

16 September 2009

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

Dear Mr Wing

This submission responds to the Australian Consumer and Competition Commission's (ACCC) *Australia Post's Draft Price Notification Issues Paper*, August 2009. The Australian Direct Marketing Association (ADMA) welcomes the opportunity to comment on this vitally important matter for the direct marketing industry.

ADMA is the peak body of the Australian direct marketing industry and represents over 500 member organisations including all the major financial institutions, telecommunications companies, energy providers, travel service companies, major charities, statutory corporations and specialist suppliers of direct marketing services. According to CEASA¹ research, 715 385 Australians were employed by the direct marketing industry in 2006 and it had revenues of \$12.8 billion pa.

Many ADMA members rely heavily on Australia Post's products both for transactional and promotional communication and any price increase will have a significant impact on their business. ADMA members report that mail is an often preferred and effective method of communication but that there is some price sensitivity.

The September 2008 price decrease coincided almost exactly with the beginning of the global financial crisis. It is therefore impossible to discern to what extent these two significant events contributed to the 4% drop in volumes for Australia Post services in 2008/2009.

It is however clear that in a period of difficult trading conditions for many companies that an increase in postage prices will have the direct result of:

- a) reducing both transactional and promotional volumes
- b) forcing organisations to expedite plans to move cheaper electronic methods of communication

¹ Commercial Economic Advisory Service of Australia Report Direct Marketing in Australia 2006

Given the extraordinary conditions that applied in the last year, it is ADMA's view that Australia Post should be encouraged to take a longer term view in relation to whether it should increase its prices and not overreact to the circumstances of the year just passed. Australia Post should wait to see whether the change in volumes is permanent or whether they start responding positively in line with a possible positive upsurge in economic activity.

Many other businesses are currently experiencing a decline in volumes and profitability with no prospect of being able to raise prices. A price increase is, in itself, a blunt instrument when applied to retain profit margins particularly in an extraordinary trading environment, and, especially when the real cause of volume increases are uncertain.

ADMA believes that Australia Post risks long term damage to the efficacy of the mail channel by over reacting to volume decreases during a period of significant economic uncertainty. Any increase in price now will almost certainly lead to a corresponding decrease in volumes which may in turn necessitate further price increases.

From a broader economic perspective any increase in price when organisations are either still in difficult trading conditions or starting to see an increase in economic activity will stymie any trend towards recovery. This will only serve to increase pressure on business revenues, business in general or the general move towards substitution.

As a result ADMA submits that:

- a) the ACCC should continue to monitor and put pressure on Australia Post to continue to reduce its costs;
- b) the increase in postage prices should be deferred indefinitely or at least until July 2010 to allow organisations to factor the increase into their budgets;
- c) any increase should be in line with Consumer Price Index increases only;
- d) there should be no change to the service standards that Australia Post must meet.

Should you require any additional information please do not hesitate to contact me directly on (02) 9277 5420.

Yours faithfully

Rob Edwards
Chief Executive Officer

ADMA RESPONSES TO THE SPECIFIC QUESTIONS POSED BY THE ACCC

THE ACCC SEEKS COMMENTS ON THE SCOPE AND DURATION OF AUSTRALIA POST'S 2009 DRAFT PRICE NOTIFICATION.

Does the information about Australia Post's intention to increase the prices of its reserved letter services in 2011/2012 provide certainty for customers about future prices for reserved services?

Marketers need as much notice as possible to incorporate price increases into their budgets, however this must be balanced with the danger of forecasting price increases that are not justifiable.

It is ADMA's understanding that organizations, quite rightly, had no way of knowing, nor expecting that further price increases would occur so soon after September 2008 and this has not been factored into their organisation's budgets. It is totally unreasonable therefore to put a further cost impost upon their business half way through the current financial year..

One option available to the ACCC is to consider the need for price notifications over the period of 2010/2011 to 2011/2012 in its assessment of Australia Post's 2009 proposal.

In light of this option, what are your views on:

- *The appropriate sharing of volume risk (ie the extent to which reserved letter volumes vary from those forecast in this notification) between Australia Post and its key customers*

Australian business is bearing a significant amount of risk with respect to the effects of the global financial crisis.

It is ADMA's view that Australian business should not be subject to further risk with respect to a variation in volumes

- *Whether Australia Post should be rewarded for reducing its costs below the ACCC's forecasts in future price notifications*

ADMA supports the introduction of a reward structure for Australia Post reducing its costs, but is uncertain as to what form those rewards should be.

- *If the 2009 model is used to assess future price notifications how should variances between actuals and forecasts be treated*

No comment

- *What would constitute a 'significant variance'?*

No comment

THE ACCC SEEKS COMMENTS ON AUSTRALIA POST'S FORECASTS OF RESERVED MAIL VOLUMES FOR THE PERIOD OF 2009/10 TO 2011/12

Do you think that Australia Post should seek price increases in the context of declining volumes?

While ADMA is sympathetic to the position that Australia Post faces in respect to producing a satisfactory return to its owners, the market dynamics are changing and with that, it is our view, that the financial constraints put on Australia Post should be re assessed. With alternate lower cost channels now available it is inevitable that there will be further deterioration in volumes of all categories of mail. However, the scramble to retain margins and return on investment by using the price lever alone will only accelerate the shift and set up a spiral from which it will be impossible to recover.

For the reasons above, therefore, it is our view therefore that Australia Post should not be seeking further price increases beyond the CPI in the context of declining volumes.

What impact do you consider increases in the prices of domestic reserved letter services will have on the demand for those services?

An increase in prices will only expedite Australian businesses migration away from Australia Post services towards electronic mediums.

This will apply for both transactional and promotional mail.

Do you agree with Australia Post's volume forecasts by category of reserved letter service? Are these forecasts reflective of the long-term trend of demand for Australia Post's mail services and your expectations of future usage?

No comment

What impact do you consider the decline of economic activity will have on volumes of Australia Post's reserved services? If there is an impact, how long do you expect that this will persist?

Declines in economic activity does reduce the demand for Australia Post's reserved services. ADMA also submits that demand for Australia Post's reserved services will increase as the Australian economic activity increases.

ADMA has no view of the longevity of the current economic downturn.

Do you think that the long term trend toward consolidation, rationalization and substitution will be affected by the recent downturn in economic conditions?

ADMA believes that the long term inexorable trend towards consolidation, rationalization and substitution will be accelerated by the recent downturn in economic conditions and that this trend will also gain further impetus by increases in postage prices.

On this basis, ADMA submits that Australia Post should defer the proposed increase in prices to allow for a proper assessment of whether the economic downturn is likely to persist and whether the Australian economy is moving out of this cycle. Such an examination will also enable a true assessment to be made of the price elasticity of the postal product.

COMMUNITY SERVICE OBLIGATIONS

THE ACCC SEEKS COMMENTS ON THE IMPACT OF AUSTRALIA POST'S CSOs ON THE COSTS OF PROVIDING ITS RESERVED LETTER SERVICES.

- *What are the key growth areas in Australia Post's delivery network? Do you agree with Australia Post's forecast increase in delivery points?*
- *To what extent do you consider the costs of providing Australia Post's letter services are predominantly fixed and invariant to volume declines?*

Does this vary with changes in volume depend on the particular network function, ie sales and acceptance, processing, transport and delivery? Are there elements of these functions where costs are more variant with changes in volume?

No comment.

PRODUCTIVITY

THE ACCC SEEKS COMMENTS ON AUSTRALIA POST'S FORECASTED PRODUCTIVITY PERFORMANCE, ITS INTERNATIONAL BENCHMARKING STUDY AND ITS VIEW ON THE ALLOCATION OF ITS PAST PRODUCTIVITY GAINS BETWEEN ITS STAKEHOLDERS.

ADMA supports Australia Post's initiative to commission a benchmarking study.

OPERATING EXPENDITURE

THE ACCC SEEKS COMMENTS ON THE EFFICIENCY OF THE OPERATING COSTS OUTLINED BY AUSTRALIA POSTS IN ITS DRAFT NOTIFICATION.

- *What are your views on the efficiency of Australia Post's operating costs (including labour costs, contractor costs, accommodation and depreciation)*
- *What factors do you consider will affect Australia Post's cost structure over time?*

ADMA offers no comment on the questions raised in this section except to strongly support the ACCC's 2008 decision that Australia Post should provide:

- a) a disaggregated financial model over at least a three year period
- b) information on how prices for Australia Post's reserved services will change over this period;

- c) information on the revenues and costs of those non-reserved services that share the same costs as reserved services other that period.

FUTURE DELIVERY DESIGN PROGRAM

THE ACCC SEEKS COMMENTS ON AUSTRALIA POST'S PROPOSED FDD PROGRAM.

- *Are the key elements of Australia Post's FDD program appropriate? Are there other projects that Australia Post could implement to reduce its costs and improve the efficiency by which it provides reserved letter services?*
- *Do you consider the pace of Australia Post's implementation of technological changes (such as enhanced OCR software and small letter sequencing) is consistent with other postal operators overseas*
- *Will the FDD be effective in constraining growth in Australia Post's operating expenditure over time?*

No comment

CAPITAL EXPENDITURE

THE ACCC SEEKS COMMENTS ON AUSTRALIA POST'S PROPOSED ASSET BASE AND CAPITAL EXPENDITURE

- *The ACCC would appreciate views on the level and composition of proposed capital expenditure for the domestic reserved letter service*
- *Is Australia Post's approach to funding its forecast capital expenditure appropriate?*

No comment

WACC

THE ACCC SEEKS COMMENTS ON AUSTRALIA POST'S RETURN ON CAPITAL.

- ARE AUSTRALIA POST'S WACC PARAMETERS APPROPRIATE?

A BENCHMARKING APPROACH IS ORDINARILY TAKEN IN ESTIMATING THE EQUITY BETA PARAMETER. WHICH DOMESTIC AND INTERNATIONAL FIRMS ARE MOST COMPARABLE TO AUSTRALIA POST'S OPERATION AND SHOULD BE USED IN BENCHMARKING THIS PARAMETER?

No comment

Structure of Australia Post's proposed price increases

THE ACCC SEEKS COMMENTS ON THE STRUCTURE OF AUSTRALIA POST'S PROPOSED PRICE INCREASES:

- *Are the letter pricing principles that Australia Post has had regard to in proposed price increases appropriate?*

Yes

Are the margins proposed by Australia Post between its PreSort and other reserved letters sufficient?

Yes