price increases on customers' planning (including the impact on the investment decisions of customers).
4. The factors identified by Australia Post that influence letter volumes.
5. The underlying assumptions in Australia Post's forecasts of future volumes regarding consolidation, rationalisation and substitution.
6. The impact of price increases on Australia Post's reserved service profitability in the context of forecast declining letter volumes.
7. The impact that the proposed price changes will have on volumes for each of the products for which Australia Post is intending to increase its prices.
8. The extent to which the level and the timing of price changes has an impact on mail volumes.
9. The key drivers of the costs of the collection, sorting and delivery services provided by Australia Post, and how these drivers could be used to inform an assessment of the allocation of costs between the different letter services provided by Australia Post.
10. The forecast growth in outputs and inputs for the reserved and non-reserved services.
11. The reasonableness of the trend growth rate for the period 2002-2007 and for the forecast period 2007-11.
12. The use of the consumer price index (CPI) as a price deflator for individual input and output price indexes.
13. The assumption of constant returns to scale for Australia Post's aggregate business.
14. The economic efficiency of Australia Post's operating costs (including labour costs, contractor costs, accommodation and depreciation).
15. Changes in Australia Post's cost structure over time.
16. The conceptual framework applied in the Bishop and Officer report for determining the capital at risk.



17. Whether current assets such as working capital and cash in the field should be incorporated into the asset base.
18. The level and composition of proposed capital expenditure for the domestic reserved letter service.
19. Australia Post's approach to incorporating forecast capital expenditure into its pricing asset base.
20. Whether the statutory tax rate or an estimate of Australia Post's effective tax rate should be incorporated into the WACC.
21. Whether the equity beta of 0.66 is reflective of the operating and financial risk of Australia Post's returns relative to the market.
22. Whether the difference between the pre-sort letter service rates is appropriate.
23. Whether the Acquisition Mail service has been priced appropriately in comparison with other mail services.
24. The likely impact of the introduction of the new Acquisition Mail service on the other types of promotional mail.