SUBMISSION TO ACCC

IN RESPECT OF DRAFT NOTIFICATION OF POSTAL PRICING INCREASES

From the office of the Chief Executive June 2002

Commentary on Issues Paper - Australia Post Corporation Ltd Draft Pricing Notification – 10 May 2002

GoMail is pleased to have the opportunity to submit its comments in respect of the above draft pricing notification.

General Issues:

1. It is noted that Australia Post has operated under the 45 cent Basic Postage Rate (BPR) pricing template since January 1992. During this time the postal industry has been through a significant degree of change, largely driven by the introduction of new mail processing automation technology and market growth.

2. Australia Post claims that the proposed price changes are aimed at positioning the letters business for ongoing profitability and compliance with its statutory obligations (primarily its Community Service Obligations) and to generate commercial returns. I shall refer to this assertion later in this submission.

In attempting to justify reasons supporting an increase to the BPR, Australia Post chooses amongst other comparatives to compare movement in specific pricing indicies for other household consumables over the same time period.

- GoMail questions the relevance of such comparisons. Australia Post is better described as an industry participant in the national express transport market - recognising its natural market advantage of being a monopoly provider of mail and parcel related delivery services.

- Price movement in the express transport sector over the same time period is a more meaningful benchmark of price and productivity performance over time. Such comparisons will confirm that this sector has experienced a decline in pricing in real terms over the same period – driven largely by competition within the sector which in turn has driven industry rationalisation and consolidation to improve operating efficiencies and industry profitability.

- Australia Post's operating model (via its monopoly – reserved powers status) has been shielded from many of these market conditions. Therefore any notification seeking to increase the BPR should be measured against relevant benchmark performance within the most relevant market sector, adjusted to take account of its privileged monopoly status.

1. Impact on users.

- There is an inherent risk in accepting unchallenged Australia Post's primary argument that physical mail volumes will fall in the future, as the basis for accepting the price increase sought. Giving credence to future events based on future hypotheses as a basis for price increase does not reflect normal commercial practice that competitive organisations face.

- Prior to the notification of its intention to increase the BPR, Australia Post had already signalled to the market the progressive removal of discounts currently available on AdPOST sendings effective 07/02 and 01/03 respectively and the removal of NSP discounts effective 07/02. The decision to change the discount regime is a defacto net price increase to Australia Post (net of the loss of marginal sendings no longer economic). This decision is however consistent with the FuturePOST direction and the industry had time to plan and adjust to the changes required.

- The impact of the growth of alternative communications channels over physical mail is not a new phenomenon. The increasing incidence of electronic substitution reflects the important societal and social changes as communities embrace new (electronic) communications mediums – this directional change will continue irrespective of relative price relationships between the different mediums.

- However this does not give Australia Post unchallenged licence to continue with its present aggressive practice of using monopoly profits derived from its reserved services to actively drive its e commerce initiatives within the non reserved services sector. Similarly it cannot argue at the same time that falling (future) volumes within its reserved services are in part grounds to justify a price increase whilst contributing to the volume demise through its own initiatives and actions.

- Australia Post commits very little promotional support or incentive to stimulate usage within the traditional letters business – rather Australia Post's strategy is to establish itself as the dominant industry player within the competitive electronic commerce sector. This is an admirable strategy except for the fact that it competes within this contestable industry segment with the privilege of unchallenged monopoly profits derived from its reserved services funding such investment. Taken to its logical conclusion such market advantage will lead to the loss of competitive alternatives within this emerging sector due to the (mis)use of monopoly profits to unfairly fund such initiatives. The question remains: is the use of this privileged market advantage within the wider public interest?

- When seeking price increases, in a competitive market environment the ability to extract a price premia would be measured against likely competitor reaction. Australia Post faces no such competitive threat. Similarly, in a contestable competitive environment maintaining ROI performance may require adjustments to an orgnanisation's operating business model - either revenue or cost adjustment or combination of both.

- Australia Post claim that price changes are required because "there is less scope for productivity improvements than over the past decade", and "it expects declines in volume growth rates". Such statements suggest the following:

a) Australia Post is at or nears best practice operating performance, and

b) therefore the consumer (both public and business) should pay for volume declines through higher unit charges under a cost plus reimbursement model.

- Within a) above, the statement about "less scope for productivity improvements" cannot be accepted without challenge – what is the opening denominator used to base meaningful comparisons. Australia Post is no different to any other public owned monopoly business, and when one considers Australia Post is an amalgam of the old PMG "institution" with more modern attributes as its base, the expectations should set the measurement "bar" higher.

- Given its publicly owned monopoly status, Australia Post is not subject to the same rigour and third party accountability (other than meeting the minimalist ROI / dividend policy set by government) nor reporting disciplines to the commercial market as is the case with publicly listed companies.

- As a statutory monopoly, Australia Post has a responsibility to exercise the maximum duty of care to ensure the mailing industry has sufficient time to respond to "market" signals and they are consistently applied.

- Australia Post's $500M FuturePOST investment strategy set forth the future vision of Australia Post to the mailing industry – with mail processing automation via the introduction of barcoding as a key element. Put more succinctly, no barcoding, no discount. The mailing industry was given forward notice of the changes allowing industry to organise itself and make the requisite investment in parallel processes, consistent with FuturePOST's direction.

- The emergence of the aggregation sector in 2000 was a positive example of how the industry invested behind the industry's blueprint for the future.

- In 1999 Australia Post signalled to the market the minimum compliance expectations to barcode volumes – 80/20 by July 2000, 90/10 by July 2001, 100/0 by July 2002 (modified back to 90/10 in Mar 02). This allowed the mailing industry to make the necessary investment in barcoding technology and / or changes in processing / lodgement arrangements via aggregation.

- Australia Post's current price justification announcement evidenced by the proposal to introduce the new mail product "Clean Mail" demonstrates a complete contradiction and inconsistency in Australia Post's previously applauded commitment to the principles underpinning FuturePOST's direction.

- Australia Post has broken its duty of care obligation by compromising on one of the foundation premises of FuturePOST – a commitment to barcoding as the industry blueprint. It is a statement of fact that right up until the proposed introduction of Clean Mail as announced in April 2002, Australia Post had been reinforcing its consistent message of barcode compliance as the only means to continue to enjoy bulk mail discounts. As recent as March 2002 the Australia Post customer awareness marketing program / publication Barcoding

July 2002 – A Way of Life, reinforced the FuturePOST commitment. As the ACCC is aware, the deliberate “oversight” by Australia Post in not recognising the aggregation sector as one of the barcoding options available to industry participants in the above industry communications medium is further demonstration of Australia Post’s dismissiveness of the aggregation sector and GoMail in particular. Such is the arrogance of the monopoly.

- Via the proposed introduction of Clean Mail, Australia Post has displayed a disregard for the significant investment made by the mailing industry in barcode technology. As from July 2002, under the principles of FuturePOST any mailer unable to meet the 90/10 barcode compliance either through its own investment in barcode technology or utilising the services of aggregation would have no choice other than to pay full rate for all mail sendings. The proposed introduction of Clean Mail effective January 2003 provides nil incentive to seek barcoding solutions as the price of postage will remain at 45c.

It is our view that Australia Post should be held accountable for its decisions – if the industry was made aware of an “about face’ would the industry participants have committed the same investment dollars and changes to processes to accommodate the future direction. The industry, not just Australia Post has committed to the underlying principles of FuturePOST.

2. Service Quality

- Australia Post service and delivery performance has historically had a red letter box focus largely representative of non business mail sendings. This focus is outdated and has manifested itself in Australia Post’s rigid and uncompromising attitude towards the mailing industry’s constant demands for changes to the 6pm lodgement deadline – despite significant advancements in mail processing and lodgement capabilities.

- Recent developments has seen Australia Post agree with the mailing industry to put in place a bulk mail monitoring program to measure the same performance characteristics of essential business mail volumes. Interestingly, despite representations by GoMail (as the market’s only mail aggregation provider and as such a significant channel for lodgement) to be included in this mail monitoring program, Australia Post has consistently refused to acknowledge aggregation as a legitimate mail lodgement channel alongside mailhouse volumes. In fact, to date all of the bulk mail monitoring conducted by Australia Post relates only to volumes channelled directly through Australia Post controlled out-stations.

- Until such time as bulk mail monitoring is representative of a wider cross section of lodgement channels, GoMail questions the validity of service measurement outputs as a means to “reward” Australia Post’s self adulation of its service performance.

3. Impact on Competition

Mail Aggregation

- The mail aggregation sector is dependent on the bulk mail presort pricing schedule released by Australia Post for its top line margin.

- The emerging sector has already been hit by the imposition of GST (but after the investment decisions were made), reducing maximum weighted average gross margin over postage from 9.2 cents to 5.7 cents per mail piece. Given normal cost pressures necessarily incurred by the aggregation sector, continued productivity improvements becomes the only mechanism to maintain net margin in the absence of other means to increase the sell price.

- The price notification proposed by Australia Post (excluding the impact of Clean Mail) provided the mechanism to put more gross margin back into the aggregation sector which would have served to sustain longer term viability.

- The Clean Mail proposal in its present form completely undermines the value proposition of the mail aggregation sector. Increasing the base presort discount price and at the same time creating a new maximum price point for unbarcoded mail volumes (target market for aggregation) represents an adverse "double whammy" effect and renders aggregation as uncompetitive.

- The maximum pricing differential between barcode pricing and full rate was 7.6 cents (45c – 37.4c). After Clean Mail the differential has been narrowed to 5.4 cents (45c – 39.6c). By the same comparison, the weighted average gross margin over postage (taking into account typical mail mix) available to the aggregation sector reduces from 5.7 cents to 3.7 cents before operating costs and margin sharing with customers.

- The mail aggregation sector was created as a result of policy change announced by Australia Post consistent with the government's competition policy guidelines for the postal sector. Mail aggregation represented a significant phase of policy reform.

- Despite the above, the concept of mail aggregation has not been embraced by Australia Post. This is demonstrated by Australia Post's expressed concerns and/or actions:
  - the aggregation value proposition to major mail generators (mailhouses and major mailers) unbarcode mail streams positions the aggregation sector in the primary relationship with such parties, with Australia Post being relegated to secondary, a position it has never been comfortable with;
  - aggregation was never intended to access commercial barcode mail stream volumes – rather provide a barcode solution to small mailers to access postage discounts via aggregation.

- continued intransigence by Australia Post in not addressing a number of the terms and conditions governing mail aggregation – whilst Australia Post set, administer and sit in judgement of those rules, and are allowed to do so without third party scrutiny there is little motivation to change.

- The proposal to introduce Clean Mail is a deliberate attempt by Australia Post to curb the growth of the aggregation sector in the major mailer segment of the market. File notes (available for the ACCC upon request) of conversations with senior Australia Post officials support the above actions and motivations. From GoMail's perspective, the authors of the Clean Mail proposal as outlined in the Draft Notification were fully aware of the resultant impact on the aggregation sector.

- GoMail has long argued the aggregation sector is a discrete business channel and as such should have its own lodgement and pricing rules applicable to it. Unlike the mailhouse sector where cost increases are simply passed on to the end customer, aggregation is not afforded the same opportunity. Gross margin available to the aggregation sector is determined by the Australia Post bulk mail pricing template – sell price / buy price determinants from which the sector sets its pricing (postage discounts passed on) with its customers.

- If Australia Post was genuinely concerned about the impact of Clean Mail on the aggregation sector, it would have confirmed a pricing template ensuring the gross margins available to aggregators were not materially impacted by the product's introduction.

- A price ceiling from 45cents to 47cents would maintain the necessary relatitivities to ensure aggregation was not adversely effected by the introduction of Clean Mail. The ACCC is asked to take this into account in its deliberations.

- The lack of (non existent) consultation with GoMail prior to the draft Notification's release - see comments in separate section – is clear evidence of Australia Post's attitude toward the role aggregation plays within the mail industry's dynamics.

- The concept of offering discounts to non barcoded mailstreams was an unpredicted development – and not consistent with the signals, advice and directions given to the industry since the announcement of FuturePOST. This adds further weight to the view that it was not only an ill conceived product by only addressing a need of those industry participants who are yet to embrace barcoding, but is a product initiative designed to marginalise aggregation.

- It is GoMail's view that Australia Post is proposing to defacto enter the aggregation business by using its own MLOCR technology to effectively compete for the same target volumes of aggregation – and with its marginal cost advantage undermining this industry sector.

The need for greater legislative and regulatory support is essential if Australia Post is to be held more accountable and subjected to greater third party scrutiny for its actions.

Document Exchange

- The Australian Document Exchange operates an alternative business to business, member to member mail and document delivery network. Whilst the pricing methodology is based on annual membership, the value of membership takes into account mail volumes – by type / quantity and the equivalent Australia Post pricing to determine membership value.

- All things equal, a general movement in the BPR provides the basis for movement in membership values – and relativities are maintained. From the document exchange perspective, price movement is welcomed.

4. Information and Consultation

Australia Post via the Code of Practice signed with MMUA the mailing industry's representative body is required in Section 4 paragraph 2 "…will consult with users of its bulk mail services and the MMUA in developing new prices for the reserved services…"

GoMail as the market's only mail aggregation provider delivering 180 million pieces of mail to Australia Post is a major stakeholder within the industry. As one of the users of Australia Post's bulk mail services, there has been no consultation, nor contact made with GoMail in respect of pricing and product changes, nor discussion on how the Draft Notification may impact the aggregation sector. As further demonstration, it should be noted GoMail was not involved (nor invited) in the consultative process between Australia Post and the MMUA - another example of Australia Post's disregard for the emerging aggregation sector.

Technical Issues:

Too often the argument about the cost of maintaining compliance with the Community Service Obligations (CSO) is used to satisfy an unquantifiable argument.

1. Efficiency of Australia Post's Operations

- Australia Post continually make self congratulatory claims about productivity improvements introduced within their operations. And so they should considering the $500M of public monies invested in its visionary industry blueprint – FuturePOST.

- Where is the accountability to demonstrate such productivity performance to industry stakeholders? As stated earlier in this submission, the origins of Australia Post and therefore starting position was a historically inefficient, lazy, over staffed, union dominated and heavily demarcated organisational structure as a base. To measure productivity improvement, external hurdles need to be set as if the performance was to be scrutinised by the external financial markets – not against internal benchmarks driven by expected dividend hurdle rates set by government.

- In considering Australia Post's claim that they near the end of the productivity improvement curve cannot go unchallenged. Benchmarked against what? How much challenge and rigour has the organisation been subjected to before making this statement as justification for a price increase? The benchmark against which such claims could be made would require third party scrutiny similar to that of other publicly traded entities under ASX reporting conditions. The market would analyse management's diligence in delivering productivity benefits as part of demonstrating ROI performance against industry best practice principles, not just those set internally (given concerns over the denominator used).

- It is our view the ACCC should satisfy itself whether Australia Post has delivered on the cost savings and productivity improvements implicit in the original FuturePOST investment recommendation. Given the sudden change in direction away from 100% barcode compliance (revised to 90%) to offering discounts on unlimited non barcode volumes suggests one of the principal foundations of the FuturePOST strategy has failed to be realised. Why then should Australia Post be rewarded.

- It is reasonable for the industry to ask how much of the sought after increase in the BPR is "funding" the Clean Mail pricing discount? Without sufficient transparency in its justification supporting the increase, this question remains unanswered.

2. Forecast Volume Growth

- The FuturePOST investment has assisted in the holding of current pricing levels through delivering cost and productivity savings and therefore contributing to the monopoly's profitability, as part of the original investment justification. The question is by how much and how much is there to go? The argument based on 10 years since the last increase is not justification given the responsibility to realise the maximum return from the $500M investment to support profitability.

- Australia Post argues that future mail volume growth will decline over the next 5 years. Presumably this analysis takes into account GDP and population growth as part of the determinants. Irrespective, in the event volume growth rates slow or decline in real terms does not automatically justify grounds for a price increase, unless a cost plus approach is the basis for justification.

- The cost plus approach pricing methodology is typical of monopoly structures, in the absence of other competitive service providers. To justify an increase on such grounds should require Australia Post to demonstrate the rigours it has employed to maximise cost savings through elimination of waste, excess or reengineering process flows.

- In the absence of advice to the contrary, monopoly structures are not exposed to the same commercial transparency and governance disciplines to deliver these outcomes – the option of simply increasing price to make up shortfall is too easy an option. The onus is on Australia Post to demonstrate to its industry with full disclosure to justify its intent.

3. Rate of Return

- The question of reasonableness of the rate of return applicable to statutory monopoly structures are normally reflective of the degree of business risks involved.

- The expected performance of an efficient monopoly supports the argument for a higher rate of return to ensure management drive efficiencies and productivity to deliver EBIT performance, without increasing prices per se.

4. Community Service Obligations

- Australia Post very cleverly use the argument of the cost of maintaining CSO's to suit its own political argument – driven more on fear and implied threat than economic substance. There is a cost of meeting those universal obligations, but such a cost obligation should be seen as part of the premia for its privileged monopoly status.

The real issue is to determine the true cost of maintaining the CSO, excluding the cost of maintaining historic old buildings and such other costs . Only upon full and open disclosure will the industry be informed as to the relevance of Australia Post's statement that it constrains its financial performance. In any event it is GoMail's view that this matter should not be taken into account as part of the justification process.

Summary:

1. The introduction of Clean Mail is ill conceived and is materially damaging to the emerging aggregation sector – and Australia Post's proposed actions behind this product are considered to be a breach of Section 46.

2. Australia Post has a duty of care to the industry. It should be required to demonstrate the return on investment achieved from its $500M FuturePOST industry blueprint, with full transparency and disclosure. Furthermore, the ACCC and industry stakeholders need to be satisfied that Australia Post can demonstrate that it has extracted all of the cost and productivity savings implicit in the FuturePOST investment rationale before any further consideration of price increases.