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Post Office Agents Association Limited
ACN 006 382 314

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

Dear Ms Arblaster,

AUSTRALIA POST'S APPLICATION FOR AN INCREASE IN POSTAGE

Thank you for the opportunity to comment on the draft issues paper related to the application by Australia Post for a price increase for a range of postal services.

Our detailed comments on the issues in the Commission's paper are attached.

POAAL supports the proposal by Australia Post for the price increases and the quantum that has been sought. Further POAAL agrees that the price of these services now needs to be reviewed on a more regular basis than the five-year cycle set for the last increase. The dynamics in the communication industry are now moving at such a pace that long periods with set prices is not consistent with managing the issues emerging in this market.

Should the Commission wish to clarify any of our comments or to seek further information that may assist its deliberations, POAAL is available for that purpose.

Yours sincerely,

Ian Kerr
CEO

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Submission to the

Australian Competition and Consumer Commission

Australia Post Draft Price Notification Issues Paper

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As Australia Post notes in its application, the efforts of its price restraint over the last 15 years has created a real benefit to the community and to its shareholder. This has only been possible through initiatives that have released substantial productivity improvements over that time.

A price increase at this time is warranted and supported by the Post Office Agents Association.

POAAL would particularly like the Commission to understand that the burden for productivity improvements achieved by Australia Post has also fallen heavily on the Australia Post's Licensees. Australia Post has achieved much of its improvemenst through investment in technology. The introduction of technology has inevitably been accompanied by increased effort at the receipt and delivery ends of the service chain. New procedures to prepare mail before sending it to processing centres and in recording delivery have contributed heavily to the effectiveness and performance of the technology, the reward harvested by Australia Post and the service provided to customers. But this has been at the expense of additional effort required by Licensees without maintaining the real value of their payments. A material amount of the Licensees' payments are directly linked to the price of postage.

It is estimated that well over 50% of Australia Post's letters revenue is achieved through its retail network. In number Licensees represent nearly 80% of that network and approximately 20% of its volume.

Unlike Australia Post, Licensees do not have economies of scale to achieve improved profitability. Licensees have borne the brunt of real decreases in price and volume while having to take on additional costs to assist Australia Post achieve efficiencies from its re-engineering.

If return on investment were considered at a community level, then the capital investment of Licensees would be included in calculations of the WACC. Although no rigour has been applied to calculating this amount in submissions to date, it is the estimation of POAAL that it would add between 10% and 15% to the capital base on which returns for this industry are assessed. That would add further weight to support price change.

The proposal to increase the price of services translates directly into revenue for Licensees. It will help sustain the small business operators that are crucial to ensuring postal services are universally available across the Australian community. It is a measured change that will be readily accounted for by the community, especially in the context of the abundant financial and service improvements that have been achieved by Australia Post and its Licensee network over the last five years.

ACCC seeks views on:

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

There is merit in the proposal that price increases for the reserved services should be considered on a more frequent basis than the five and ten year periods previously adopted. In the past the long term between price reviews was in part recognition that material productivity gains were yet to be realised within Australia Post.

The performance of the organisation over the last few years has demonstrated that it has realised those opportunities to the benefit of the shareholder and the consumer.

The situation for the future is entirely different. Letter mail is growth is problematic with forecasts showing flat or negative growth after many decades of modest increases. In contrast to the past the future of this service needs to be assessed on more frequent intervals than last five-year program. The changes in the communication industry have certainly accelerated over the last few years and this is unlikely to abate in the future.

The feed back POAAL members have received from small to medium businesses is that regular and modest increases enables better planning rather than large periodic increases. This is in keeping with the pricing strategies of these organisations.

If more regular increases are to be adopted, then new mechanisms or formulas to review the merit of the increase will also need to be established. This would allow the process to be more expeditious than the current process which is designed for intervals of several years between reviews.

ACCC seeks views on:

- The factors identified by Australia Post that influence letter volumes
- The underlying assumptions in Australia Post's forecasts of the future volumes regarding consolidation, rationalisation and substitution
- The impact of price increases on Australia Post's reserved service profitability in the context of forecast declining letter volumes.

POAAL is not in a position to offer comments on the influences over letter volumes other than common understandings of broader trends within the domestic and mercantile community towards electronic exchange of data and information.

The substitution of traditional mail for these services may increase initially as a reaction to price increases but this is unlikely to have a material effect on the long-term use of the mail service.

Hard copy mail has its place in commercial communication strategies. It is the experience of POAAL members that the reaction of consumers to personalised hard copy mail is still stronger than similar communications sent via email. If hard copy promotional mail received, say a 3% response rate compared to, say a 0.1% response from electronic mail then organisations would make cost benefit decisions around those outcomes.

If hard copy mail is to survive it has to have a value-added proposition in its own right. Its price, because it is of a completely different scale to electronic substitutes, is simply one of a number of factors in commercial decisions that will be made about its future use.

In the absence of volume increases the only means left to achieve service profitability is a commitment to cost reduction and/or price increase.

Cost reductions seem challenging given the productivity harvested over the last decade although POAAL has other comments on this issue later in our response.

The cross subsidising of reserved services by non-reserved services is unsustainable given the competition in those markets. POAAL notes that this issue was comprehensively addressed in the Commission's recent report on *Assessing Cross Subsidy in Australia Post*. The report of April 2008 broadly concluded that there was no cross subsidy of reserved services to non-reserved services. If anything non-reserved services provided subsidy to reserved services.

Price increases subject to appropriate justification seem the most sustainable proposition.

ACCC seeks views on:

- The impact that the proposed price changes will have on volumes for each of the products for which Australia Post is intending to increase prices
- The extent to which the level and the timing of price changes has an impact on mail volumes

It has been the experience of POAAL members that a price increase is characterised by a brief period of increased volume prior to the price changes. This is then followed by a two- to three-month period of decreased activity. Within a short time volumes are back to normal and businesses have accommodated the change in their costs and charges.

With an appropriate period of notification, companies and domestic customers readily adjust their budget expectations. Some industries more reliant on mail to transact business will no doubt argue for a long lead-time. A sensible balance needs to be struck. POAAL understands that a 30 day period of notice is planned.

For the small to medium business customers served by POAAL members a two-month lead time is preferable. This allows a period for any price adjustments in their services and for that to be communicated to their clients.

Medium size businesses prefer notification before the end of the financial year to assist with budget planning for the year ahead.

The package of changes to be announced by Australia Post has merit. It achieves a balance between a 10% change in small and large letters and much smaller increases for business mail. This should help minimise the impact of the price changes to the major sources of mail volumes.

ACCC seeks views on:

- 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.

POAAL comments later in this submission on the opportunities for improved cost performance.

ACCC seeks views on:

- The forecast growth in the outputs and inputs for the reserved and non-reserved services
- The reasonableness of the trend growth rate for the period 2002-2007 and for the forecast period 2007-11
- The use of the CPI as a price deflator for individual input and output price indexes
- The assumption of constant returns to scale for Australia's aggregate business.

POAAL has no basis on which to make comments on future growth trends or the use of the CPI as a price deflator in favour a more appropriate index.

ACCC seeks views on:

- The economic efficiency of Australia Post's operating costs (including labour costs, contractor costs, accommodation and depreciation)
- Changes in Australia Post's cost structure over time

Measures to improve the efficiency of Australia Post's operating costs have been driven in the past by various strategies to substitute labour with capital or by transferring costs to other parties.

In these strategies they have been successful in a wide range of initiatives.

Innovative and world class technology in mail centres has enabled additional mail volumes to be managed with the same or slightly reduced labour costs as well as extending the quality and reliability of the services.

In its retail network significant cost savings were made by both reducing staff and converting many corporate outlets to Licensed (franchised) operations.

In addition Australia Post has transferred a number of costs to mail contractors. In Licensed Post Offices new or enhanced services have required Licensees to undertake some type of preparation or registration. A recent example is Australia Post's new 5kg Express Post satchel. Although this product is not available for purchase through Licensed Post Offices (and thus no commission is received) it must be accepted and prepared for sorting at the processing centre.

Other examples exist in the pre-sorting of mail and the scanning of items prior to final delivery. This is in addition to items requiring "carding" for later collection by customers, resolving incorrectly addressed mail and handling returns. The latter in particular distinguishes the Australia Post service from its competition.

All of these contribute to the service experience of the client and to the efficiencies of Australia Post but are done without extra reward for the Licensees and/or Mail Contractors who contribute to the service.

Fuel costs have increased sharply over the last few years. Australia Post has resisted all but the most determined attempts by mail and parcel contractors (a number of whom are also Licensees) to adjust the sums they receive for the delivery of mail and parcels. Given the extensive distances involved in serving many regional areas these costs have been significant and are largely borne by contractors.

While the extent of reform in Australia Post has been a major contributor to increased productivity it has to be noted that the pace of this reform appears to have slowed in more recent times.

The use of contract labour now has different economies with new superannuation and state payroll tax requirements. However, the use of contract labour by Australia Post in the areas of transport and delivery staff has been low. Where it has occurred it has often been in situations where local demand for labour has forced the use of other innovative employment strategies. An example is in Western Australia where most of the employment capacity has transferred to the mining industry.

Although much was made by Australia Post of the introduction of a new franchising format into its retail network very few have eventuated and they do not perform as efficiently as LPOs.

The reform programs and productivity opportunities that Australia Post intends to pursue in the future, especially in the light of its future capital investment program are not clear.

The Commission may wish to seek greater transparency on the future measures, other than price increases, that Australia Post will pursue to ensure it achieves sustained profitability.

ACCC seeks views on:

- The conceptual framework applied in the Bishop and Officer report for determining the capital at risk
- Whether current assets such as working capital and cash in the field should be incorporated into the asset base.

POAAL has no comment on the Bishop and Officer report and its assessment of capital at risk.

With respect to working capital, POAAL regularly works with Australia Post to reduce the cash-on-hand across the LPO retail network.

While this is primarily for purposes of developing and implementing appropriate security measures, POAAL is aware that funds on hand are extensive.

It would be reasonable that this number be included in measures of the Weighted Average Cost of Capital when considering Australia Post's return on capital. The funds are not able to be invested and should be considered part of the asset base against which a "reasonable rate of return" is calculated.

ACCC seeks views on:

- The level and composition of the proposed capital expenditure for the domestic reserved letter service
- Australia Post's approach in incorporating forecast capital expenditure into its pricing asset base.

POAAL has no comment on these issues.

ACCC seeks views on:

- Whether the statutory tax rate or an estimate of Australia Post's effective tax rate should be incorporated into the WACC
- Whether the equity beta of 0.66 is reflective of the operating and financial risk of Australia Post's returns relative to the market

While these issues are not the prime expertise of POAAL it would seem reasonable to follow earlier reviews by the Commission that used the statutory tax rate. The effective tax rate is not known until the end of the financial year. It can depend on a range of one-off in-year events that are not particularly relevant to the assessment of a reasonable rate of return.

No doubt the equity beta is meant to represent the lower market risk of Australia Post. POAAL has no comment on the analysis provided in the report by Professor Officer.

ACCC seeks views on:

- Whether the difference between the pre-sort letter services rates is appropriate
- Whether the Acquisition Mail service has been priced appropriately in comparison with other mail services
- The likely impact of the introduction of the new Acquisition Mails service on the other types of promotional mail.

Forecasts on the impact of the Acquisition Mails service on the volume of other mail are difficult. There may be some cannibalisation of existing services in business related mail.

POAAL understands that Australia Post is attempting to respond to a niche market not currently catered for in the range of existing postal services. That is, between unaddressed mail and fully addressed mail.

The discount against the existing clean mail is extensive. Proposed prices of 48c for existing small letter clean mail compare with acquisition mail priced at 28c (intrastate) or 30c (interstate). More substantial discounts are available in the "small plus" category of mail. This pricing seems to have been made on the basis of marginal costs associated with the additional service. This would need to be monitored as experience with the volumes of this service becomes known. No doubt the Commission will be able to assess the impact of this pricing in its review of Australia Post's record keeping and its assessment of any cross subsidy between reserved and non-reserved services.

POAAL is of the view that this type of product development by Australia Post is to be commended.