POAAL
Post Office Agents Association Limited

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Mr. Anthony Wing
General Manager—Transport and General Prices Oversight
Australian Competition and Consumer Commission
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Dear Mr Wing,

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.

POAAL supports the proposal by Australia Post for price increases in its reserved service and the quantum that has been sought. The organisation has an enviable record of improvement over a sustained period. Over many years it has adopted a measured and conservative approach to its pricing proposals and Australians across all sections of the community have been the beneficiaries of its performance. It continues to face significant challenges delivering a universal postal service across a vast continent.

Our detailed comments on the issues in the Commission's paper are attached. POAAL offers these views in its role as the trusted and experienced industry body that protects, preserves and promotes the business interests of its members. These small business people provide an important front-line insight into the operations of the postal service in the diverse communities they serve.

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
Chief Executive Officer

Submission to the

Australian Competition and Consumer Commission

Australia Post Draft Price Notification Issues Paper

Post Office Agents Association Limited

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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 2011/12 provide certainty to customers about future prices for reserved services?
- One option available to the ACCC is to consider the need for price notifications over the period 2010/11 to 2011/12 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 (i.e. the extent to which reserved letter volumes vary from those forecast in this notification) between Australia Post and its key customers;
  - whether Australia Post should be rewarded for reducing its costs below the ACCC's forecasts in future price notifications;
  - if the 2009 model is used to assess future price notifications, how should variances between actuals and forecasts be treated?
  - what would constitute a 'significant' variance?

In our view it is reasonable that Australia Post forecast a price increase in 2011/12 without specifying its quantum at this stage. This view is because:

- the marketplace for hard copy mail is changing quite rapidly and further experience is necessary to estimate its effect before committing to a specific change;
- the size of Australia Post's past price increases have been contained within reasonable limits giving reasonable certainty about the range of its likely change; and
- commercial organisations live with and manage uncertainty so the nature of the forecast provided by Australia Post should be sufficient for their planning purposes.

The effect of incentives and penalties suggested by the ACCC's questions seem to be complicated and unlikely to create any further pressure for Australia Post to improve productivity.

Rather it is considered that the current public assessment process by the Commission reviewing the merit of an application for a price increase is sufficient incentive to perform. Other difficulties include the following.

- Incentives built around forecasts could encourage the process to be become corrupt.

- Decisions by Australia Post and commercial entities using their services are unlikely to be linked in any risk sharing process – each makes their own assessments depending on the drivers of demand they are experiencing and the market's response to evolving technology. Businesses and their agents using hard copy mail may well have just as an uncertain future as Australia Post.

- Events in the immediate future may disguise the long-term trends in the use of mail. These include the elections in NSW (March 2011) and the Commonwealth (late 2010 or early 2011) together with the return of economic growth and the marketing processes around that cycle of activity.

In any event an assessment of the accuracy of forecasting and the impact of subsequent price notifications can be made when evaluating subsequent applications.

It has also been the experience of POAAL, and the Commission has previously noted, that the delivery efficiency of hard copy mail, rather than price of the postal service, is a principal determinate in exercising choice about the use of alternatives. 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 as structural change to the communication sector makes its way through the economy. It is for this reason that POAAL supports more frequent price reviews as these changes and their impact on Australia Post services are yet to be understood.

One assumption however, that could be tested is the need to increase postage rates in increments of five cents. If the Commission were to encourage Australia Post to adopt a minium sale quantity of five stamps, the postage rate could be increased in smaller increments while still having a viable price point for customers and an opportunity to contribute to further efficiencies in domestic sales.

The ACCC seeks comments on Australia Post's forecasts of reserved mail volumes for the period 2009/10 to 2011/12.

- Do you think Australia Post should seek price increases in the context of declining volumes? What impact do you consider increases in the price of domestic reserved letter services will have on the demand for those services?
- 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 about future usage? What impact do you consider the decline in current 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?
- Do you think that the long-term trend toward consolidation, rationalisation, and substitution will be affected by the recent downturn in economic conditions?

Price increases in era of declining volume

In the absence of volume growth it is difficult for Australia Post not to seek price increases to offset its growing costs. The price elasticity of the standard letter service has been canvassed previously and POAAL identified its own experience with the volume of business activity around price rises. That is, a short period of increased usage ahead of the price change followed by a short period of reduced sales before a return to "normal" activity.

Australia Post has previously acknowledged that it needs to seek alternative business growth opportunities, both to obtain growth and to replace the revenue lost from declining volumes of hard copy mail, especially in the domestic market sector it dominates.

Accuracy of volume forecasts and Long-term trends

Other organisations more active in originating hard copy mail will be better placed to comment on the question of future volume trends. Despite past forecasts of doom, mail until recent years continued to experience steady growth. It is clear now however, that the market place has irreversibly changed.

The impact of recent economic difficulties may have delayed the full impact of this change on Australia Post as organisations make the flight back to low cost carriers.

But the electronic alternatives and their increasing acceptance by the community present a materially different value proposition to hard copy mail and this trend is obviously increasing.

Although the economy is already showing signs of returning to strength it is evident that all organisations that have survived the downturn have had a sharp look at costs and value in their operations. The trend to consolidation and re-evaluation of past practices and their impact will be part of those assessments.

This could further accelerate the move towards less expensive alternatives. This direction will be little influenced by a price increase in Australia Post's reserved services.

Even anecdotally it is clear that organisations are publishing annual reports on line rather than posting hard copy, and encouraging the receipt and payment of bills and accounts via email accompanied by financial incentives or penalties to help drive behaviour. The community is showing an increasing acceptance of these incentives because it suits the time-poor nature of their lifestyles. These changes are not temporary and have a material impact on Australia Post.

Despite several announcements by Australia Post about its plans for expansion by either leveraging off its delivery network or acquisition, little seems to have been achieved. Certainly the Australia Post submission is silent on the impact of these strategies taken over the last few years. It can be assumed they have had little effect compared to the loss of volume of its core business activities.

The assessments of long-term growth forecasts commissioned by Australia Post appear reasonable. They are probably as accurate as any forecast can be in the present climate.

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 that 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, i.e. sales and acceptance, processing, transport and delivery? Are there elements of these functions where costs are more variant with changes in volumes?

Growth in Australia Post's delivery points

It is reasonable to accept that Australia Post faithfully records the growth in delivery points that have occurred over the last few years. However, it is the assessment of our organisation that the majority of these occur in urban areas. This reflects the population's move from regional areas to the more densely populated areas on the coast.

The cost of meeting expanding growth in urban areas tends to be incremental in nature. As identified in Australia Post's own commissioned studies, customer density has a favourable impact on productivity.

It is fair to say however, that Australia Post's delivery challenges are significant. Comparisons with other postal administrations using delivery route length would, as the studies indicate, give a better comparison for Australia Post. In older countries such as the United Kingdom high housing density results in much less distance between delivery-points than in this country.

In principle it could be argued that none of an organisation's costs are fixed in the long term. Other postal operators, especially those subject to commercial demands, have explored means of more cost effective delivery. For instance, Canada's delivery box suite for new urban areas. Mail is delivered to a group of letterboxes at the end of the street rather than to every household. Others have examined means of varying delivery schedules where mail volumes don't merit every day delivery either permanently or seasonally.

With a more flexible workforce, staff costs could be made variable around volume experienced during the seasons of the year and any downturns that occur in the economic cycle. Australia Post has identified this strategy for some years but its plans and the schedule for completion are not stated. The use of mechanised support for delivery staff is another option discussed by Australia Post but without the detail required to assess its impact.

All of these proposals would have had the cost/benefit assessments set out in a business case for consideration by the Australia Post Board. So Australia Post should make it available.

Letter sorting equipment in mail centres is a major cost but no doubt the Board approved these investments on the basis that they would improve productivity and efficiency. By Australia Post's own admission it is yet to reap the full potential and productivity from its major investment in mail sorting equipment. For example, its capacity to sort by delivery sequence to individual delivery rounds or private boxes is unrealised.

The ACCC seeks comments on Australia Post's forecasted productivity performance, its international benchmarking study and its views on the allocation of its past productivity gains between its stakeholders.

- To what extent should the ACCC have regard to Australia Post's past and forecast productivity performance in assessing the efficiency of the costs that it is seeking to recover from consumers through prices?
- Are the postal operators which Australia Post's productivity has been benchmarked against appropriate, or are there substantial differences in the nature of the selected postal operators operations? Should other international postal operators have been included in Australia Post's benchmarking study? If so, on what basis?
- Are the adjustments made to the international benchmarking study to account for mail density and customer density appropriate? Are there any other significant differences between the identified international postal operators that should be incorporated into the study?
- Australia Post's productivity dividend study indicates that the productivity gains that it has made over the period 1998 to 2009 have been captured by consumers and labour (contractors and staff). Do you think that this is appropriate?

Of some concern is the lack of detail in the Australia Post forecast on future productivity improvements. The current economic challenges only increase the pressure for all organisations to identify and implement efficiencies for their survival. The means quoted by Australia Post to improve its future performance have all been listed before. There remains no detail on the initiatives, their timing and impact.

Sharing productivity

The assertion that past productivity gains have been shared with consumers, contractors and staff needs to be seriously examined by the Commission.

It would seem to us that the major beneficiary has been the owner. When taxes, statutory charges, dividends and special dividends are taken together the major beneficiary of Australia Post's past performance appears to be the Government. Yet the studies commissioned by Australia Post suggest it has fared worse in the share of productivity the organisation has produced.

Staff also seem to have been well rewarded. The Australia Post submission draws the Commission's attention to the reducing proportion of labour used compared to the past. But the question remains: have they gone far enough and received sufficient productivity improvements for the additional reward staff have been given? The Future Delivery Design (FDD) program states nothing other than obvious and previously identified measures regarding greater flexibility with staff and the exploitation of the sequencing capability of its existing letter sorting equipment. But there is no timetable for its completion.

The benefit to customers is evident in the real decrease in postal costs. Some would question whether the one price sustained over many years indicates that significant inefficiency may have been in place when that fixed-price regime commenced. The study submitted by Australia Post suggests that customers have benefited by 180% of the value of productivity gain.

On the other hand contractors, especially Post Office Licensees, have had a substantial part of their reward tied to the fixed price of postage over many years. They have also been compelled to undertake more of Australia Post's work for no additional reward. The more valuable clients serviced by LPOs have been transferred without compensation to a direct relationship with Australia Post. Mail contractors have until more recent times had to bear the cost of significant fuel increases and new tasks that improve value for Australia Post and its clients but impose additional costs for no reward.

The argument that the increased costs paid to mail contractors indicates that they have reaped substantial benefits from the productivity of Australia Post needs to be tested. Most of the increased payments have arisen from an increase in fuel and operating costs. These would have been borne by Australia Post no matter what the mode of delivery and cannot be considered a reward for contractors.

It is our view that Australia Post transferred a lot of the increased fuel charges onto its contractors until pressure to relent became irresistible. Although the competitive nature of the market has forced some increase in contractor costs these are very recent characteristics compared to the long term trends in the studies. In prior periods, despite fuel price increases, Australia Post successfully transferred that burden to its contractors.

This section of the Australia Post commissioned study also suggests that without more reward for the Government, Australia Post will not be “motivated” to make capital investments to sustain its statutory obligations. The credibility of some of this type of argument needs to be reviewed.

Issues related to the benchmarking studies

The Postal administrations compared in the Economic Insights' paper are those commonly used to benchmark Australia Post's performance and are reasonable.

However, most of these come from a similar government owned background. Future comparisons might be better made against relevant commercial organisations in a disaggregated way. For example, sales and acceptance performance should be benchmarked against the better industry performers. Similarly, transport and delivery performance should be compared with good performers in that industry. Comparisons with other postal administrations are not always a comparison of industry best practice.

In addition to mail and customer density issues discussed in the Australia Post commissioned study there are also differences related to delivery mode that are likely to impact on efficiency. For example the North American postal organisations rely more heavily on motorised transport for mail delivery. Canada requires new housing estates to have delivery to mail box suites for the street rather than be delivered to the household. The USA also has a traditionally higher mail density reflective of that country's highly dispersed population and its historical use of mail to transact business.

Although these may represent opportunities for further improvement in Australia Post it is recognised that Total Factor Productivity, if properly applied, still makes assessments of comparative performance reasonable and this performance is quite impressive. This includes comparisons of Australia Post's own performance over time.

The ACCC seeks comments on the efficiency of the operating costs outlined by Australia Post in its draft price 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?

The main information that guides POAAL on the efficiency of the Australia Post costs is the Denis Lawrence report of 1 July 2009 and the Economic Insights Pty Ltd International benchmarking study dated 5 June 2009.

These reports present a picture of a sustained performance over a number of years where material improvements have been made when compared to other postal administrations. Labour productivity (ranking third) over the recent past is strong. The efficiency of the non-labour components of the Total Factor Productivity (TFP) measures is poorer by comparison with other operating expenses which is ranked sixth, plant and equipment ranked fifth and land and buildings third.

If other administrations have provided better improvements with labour productivity or are ahead of Australia Post in non-labour factors then Australia Post should target these better benchmarks. This could be especially the case in labour productivity that is still a material determinate in TFP.

It is unclear from the report if those administrations with better labour productivity have had changes in their framework imposed on them, as Australia Post has, to operate commercially with more restricted reserve service criteria. Nor is it evident whether the base from which they are measured is an indication of their poor past performance with enhanced opportunities for productivity over those which were operating more efficiently at the start of the period.

The reports indicate however, that many of the non-labour factors have a small influence especially in comparison to labour and should not be used to deny the Australia Post price application.

POAAL has noted in the past that the use of FTEs as an input factor of productivity is critical to realistic assessments. Yet past assessments have not included the labour used by contractors especially Licensees. This issue has been addressed in the last review to include some calculated input of Licensee labour. However, accommodation costs of Licensees do not appear to have been included in the assessment of non labour input factors. Licensees not only provide their own accommodation for the operation of their postal business, but many of them in regional and country areas are also required to provide space for Mail Contractors and postal delivery staff to set up their rounds.

These accommodation costs are obviously an element in the sale price of a Licensed Post Office. Given the current sale prices of LPOs and the extensive number of them across the nation, these inputs would be material in a TFP calculation.

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 letters sequencing) is consistent with other postal operators overseas?
- Will the FDD be effective in constraining growth in Australia Post's operating expenditure over time?

The common feature on which all interested parties provided comment in Australia Post's last submission was 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.

In these circumstances further information should be provided by Australia Post to outline the initiatives other than price increases that will be used to achieve improved performance. If available, a more realistic assessment of the impact of various initiatives could be made.

Two major initiatives for the future identified by Australia Post are enhanced OCR and letter sequencing. These are understood to be extensions of the current capability of existing letter sorting equipment rather than requiring substantial additional investment. Anecdotal evidence from visits by senior POAAL officers to other postal administrations or through attendance at international conferences indicates that these opportunities are well underway in other postal authorities. In any event they seem not to be limited by the technical capability of the equipment but the industrial climate in which Australia Post is operating. This must be disappointing in terms of the rewards staff have received over the years.

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?

Australia Post's investment strategy seems to be based around renewal of its existing infrastructure rather than investing in future revenue streams or cost reduction. It is debatable if this is a sustainable investment approach.

It appears that those growth opportunities that Australia Post has invested in, such as StarTrak Express and Australian Air Express, are yet to be realised.

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 operations and should be used in benchmarking this parameter?

While these issues are not the prime expertise of POAAL it would seem reasonable to follow earlier reviews by the Commission including the current parameters.

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 proposing price increases appropriate?
- Are the margins proposed by Australia Post between its PreSort and other reserved letters sufficient?

The letter pricing principles and the margins proposed by Australia Post seem reasonable on the basis of the available information and are supported by POAAL.