



# POAAL

Post Office Agents Association Limited  
A.C.N. 006 382 314

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4 July 2008

Mr Anthony Wing  
General Manager – Prices Oversight  
Australian Competition and Consumer Commission  
GPO Box 520  
MELBOURNE VIC 3001

Dear Mr Wing,

**Australian Competition & Consumer Commission's Preliminary View on the  
Australia Post application for an increase in postage**

Thank you for the opportunity to comment on the Commission's preliminary view of the application by Australia Post for a price increase for a range of postal services.

Our detailed comments are attached.

POAAL supports the Commission's conclusion that it should not object to the application for a price increase by Australia Post.

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



# POAAL

Post Office Agents Association Limited

## **Submission to the**

# Australian Competition and Consumer Commission

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## Preliminary View of Australia Post's Draft Price Notification

### **Post Office Agents Association Limited**

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POAAL supports the preliminary view of the Commission that the price change sought by Australia Post should be allowed. Our organisation takes this opportunity to make a number of observations about the Commission's paper and the proposed management of these issues in future.

## **Cost allocations**

POAAL notes the comments of the Commission with respect to the challenges associated with the allocation of costs between reserved and non-reserved services. POAAL agrees that the Commission and Australia Post need to develop appropriate methodologies to further understand these aspects when establishing future prices for reserved services.

Such transparency also allows the community and interested parties to assess trends in the organisation's efficiency and the quantum and appropriateness of Australia Post's community service obligations (CSOs).

We note that CSOs are estimated to have increased from \$79m to \$97.3m over the four years from 2003/04. Even in an organisation the size of Australia Post these are material costs. They need to be considered not only in establishing prices for the regulated service but also by policy makers in ensuring that they continue to be acceptable.

Although there is some debate about the best methodology to be used in establishing costs and their allocation to different services, POAAL notes that the implications are not of such magnitude that the price increase should be denied.

It is of some concern however, that several important inadequacies in the discipline of cost allocation used by Australia Post have been identified. This includes the cost allocation methods used for the sorting of inward mail by Licensees and for contracted roadside delivery<sup>1</sup>.

POAAL is not aware that any assessment has been undertaken by Australia Post of actual field operations that would enable it to make sensible cost allocations for these activities. This in turn casts doubt on the veracity of the activity costing methodology used by Australia Post.

POAAL also notes with concern, that the Australia Post Regulatory Accounting Procedures Manual "uses a terminology for cost categories that is quite different from the categories set out in the ACCC's Record Keeping Rules"<sup>2</sup>(RKR). As the WIK report confirms, this confusion impedes transparency. Given that the RKR

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<sup>1</sup> WIK Consult GmbH – Non Confidential Summary – Page 3

<sup>2</sup> Ibid Page 1

have been established for some time this lack of conformity by Australia Post is worrying.

For the future there was a general view by the Commission that more regular price increases could be allowed subject to important conditions. As set out in our earlier submission POAAL agrees that these more regular price increases should occur. We also support the conclusion that the Commission and Australia Post should work toward an agreed costing methodology. This must conform to the accepted RKR. This process and its outcomes should also be made transparent in future price evaluations<sup>3</sup>.

POAAL also agrees with the views of the Commission and the MMUA that future price changes should occur in a framework that places appropriate pressure on Australia Post to pursue efficiencies.

POAAL considers that there is only a small risk of Australia Post relying inappropriately on price rises alone. This is based on the fact that

- much of the infrastructure of the organisation supports the delivery of both reserved and non-reserved services;
- the profit contribution of reserved services is now relatively low (approximately 5 per cent); and
- market forces for the non-reserved services will pressure Australia Post to operate in an efficient manner.

However, the community's confidence in the ACCC's assessment will require confirmation that a proper evaluation of the merits of the price increase has been undertaken.

## **Forecast demand**

The challenge of forecasting demand for Australia Post reserved services has existed for many years. Numerous external consultants have made it their business to predict the demise of Australia Post in the emerging electronic era. All have been contradicted by steady growth in the years following their reports.

It seems however, that flat or declining mail growth may now reflect a permanent change in the nature of commerce.

Past trends could be reasonably linked to economic cycles. We note the Commission's observation on the changing relationship between growth for Australia Post and non-farm GDP. It has been the observation of POAAL over many years that Australia Post was, at least for a period, somewhat resistant to

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<sup>3</sup> ACCC's Preliminary View Page 68

downturns in the economy. In these periods companies made the transition back to Australia Post from more expensive delivery options. Overseas studies support the POAAL view that price increases are relatively inelastic and demand, in the medium term, has not reduced profit following the price increase.

It has also been the experience of POAAL, as the Commission's paper notes<sup>4</sup>, that the delivery efficiency of hard copy mail, rather than price of the postal service, is a principle determinate in exercising choice about the use of alternatives<sup>5</sup>. Electronic substitutes, for example, are exponentially less expensive than the postal service.

There are now strong signs that the relationship between GDP and the cost of substitutes is likely to change over the coming period<sup>6</sup> as structural change to the communication sector makes its way through the economy. It is for this reason that POAAL supports more frequent reviews as these changes and their impact on Australia Post services are yet to be understood.

## **Future productivity**

One of the main concerns about the application by Australia Post is the lack of detail in its forecast with respect to future productivity improvements. While POAAL supports this price increase it agrees that regular future price increases should not be used to avoid further productivity improvements.

The tenor of the Australia Post application is that the organisation feels it has exhausted these opportunities and that marginal benefits remain to be achieved.

That attitude is disturbing in an organisation with a commercial focus. Its response to the external parties' submissions on its application provided scant indication about the future use of contractors or other structural changes considered necessary to maintain productivity growth. There is no detail on how it will ensure decreases in costs are used to offset future labour price movements to sustain itself. These are regular features in announcements of commercial organisations subject to the scrutiny of the Australian Stock Exchange.

The common feature on which all interested parties have provided comment<sup>7</sup> is the unrealised potential in Australia Post's productivity. They agree that the Commission needs to ensure that price rises do not provide a disincentive for these opportunities to be pursued.

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<sup>4</sup> Ibid Page 77

<sup>5</sup> Ibid Page 83

<sup>6</sup> Ibid Page 79

<sup>7</sup> Ibid Page 118

It is noted that Australia Post has

- regularly underestimated future demand<sup>8</sup>,
- unrealised gains from past capital investment especially in mail technology<sup>9</sup>
- projected increases in labour usage in the immediate period ahead<sup>10</sup>, and
- followed the practice of allowing wage increases at or in excess of CPI.

In these circumstances further effort should be provided by the organisation to outline the initiatives other than price increases that will be used to achieve improved performance.

This is especially so in the light of Australia Post's major capital expansion planned over the coming years<sup>11</sup>. Although largely dealt with by the Commission in terms of the governance around capital allocation and its costs, it has not been linked with the productivity plans for the organisation, at least in the material released for public scrutiny.

POAAL raises this because one of the major future efficiency opportunities for Australia Post is the further substitution of staff labour by either capital or contractors.

## **Conclusion**

POAAL agrees that more frequent price reviews are reasonable but not without the rigour of review by the Commission.

Further, POAAL agrees with the Commission that to support future price increases a disaggregated model of costs needs to be provided of the coming three-year period.

As part of that process Australia Post should be more transparent on productivity gains to be achieved so that it is clear the burden of cost growth is not borne by its customers and contractors alone.

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<sup>8</sup> Ibid Page 128

<sup>9</sup> Ibid Page 136

<sup>10</sup> Ibid Page 134

<sup>11</sup> Ibid Page 109