

# **Australia Post's Pricing Proposal**

**(Introduction presented by Gary Lee, Group Manager Letters, Australia Post - at the ACCC Technical Issues Forum on 11 July 2002)**

## **Introduction**

Good morning Mr Commissioner, Good morning Ladies and Gentlemen.

Thank you for the opportunity to outline to this Technical Issues Forum the basis and reason for Australia Post's pricing proposal which is the subject of the current draft notification to the ACCC.

May I first introduce the other members of Australia Post's panel for today's session.

- Mr Peter Meehan - Chief Finance Officer
- Mr Jim Marshall - General Manager, Mail and Networks Division

In my role as Group Manager Letters, I have the responsibility for the Letters product in Australia Post including the development of the business strategy and product development and pricing. In this session we will be supported by:

- Chris Koo, Letters Strategy                      Terry Sinclair, Network Operations
- Alan Marshall, Financial Strategy              Greg Woods, Product Manager
- John Stephens, Product Costing

and Mr Ross Cartey of Price Waterhouse Coopers who has provided consulting advice to this project.

**What is in the Notification?**

The draft notification, which was submitted to the ACCC on the 30<sup>th</sup> of April notifies changes in prices and conditions (including a new service) for Ordinary Letters and Bulk Mail. The key changes are an increase of 5 cents in the Basic Postage Rate to 50 cents and increases to Bulk Mail prices of around 2.2 cents (including GST). Overall the changes represent weighted average increases of 7.9% to Ordinary letters and 3.5% to Bulk letters equating to an average price increase of 5.1%. Apart from the effects of the removal of Ad Post, and the introduction of GST. The increases, if approved to commence in January 2003, will represent the first general price increases in eleven years.

**What's not in the Notification?**

While the ACCC has been advised of pending changes, large letters over 250 grams are not included. Furthermore, although part of the reserved service, incoming International letters are not part of the notification.

It is also appropriate to note that this notification is separate to the already ACCC approved changes to Ad Post through the removal of the discount in 2 stages in July 2002 and January 2003. After these changes customers using mail for Advertising purposes will be subject to the same prices as Pre Sort barcode customers.

**Primary Objective of the Notification**

The primary objective of the price rises is to achieve appropriate profit levels for the letters business.

**What are appropriate profit levels?**

Profit targets for the letters business are set within the context of Australia Post's Corporate Plan. In determining the Australia Post's corporate financial target, the Board is required under S38 of the Act to consider:

- The need to earn a reasonable return on assets.
- The expectation of a reasonable dividend return to the Commonwealth.
- The need to maintain a reasonable level of reserves and the cost of Community Service Obligations.

**Letter prices are set in this context under the following principles:**

- The Basic Postage Rate – the rate for the standard letter by ordinary post (currently 45 cents) is the keystone of the pricing structure.
- Carriage of the Standard Postal Article by Ordinary Post is central to the Community Service Obligation. Pricing of the Standard Postal Article (the Basic Postage Rate) will reflect the need to maintain an affordable rate. As a result the Basic Postage Rate is not expected to fully recover the costs of providing these services.
- Consequently prices for other letter services will contain a cross subsidy to the Standard Postal Article.
- Subject to this need to cross subsidise, letter prices will be set to achieve an appropriate aggregate rate of return for the letters business as a whole.
- Bulk inter connection prices will, in addition to the requirements of S32A(2)(c), broadly reflect the level of work saved by Australia Post through work carried out by customers.

- Bulk interconnection prices will be applied uniformly for carriage within Australia subject to the point of lodgement (Inter/Intra state prices apply).
- Subject to meeting minimum agreed quantities and conditions, Bulk Interconnection Prices will be applied uniformly regardless of volume.
- The pricing structure will reflect Australia Post's commercial, social and governmental obligations.
- The primary social obligation is to supply a letter service that is accessible, available equitably and meets community needs.
- The pricing structure will be as simple as possible.
- Prices will be set to enable Australia Post to meet its statutory requirement to provide an adequate commercial return and to fund the Community Service Obligations.
- Price changes will be made as infrequently as possible, with adequate notice and after appropriate consultation with stakeholders.

### **Price rises are needed to maintain profitability**

As noted before apart from the changes associated with Ad Post and the introduction of the GST, Australia Post has not had a general price increase since 1992. Appropriate profits have been maintained from the Letters business through this extended period from a combination of productivity, volume increases, and customer work share. These results have been achieved through a period when Consumer Price Index increases of 26% have resulted in significant cost increases to Australia Post. This freeze cannot be maintained and appropriate returns achieved as:

### **Post absorbs the GST on the Standard Postal Article**

With the implementation of GST in July 2001, Post was required to maintain the 45 cent Basic Postage Rate by absorbing the GST. In order to maintain price incentives for barcoding certain Presort prices were also reduced. This has resulted in an annual cost to the Letters business of \$90m and a saving to businesses, able to claim the GST as an input, of \$75m p.a.

### **Volume growth declines**

Through the 1990's mail volume growth tracked or exceeded Gross Domestic Product (GDP) and achieved compound annual growth rate of 4.7%. Following a spectacular 6.5% growth in 2000, mail volumes declined in 2001. Analysis of the past decade has determined that while there has been a loose connection between Gross Domestic Product growth and mail volume growth the primary stimuli have been a series of one off events such as the introduction of mobile and other telecommunications services, financial regulation changes and the implementation of GST and the impact of stock market activities. As these events are not expected to be repeated in this decade, and as technology substitution and mail piece consolidation increase, the volume growth outlook is subdued and decline is expected from around 2005/2006. In these circumstances the volume related productivity gains experienced in the last decade will not be repeated.

**Productivity gains peak**

During this same period (1991-2001) Australia Post has achieved productivity gains of 67%, more than double the national average of 28.7%. These gains will peak with the completion of Future Post and related projects and while the Corporation will continue to pursue future improvements the same rate of improvement cannot be maintained.

Technological advances, such as were introduced under Future Post have plateaued and are unlikely to be repeated.

**In Conclusion**

Australia Post delivers high standard, reliable services which have supported essential business communications.

The reliability reputation and performance of Australia Post's letter service is recognised by business and the general public alike as a contributor to our success as a nation.

It is our intention to maintain and to build on this reputation and contribution, but this can only be achieved if the business is able to continue to achieve adequate returns to facilitate ongoing investment.

As Commissioner Martin has stated, in the end the ACCC will examine the notification to determine whether Australia Post has efficiently used its assets and whether the proposed price increases are appropriate. Today we will have the opportunity to examine the notification in the light of the issues raised by those present and others not here. We submit that Australia Post's proposal more than meets both of these determinants.