

**REVIEW OF THE *AUSTRALIAN POSTAL  
CORPORATION ACT***

**Final Report, Volume Two  
February 1998**

**National Competition Council**

Commonwealth of Australia 1998

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Inquiries or comments on this report should be directed to:

Ms Deborah Cope  
Deputy Executive Director  
National Competition Council  
GPO Box 250B  
Melbourne 3001 Australia

ph: (03) 9285 7491  
fax: (03) 9285 7477  
website: <http://www.ncc.gov.au>

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# Abbreviations

AaE	-	Australian air Express Pty Ltd
ABS	-	Australian Bureau of Statistics
ACA	-	Australian Communications Authority
ACCC	-	Australian Competition and Consumer Commission
ACCI	-	Australian Chamber of Commerce and Industry
ACTU	-	Australian Council of Trade Unions
ALGA	-	Australian Local Government Association
ASX	-	Australian Stock Exchange
ATSIC	-	Aboriginal and Torres Strait Islanders' Commission
BIE	-	Bureau of Industry Economics
CDEP	-	Community Development and Education Program
CEPU	-	The Communications, Electrical, Plumbing Union
CPA	-	Community Postal Agencies
CPSU	-	Community and Public Sector Union
CSO	-	Community Service Obligations
CWA	-	Country Women's Association
DIST	-	Department of Industry, Science and Tourism
DOCA	-	Department of Communications and the Arts
DRCS	-	Digital Radio Concentrator Systems
DX	-	AUSDOC's Australian Document Exchange Pty Ltd
EBIT	-	Earnings Before Interest and Taxes
EDI	-	Electronic Data Interchange
EFT	-	Electronic Funds Transfer
EFTPOS	-	Electronic Funds Transfer Point of Sale
ELADS	-	Electronic Lodgement and Delivery System
EPOS	-	Electronic Point of Sale
EU	-	European Union
GBEGA	-	Government Business Enterprises Governance Arrangements
GBE	-	Government Business Enterprise

## Abbreviations

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IC	-	Industry Commission
ICPA	-	Isolated Children's Parents' Association
IDP	-	International Data Post
LPO	-	Licensed Post Office
LPOAL	-	Licensed Post Officers of Australia Ltd
MMUA	-	Major Mail Users of Australia
NCC	-	National Competition Council
NERA	-	National Economic Research Associates
NFF	-	National Farmers' Federation
OCR	-	Optical Character Readers
PC	-	Personal Computer
POA	-	Post Office Agent
POAAL	-	The Post Office Agents Association Limited
PMG	-	Postmaster General
QCIS	-	Queensland Commercial Independent Stationers
RDFG	-	Rural Delivery Frequency Guide
RPM	-	Resale Price Maintenance
SCNPMGTE	-	Steering Committee on National Performance Monitoring of Government Trading Enterprises
TAF	-	Telecommunications Access Forum
TPA	-	Trade Practices Act 1974
UBR	-	Urban Base Rate
UPU	-	Universal Postal Union
USO	-	Universal Service Obligation

# Terms of Reference

I, PETER HOWARD COSTELLO, hereby:

1. In accordance with the Commonwealth Government's Legislation Review Schedule, refer to the National Competition Council the *Australian Postal Corporation Act 1989* (and associated regulatory and institutional arrangements) for inquiry and report within nine months of the date of receipt of this reference.
2. Request that the Council advise on practical courses of action to improve competition, efficiency and consumer welfare in the postal services sector. In so doing, the Council should have regard to the objective that the legislation/regulation should be retained only if the benefits to the community as a whole outweigh the costs; and if the objectives of the legislation/regulation cannot be achieved more efficiently through other means, including non-legislative approaches.
3. Request that the Council, in so doing, have regard to:
  - (a) the Government's commitments to maintain Australia Post in full public ownership and provide a standard letter service to all Australians at a uniform price;
  - (b) the Government's commitment to accelerate and strengthen the micro-economic reform process, including through improving the competitiveness of markets, particularly those which provide infrastructure services, in order to improve Australia's economic performance and living standards;
  - (c) the Government's obligations under the Competition Principles Agreement executed in April 1995 which embodies commitments in relation to competitive neutrality, structural reform of public monopolies, access to services provided by means of significant infrastructure facilities, price oversight and legislation review;
  - (d) the current obligations on Australia Post specified in s26, s27 and s28 of the *Australian Postal Corporation Act 1989* to: perform its functions in a manner consistent with sound commercial practice; provide a letter service at a single uniform rate of postage for the carriage within Australia, by ordinary post, of letters that are standard postal articles; and meet any performance standards set for it;
  - (e) Australia Post's current and prospective level of financial and service performance and the flow of benefits to the community from that performance improvement;

- (f) the findings and the reforms arising from the 1992 report by the Industry Commission on mail, courier and parcel services; and
  - (g) experience with postal regulatory reforms undertaken overseas.
4. Without limiting the scope of the reference, request that the Council examine:
- (a) the need for a statutory reservation to Australia Post of the exclusive right to carry letters and the implications of a reduction or removal of the reservation;
  - (b) the specification, scope and extent of:
    - (i) the current letter service reservation and whether it is consistent with the Government's commitment to provision of a universal letter service;
    - (ii) the current community service obligations provided under s27 of the *Australian Postal Corporation Act 1989* and whether current arrangements satisfactorily meet the Government's commitment to community access to services;
  - (c) the scope, extent and organisational structure of commercial activities undertaken by Australia Post other than the reserved letter service. The competitive neutrality issues that may arise including the associated benefits and costs from these activities, should be identified and addressed as necessary.
  - (d) the operation of the current letter mail interconnection arrangements and the possible application of the general interconnection arrangements under the *Trade Practices Act 1974*; and
  - (e) the consequences for small business and other users of further reform of the *Australian Postal Corporation Act 1989*.
5. Request the Council in undertaking the review advertise nationally, consult with key interest groups and affected parties, and release an interim and a final report. The Government will respond to the final report produced by the Council.

# Chapter One: Communications Services

*Since European settlement there have been major changes in the provision of communications services in Australia. These changes have reflected advances in the technology used to deliver postal and telephonic communications services and in the institutional arrangements put in place to ensure that these services are available to all Australians. Technological and institutional evolution in the provision of telecommunications services has advanced considerably in recent years. This has raised the issue of whether current arrangements for provision of postal communications services are the best available to serve Australia's future communications needs.*

## 1.1 The Importance of Communications Services to Australia

Communications services are critically important to Australia's development and to overcoming the challenges of geography and demographics that confront this country. Australia's population is dispersed and relatively small compared to our major trading partners. In addition, we are physically isolated from a number of countries which are culturally and economically important to us.

Faced with these limitations, the provision of efficient, reliable, contemporary communications services is viewed as critical to this country. Communications services are the means through which business and personal relationships are maintained, information about our culture is disseminated and links with the rest of the world are built. A dynamic and flexible communications market capable of fostering a range of communications services and providers is a key component of Australia's future social and economic prosperity.

## 1.2 Market Convergence

Responsibility for providing both postal (physical) and telephonic (electronic) communications services in Australia was vested in the Commonwealth



*Box 1.1 Australian Postal Services*

Official postal services were first provided in Australia in 1809 when a post office was established in Sydney. Services were introduced progressively in the other colonies, although it was not until Federation that an Australia-wide postal service was introduced. Australia Post became the monopoly provider of postal services in 1901. The Post and Telegraphic Act 1901 granted the Postmaster General's Department (PMG) reserved services protection to carry all letters weighing up to one pound (approximately 450 grams). A uniform letter rate was later introduced (Penny Postage) throughout the Commonwealth.

Australia Post as we now know it was established in 1975 following the separation of the Postmaster General's Department into telecommunications and postal authorities. In 1989, Australia Post was corporatised and now operates as a Commonwealth Government Business Enterprise (GBE) under the Australian Postal Corporation Act 1989.

Today, Australia Post's services extend well beyond the basic letter service and include parcel services, international mail, retail services, financial services and other ancillary products. In 1996-97, household customers alone sent almost 500 million letters and Australia Post carried a total of 4205.7 million articles, including letters, parcels, international mail and other mail such as unaddressed mail.

Postmaster-General's Department in 1901. In 1975, the PMG was separated into postal and telecommunications entities, creating Australia Post and Telecom (now trading as Telstra) as providers of physical and electronic communications services, respectively.

This institutional divergence has served to reinforce the distinction between physical and electronic communications services and perceptions about their relative positions in the communications market. However, this distinction is becoming increasingly blurred with growing convergence between delivery technologies and communications services.

Services and mediums for service delivery traditionally associated with post and telecommunications - as well as computing, entertainment and various forms of commerce - are merging to form new integrated services and service

delivery media. The internet is the most recognisable example of the integration of varied electronic services. Australia Post's hybrid postal/telecommunications service, EDIPost, is an example of integration between electronic and physical communications services.

With amalgams of services becoming increasingly available, a broader view of communications options and the communications market is needed. While traditional postal services - in particular, physical mail services - are an important component of this market, they are only one part of a market which is rapidly evolving.

### **1.3 Growth of Electronic Communications Services**

The communications industry is one of the most diverse and dynamic sectors of the Australian economy, covering postal services, telecommunications, radio and television broadcasting services. The industry is characterised by high levels of investment and growth, increased competition and technological change.

Market liberalisation in Australia's telecommunications sector over the past eight years has led to a raft of new entrants and increased competition in equipment and service provision. The reforms have included open competition in the supply of telecommunications customer equipment and the licensing of several fixed network and mobile telephone service carriers. These reforms have contributed to increased market growth, investment, employment, service quality and product range, and lower prices. Between 1989 and 1994, the telecommunications industry's share in Gross Domestic Product grew from 2.6 percent to 3.2 percent. This rate of growth was above the OECD average (Budde 1997b, p. 45).

With more affordable information transmission services and equipment such as facsimile machines and personal computers, the penetration of electronic communications services into the market place has been significant. Increasingly, electronic communications services are offering more reliable and efficient means of communications; through verbal means and through use of text and graphics. At the same time, economies of scale in service provision are increasing affordability. As is frequently the case with new communications technologies, business users have been the early adopters of these new services.

However, as affordability increases, penetration of the business market is being followed by adoption in the residential sector.

Widespread acceptance of these new services is affecting the demand for postal services. As it is estimated that approximately 86 percent of physical mail is sent by business (Australia Post, submission 99, p. 16), the impact of new electronic communications services on Australia Post's core revenue has the potential to be significant.

As noted by NERA<sup>1</sup>:

*The threat from electronic communications is significant. Competition from new postal operators is not the only threat to the financial viability of incumbent postal authorities. Finland Post has stated that the greatest threat comes from new technology with about one third of all traditional letters having been replaced by data transfers, telefax and electronic mail services. Sweden Post, attributes the significant decline in its profit over the past two years to technological developments as well as postal competition. All other postal operators reviewed in this study have also recognised the threat from electronic communications (NERA 1997a, p. 26).*

The impact of advances in telecommunications on the use of postal services by different groups of Australia Post's customers is discussed further in Chapter Two.

The following sections identify a number of new electronic communications services which are showing their potential as growth services and as substitutes for postal services. These are:

- internet;
- electronic mail (e-mail);
- fax;
- electronic document interchange;
- electronic funds transfer; and
- digital television.

The data provide some illustration of recent and forecast growth in these services.

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<sup>1</sup> National Economic Research Associates (NERA) is a consultant to this review (see Appendices Four and Five).

### **1.3.1 Internet**

The number of internet users globally is estimated at over 60 million (Budde 1997c, p. 152). While there is some conjecture about the level of growth and current number of internet users in Australia, figures for 1997 suggest that there are approximately 2.9 million users of internet services in this country (Budde 1997c, p. 150).

The growth of internet services in Australia is reflected in retail initiatives aimed at introducing these services to a mass market. For example, Telstra's "Big Pond" internet service packages a range of services for both residential and business users and is coupled with a marketing strategy through major retail outlets. Further, it is noteworthy that the number of internet services in Australia has increased from approximately 50 to 470 between 1995 and 1997 (Budde 1997c, p. 155).

To access the internet, a personal computer, modem and telephone line of sufficient quality are required. The number of personal computers in Australia has grown from 1.4 million to approximately 6 million over the past decade (Budde 1997c, p. 147). In 1996-97, Australia's business and residential modem markets grew by 35 percent and 70 percent, respectively (Budde 1996, p. 134). The growth in modem sales has been linked directly to the increasing popularity of internet services.

Internet traffic over Telstra's network is currently growing by an average of 8.5 percent per month. By 1998, it is expected that it will be greater than the level of voice traffic. Consequently, Telstra will be investing \$200 million in its internet infrastructure between 1996 and 1998 (Budde 1997c, pp. 158-159).

### **1.3.2 Electronic Mail**

The complementarity between internet and electronic mail services and the increasing availability of more user friendly e-mail software are viewed as key drivers behind the take up of e-mail services. It is estimated that over 80 percent of business use of the internet is e-mail use (Budde 1997c, p. 163).

Between 1992 and 1996, the number of e-mail services available in Australia grew from 25 to 49 (Budde 1996, p. 130). The use of e-mail services is expected to grow rapidly over the remainder of the 1990s as new and complementary

technologies and services emerge. For example, electronic trading services are likely to provide a major impetus to the use of e-mail services once the internet is perceived as a secure means of undertaking financial transactions.

The use of e-mail in conjunction with internet services is considered to be a developing foundation for the often heralded 'information super highway' and a key vehicle for the predicted boom in electronic communications services. NERA has commented that:

*The main drivers of the growth in e-mail traffic will be the penetration of PCs and PC like terminals and the penetration of internet access in homes and businesses. The value of using e-mail as a means of communications increases with the number of users connected to the same network. It is widely expected that the penetration of internet access will grow very rapidly over the next 10 to 20 years, possibly approaching that of the telephone today (NERA 1997b, p. iv).*

### 1.3.3 Fax

Approximately 35 million facsimile machines have been installed worldwide (Budde 1997a, p. 9). In Australia, the number of facsimile installations grew from fifty thousand to one million between 1986 and 1996. The current growth rate is between 10 and 15 percent. It is also estimated that over one million personal computers in Australia have fax capability (Budde 1997c, pp. 144-145). Between 1992 and 1996, the total number of facsimile services offered by telecommunications carriers and services providers in Australia increased from 11 to 43 (Budde 1996, p. 130). Enhanced facsimile services offered include fax information services, broadcast faxing, fax mail boxes and store and forward services.

The number of pages faxed in Australia each year is estimated to be between three and five billion (Budde 1997c, p. 144). While most businesses in Australia have a facsimile machine, current estimates of the percentage of households with machines range between 4 percent (Budde 1997a, p. 9) and 10 percent (Sutton & Ofei-Mensah 1996, p. 5). Up to 25 percent of home-based businesses have a facsimile machine (Sutton & Ofei-Mensah 1996, p. 5).

It is estimated that a third of all telecommunications expenditure is facsimile traffic (Budde 1997a, p. 9). This is projected to increase in the medium term with the take-up of new services such as fax information and fax on demand. However, facsimile services are expected to be progressively replaced by e-mail in the next century.

#### **1.3.4 Electronic Document Interchange**

Electronic Document Interchange (EDI) services provide for the electronic exchange of commercial documents, such as invoices and purchase orders, and logistical information for management purposes (for example, manufacturing and material release schedules).

EDI has been slowly accepted in Australia. The number of EDI services available increased from 22 to 33 between 1992 and 1996 and use of EDI services is expected to plateau over the next three years (Budde 1996, p. 130 and 133). It is anticipated that many of the functions currently performed by EDI services will in future be carried out by e-mail or personal computer based facsimile services.

#### **1.3.5 Electronic Funds Transfer**

Electronic Funds Transfer (EFT) covers a wide range of electronic banking services which include automatic teller machines, phone banking and electronic funds transfer at point of sale (EFTPOS).

Use of EFTPOS in Australia grew markedly over the first half of the 1990s. Between 1990 and 1996 the number of EFTPOS terminals in use increased from fifteen thousand to one hundred thousand, while annual transactions grew from 61 million to 710 million over this period (Budde 1997c, p. 168). Between 1992 and 1996, the number of EFTPOS services available in Australia grew from 5 to 27 (Budde 1996, p. 130). The level of access to EFTPOS facilities in Australia is greater than that available in Japan and the United States.

Use of EFT is predicted to grow in Australia with greater acceptance of home banking applications through services such as the internet and interactive television. The take-up of these services is viewed as critical to the mass-

market adoption of home banking. It was estimated that by 1998, ten percent of all bank transactions will be done by telephone (Budde 1997c, p. 167).

### 1.3.6 Digital Television

The development of digital broadcasting is viewed as having the potential to provide a low-cost and convenient means of delivering internet services to the home. As noted by NERA:

*... digital TVs are likely to offer a more user friendly means of accessing internet information and preparing simple e-mails by making use of navigational systems and electronic programme guides designed for a less computer literate target market (NERA 1997b, p. 26).*

The Australian Broadcasting Authority has been analysing the provision of digital terrestrial television services in Australia and anticipates that the first services will be available in metropolitan areas by the year 2000 (NERA 1997b, p. 37). Wide scale marketing of these services is expected in the early years of next century, by which time digital television sets will be commercially available. NERA considers that the take-up of digital television services by residential users will be significant in stimulating the market penetration of internet services, and has commented that:

*Digital TVs are likely to enter homes which would otherwise not have purchased a PC. Significantly 99% of Australian households have a television receiver, compared to only 30% having a PC (NERA 1997b, p. 26).*

## 1.4 Substitution of Postal Services

Liberalising telecommunications markets in Australia and overseas has enabled competition in what were formally monopoly markets and is facilitating lower prices for customer equipment and information transmission services. Analysis by the Australian Telecommunications Authority (AUSTEL) has indicated that these lower prices have benefited users of electronic communications services in Australia (DOCA 1994, p.13).

More affordable equipment and transmission services have been key drivers in the take-up of electronic communications services. Technological development and product innovation have also served to produce an array of new services, which are competing in markets traditionally served by physical mail. As noted by NERA:

*The range of terminals and other equipment used to access electronic media will increase and their real costs will fall. In the business environment, Net PCs will be used in addition to standard PCs. NetPCs are a low cost alternative to a PC and act as a dumb terminal with all the processing done online via the network. In the household environment, WebTVs and digital television sets (or a digital set top box for an analogue TV set) will provide a relatively low cost means of access to the internet, when combined with a modem and telephone link for the return path (NERA 1997b, p. iii).*

The potential for wide-scale substitution of certain types of physical mail services is apparent. For example, EFT services such as phone banking and electronic bill payment are replacing the need to forward cheque payment by mail. Further, advertising products and services through the internet replaces the need to have such information forwarded by mail in hard copy (paper) form. Moreover, as commerce becomes more reliant on information and efficient information transmission, and with the growth in importance of service industries, businesses are augmenting their use of electronic communications services to gain a competitive advantage.

The extent of potential competition to traditional postal services from electronic communications has been identified in the World Bank report, “Redirecting Mail: Postal Sector Reform”. The World Bank’s analysis is reproduced in Box 1.2. As discussed previously, many of the services identified by the World Bank have a growing market presence in Australia.

## **1.5 Australia Post’s Changing Role**

Notwithstanding the recent growth of electronic communications services which compete with traditional postal services, the volume of mail carried in Australia has increased in recent years. Between 1990 and 1996, the total volume of mail in Australia increased at 3.6 percent (Sutton & Ofei-Mensah 1996, p. 3),



**Box 1.2** *Characteristics of Electronic Communications Service*

<b>Service</b>	<b>Competes with</b>	<b>Cost</b>	<b>Equipment and other costs</b>	<b>Speed</b>	<b>Reliability</b>	<b>Other features</b>
<b><i>E-mail/-internet</i></b>	<ul style="list-style-type: none"> <li>• letter mail (business and residential)</li> <li>• carriage of publications, catalogues, etc.</li> <li>• express mail</li> <li>• bulk mail</li> </ul>	<ul style="list-style-type: none"> <li>• low within network</li> <li>• higher across networks</li> <li>• much lower than express mail</li> </ul>	<ul style="list-style-type: none"> <li>• PC terminal, modem, phonenumber, E-mail account</li> </ul>	High	High	<ul style="list-style-type: none"> <li>• facilitates data exchange and management</li> <li>• size of network important</li> <li>• lack of standards</li> <li>• document formatting difficult</li> </ul>
<b><i>Fax</i></b>	<ul style="list-style-type: none"> <li>• letter mail (business)</li> <li>• express mail</li> </ul>	<ul style="list-style-type: none"> <li>• cost of telephone calls (varies with scanning speed, size of document, area, time, day)</li> <li>• transmission can be delayed to economise</li> <li>• much lower than express mail</li> </ul>	<ul style="list-style-type: none"> <li>• facsimile machine and phone line (not necessarily dedicated)</li> <li>• PC with fax/modem, phone line</li> </ul>	High	High	<ul style="list-style-type: none"> <li>• facilitates data exchange and management</li> <li>• document not legal*</li> <li>• limited capacity of fax machine</li> <li>• document clarity lower than mail</li> </ul>
<b><i>EDI</i></b>	<ul style="list-style-type: none"> <li>• letter mail (business)</li> <li>• express mail</li> </ul>	<ul style="list-style-type: none"> <li>• low within network</li> <li>• higher across network</li> <li>• much lower than express mail</li> </ul>	<ul style="list-style-type: none"> <li>• PC terminal, modem, phone line, EDI software and subscription</li> </ul>	High	High	<ul style="list-style-type: none"> <li>• facilitates data exchange management</li> <li>• size of network important</li> <li>• instantaneous transaction/confirmation</li> <li>• restricted type of communication/use</li> </ul>

\* In Australia, documents sent by fax are generally accepted as 'legal'.

<b>Service</b>	<b>Competes with</b>	<b>Cost</b>	<b>Equipment and other costs</b>	<b>Speed</b>	<b>Reliability</b>	<b>Other features</b>
<b><i>EFT</i></b>	<ul style="list-style-type: none"> <li>• letter mail (business and residential)</li> <li>• express mail</li> </ul>	<ul style="list-style-type: none"> <li>• often free for user</li> <li>• or flat fee, higher than letter mail</li> </ul>	<ul style="list-style-type: none"> <li>• telephone account with both financial institutions, access to an ATM, etc.</li> </ul>	High	High	<ul style="list-style-type: none"> <li>• restricted type of communications/use</li> <li>• instantaneous transaction/confirmation</li> </ul>
<b><i>Telephone</i></b>	<ul style="list-style-type: none"> <li>• first class mail (business and residential)</li> <li>• express mail</li> <li>• bulk mail</li> </ul>	<ul style="list-style-type: none"> <li>• generally higher than letter mail</li> </ul>	<ul style="list-style-type: none"> <li>• telephone line/connection and instrument</li> </ul>	High	High-medium	<ul style="list-style-type: none"> <li>• recipient of communication generally has to be present</li> <li>• regarded as more intrusive for advertising purposes</li> </ul>
<b><i>Radio/television</i></b>	<ul style="list-style-type: none"> <li>• unaddressed bulk mail</li> </ul>	<ul style="list-style-type: none"> <li>• high cost for broadcasting time</li> </ul>	<ul style="list-style-type: none"> <li>• instrument</li> </ul>	High	Medium	<ul style="list-style-type: none"> <li>• access mass audience but does not target</li> <li>• recipient of communication must be present</li> </ul>
<b><i>Interactive television</i></b>	<ul style="list-style-type: none"> <li>• letter mail</li> <li>• bulk mail</li> <li>• transmission of publications, catalogues, etc.</li> </ul>	<ul style="list-style-type: none"> <li>• variable</li> </ul>	<ul style="list-style-type: none"> <li>• telephone line, terminal, modem, subscription</li> </ul>	High	Selective	<ul style="list-style-type: none"> <li>• capable of multiple uses (communication, shopping, banking, information retrieval, etc.)</li> </ul>

Source: Ranganathan and Dey 1996, p. 134

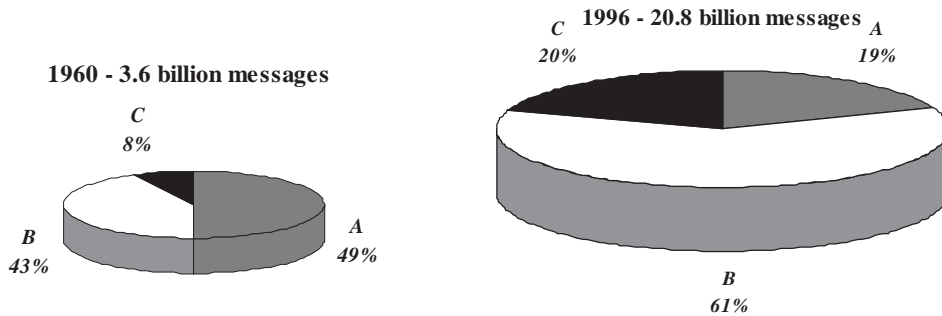
and mail volumes are predicted to rise by approximately 4 percent each year into the next century (Australia Post, submission 8, p. 23).

Mail volumes can be categorised in terms of market segment (for example, business or household) and analysed in terms of origin and destination. In commenting on recent mail volumes carried in Australia, NERA has noted that:

*Over the last eight years, the business to household segment has more than doubled but letter mail flowing from households, on the other hand, has almost halved. Business to business mail has grown by 23 per cent over that period, but has declined in recent years (NERA 1997b, p. i).*

Within the broader communications market, postal services' market share is clearly diminishing. In its submission, Australia Post provided the information in Chart 1.1 on its changing position in the 'messaging market' between 1960 and 1996. Over this 36 year period, the number of message transactions in Australia grew from approximately 3.6 billion to 20.8 billion.

Chart 1.1 Comparison of Messaging Market Share by Volume: 1960 and 1996



**Legend:**

- A** Postal Services
- B** Telecommunications (Phone, telegrams, telex, fax etc. Excludes electronic funds transfer such as bill payment, EFTPOS and ATM transactions.)
- C** Other (Includes courier freight, and unaddressed leaflets.)

Source: Australia Post, Submission 8, p.23

Customer demand and growth in the electronic communications market (that is, telecommunications) have served to compel Australia Post to diversify its service range. Faced with this evolving market, Australia Post is embracing new technology in service provision and has expanded the range of communications services it provides beyond physical mail services. It has launched a range of new electronic services, a number of which are linked to traditional physical mail and benefit customers through synergy between electronic and physical communications.

The communications services supplied by Australia Post are listed in Box 1.3. As is apparent from the box, Australia Post's range of services now covers a broad spectrum encompassing traditional physical mail, hybrid physical/electronic communications services and distinct electronic communications services.

## **1.6 The Challenge for Postal Services**

Increased competition from other communications services does not mean that the use of traditional postal services will automatically fall or become obsolete. However, it does mean that postal service providers must be more innovative and responsive to consumer demands. In analysing the implications for postal services of increased competition from electronic communications services, NERA has provided three possible future scenarios for growth in letter traffic, as well as quantitative estimates of future growth under these scenarios.

The "base case" scenario (scenario 1) assumes that letter traffic volumes continue to grow at historic growth rates, estimated to be 3 percent per annum, and therefore considers that the future impact of electronic communications will be the same as in the past. NERA has considered two further scenarios, which anticipate that the substitution into electronic communications will accelerate, specifically:

- a low impact scenario (scenario 3), in which it is projected that 13 percent of total domestic letter traffic will be diverted to the internet by 2002; 18 percent by 2007; and 21 percent by 2017; and
- a high impact scenario (scenario 2), in which it is projected that 24 percent of total domestic letter traffic will be diverted to the internet by 2002; 38 percent by 2007; and 52 percent by 2017.

**Box 1.3**      *Communications Services Provided by Australia Post*

**Traditional Physical Mail and Parcel Services:** These are the services that we normally associate with ‘post’, and provide for pick-up, carriage and delivery of parcels or hard copy information (that is, letters and other printed material).

**Letter Post**

**Direct Mail**

*Delivery of advertising and other printed material*

**Print Post**

*Publications delivery*

**Business Post International**

*International express post delivery*

**Parcel Post**

**Express Post**

**International Post**

**PreSort Letters**

*Bulk mail delivery*

**Registered Post**

*Registered letter delivery*

**Direct Entry**

*Bulk international mail and courier delivery into Australia*

**Signed Courier (through**

**Australia Air Express)**

*Overnight domestic courier delivery*

**Electronic communications and financial services:** These services are usually associated with telecommunications services, and provide for electronic transmission of voice, text, graphics or money from sender to receiver through purely electronic means.

**giroPost**

*On-line banking service for customers of nine banks*

**TaxPackExpress**

*Electronic lodgement of tax returns*    *Facsimile transmission*

**Bill Payment**

*Over-the-counter bill payment*

**FaxPost**

**Hybrid electronic/physical communications services:** These services integrate traditional mail services and electronic communications services by combining electronic transmission with the carriage of information in hard copy form. These services involve the electronic transmission of information to centralised points, the conversion of this data into hard copy form and then delivery of printed material using the mail service.

**EDIPost**

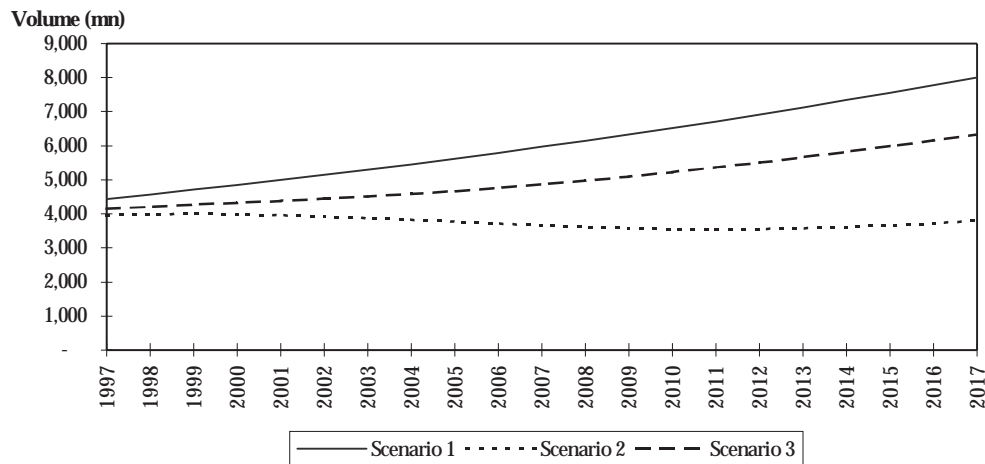
*Domestic electronic-to-physical mail delivery*

**ePost**

*International electronic-to-physical mail delivery*

The impact of electronic communications services on future letter growth, as projected by NERA (NERA 1997b, p. vi), is illustrated below.

**Figure 1: Projected letter traffic under Scenarios 1,2, and 3 (1997-2017)**



Source: NERA estimates

It is noteworthy that NERA concluded that:

*The projections ... suggest that with high rates of penetration and use of electronic media, the volume of domestic letter traffic is unlikely to decline significantly over the next 20 years. In our high impact scenario AP's letter traffic will decline at an average rate of 0.2 per cent p.a., with negative traffic growth expected to occur between years 3 and 13 (NERA 1997b, p. 51).*

Faced with the challenge of a changing communications market, Australia Post has acknowledged that technological evolution is a source of new business opportunities and is pursuing these opportunities by providing new and innovative services. Other postal communications companies operating in Australia are also providing new technology solutions in place of traditional postal services. A number of private companies now offer a range of integrated communications services which combine information processing with document creation and distribution services in a total service package.

By combining the mail system's universal access and delivery capability with the speed, efficiency and reliability of electronic media, many of the new services

supplied by Australia Post, and private communications companies such as Streetfile, Salmat and Hermes Precisa, demonstrate the opportunities for value to be added to the existing postal service through service innovation. Greater competition in the provision of postal services has the potential to facilitate further innovation and market growth.

Reforms which aim to increase competition and growth in the postal services industry are likely to have a positive effect on employment in this industry. There is also a relationship between efficiencies in communications industries, such as postal services, and growth in the general economy. Communications services are an important input for businesses and a reduction in costs is likely to increase productivity, which will contribute to further growth and employment in the economy.

Whether current regulatory and institutional arrangements provide the most appropriate framework to drive innovation, efficiency, growth and, ultimately, consumer benefit in the postal services market of the future is a key issue for this review.

## Chapter Two: Future Needs for Postal Services

*Increased competition from electronic communications services will not affect all aspects of the postal services industry uniformly. The impact will vary between different types of services and different groups of customers*

*As a large diverse company in the industry, much of the challenge of managing various complex change will fall to Australia Post.*

*Consequently, it is timely to examine the postal market and the need for reform at a time of rapid change in the market and in light of the Commonwealth Government's National Competition Policy commitments.*

Australia Post is Australia's largest mail, courier and parcel services provider for the transfer of messages and goods. It also provides third party agency services such as the payment of certain bills. About 60 percent of Australia Post's activities are open to competition. The remaining 40 percent are reserved to Australia Post by the *Australian Postal Corporation Act 1989* (the Act) which gives it substantial protection from competition in these areas.

Overall Australia Post's business does, and will continue to, focus on physical mail. The future need for these services, however, will be affected by the development of new electronic communications services.

The impact of new communications technology will differ between types of services. In the case of messages, technology is both enhancing the types of services Australia Post produces and increasing the range of competing products. In areas such as parcels delivery, where the impact of new communications technology is much less, developments such as electronic tracking are expanding the range of service options. As noted in the previous chapter, these developments place Australia Post in a dynamic



and challenging environment. This chapter will look at the impact of these changes on three key segments of Australia Post's activities:

- messages;
- parcels; and
- banking and agency services.

The chapter will also discuss how changes in telecommunications technology are affecting the demand for postal services by some of the key customer groups in each segment. It will then look at the origins of the current review and its role in ensuring that postal services continue their valuable contribution to communications in Australia.

## 2.1 Messages Market

The types of postal services used to send messages include standard letters and express post. Electronic substitutes for these physical mail services include facsimiles, Electronic Document Interchange, Electronic Funds Transfer, telephone, radio, television and interactive television. The relative strengths, weaknesses and general characteristics of these different services are set out in Box 1.2. Australia Post argues in its submission to this review that its core letter business is part of a much larger market covering the transfer of messages in either physical or electronic form:

*While the letter monopoly has restricted competition for the carriage of personalised addressed, hard-copy communications, letters are still fully exposed to competition from electronic messaging technologies, including the telephone, fax, e-mail, the internet, paging services and voice mail. These alternatives are faster and cheaper than letters, and increasingly accessible to businesses and households (Australia Post, submission 8, p. 11).*

Ausdoc agrees that businesses, in particular, are demanding more comprehensive solutions to their communications needs. This will naturally increase the need for Australia Post to compete against other options for communication. Ausdoc has said:

*Postal services continue to develop in this market and while postal services share of the communication sector has fallen the volume of Post's business continues to grow. Within this environment Businesses' attitudes are changing. Costs and services are being reviewed, suppliers are being rationalised and*

*more demands are being placed on service operators to provide total solutions and to continually deliver value added services. This is particularly significant in the demands Business places on its message management solution (Ausdoc, submission 9, p. 7).*

The demand for comprehensive solutions to communications problems is also taking on a global perspective. Hence another vital issue for this review is the current need for a nationally and internationally competitive postal service to provide opportunities for business in new markets. TNT argued that:

*The fact is that the postal service is a vital element in the nation's economic infrastructure. Its structure and the manner in which it is regulated have profound implications for the competitiveness of Australian businesses. Never has this been more so than now with the globalisation of trading and the advent of electronic commerce. Companies now shop around globally for the most efficient mailing and delivery services just as they shop around for the most efficient and competitive telecommunications systems. Hubbing of postal services in technologically advanced and competitively open countries such as Sweden is becoming a reality. Australia has an unparalleled opportunity to play a key role as a postal hub in the Asian region if flexible, pro-competitive regulatory approaches are adopted. The best placed operator to benefit from this strategy would have to be the incumbent, Australia Post (TNT Limited, submission 87, p. 3).*

Governments and postal authorities overseas have also recognised the increased pressure that advances in telecommunications place on postal services providers. NERA argues that more commercial focus of postal services in other countries, governments are giving postal authorities more freedom to compete in other communications markets. NERA noted:

*To some extent, liberalisation is also being seen as a way to meet the increased threat provided by new technologies. Governments in Sweden and Finland have completely removed the reserved service. Spain's postal system is very liberalised although mail traffic between cities remains reserved to the public postal operator. The New Zealand Government has recently*

*announced plans to liberalise, while the position in the UK is under review (NERA, 1997a, p. 11).*

Still the ability to choose between different communications options is not uniform across all types of customers. The Insurance Council of Australia (ICA) has said:

*The industry considers it will be some time before the new communication technologies represent a realistic option for many of the interactions currently utilising post. The level of acceptance of the new technologies with many of the smaller businesses that the industry deals with is low. This is also the case with the majority of the households that the industry services. ... Although the industry expects that attitudes towards the new technologies will change reasonably quickly, the ability to access and use the new technologies is another factor that will moderate the pace and extent to which they are used as an alternative to post (ICA, submission 134, p. 1).*

The lack of reliability and reach of electronic communications is an important consideration for rural users. The National Farmers' Federation (the NFF) has said that the reliance on Australia Post has increased, rather than decreased, in rural Australia:

*Despite the improvement in communications technology, people in rural areas are still heavily reliant on the services provided by Australia Post, especially where people do not have the same access to alternative modes of communication as those living in urban Australia (NFF, submission 39, p. 10).*

The Industry Commission (IC) has said:

*Despite Australia Post's declining share of the burgeoning message market, mail volumes have continued to grow at around two percent a year between 1960 and 1996. This continued growth is evidence that hard copy messaging still has an important place in a market otherwise dominated by near instantaneous electronic messaging (IC, submission 58, p. 5).*

Also, receiving information in an electronic form will not suit everyone. Lack of privacy, for example, makes e-mail or fax messages inappropriate for some types of

communication. Messages sent by e-mail, unless encrypted<sup>1</sup>, can be accessed by others and pose a security problem, particularly in business. NERA has said:

*Security considerations, privacy and authenticity, are particularly important for business communications which may be legally binding and/or which are of a financial or commercial nature. Already some of these communications may be sent through standardised encryption methods. We expect this to occur within the next five years (NERA 1997b, p. ii).*

Most computer systems retain a copy of any electronic messages they receive. This allows interested people who have sufficient technical knowledge and access to the system, to read messages. Similarly, most contemporary facsimile machines keep comprehensive records which provide daily reports of incoming and outgoing messages. Hence, whilst there is substitution in the electronic messaging market, customer privacy is one reason why physical mail will continue to be important. Moreover NERA has said:

*The appearance advantage of a letter will be eroded somewhat by the advent of high speed colour printers and the ability to send formatted e-mails. However, the following considerations will maintain the advantages of letters:*

- *full colour printing will remain considerably slower than monochrome printing by inkjet or laser printer;*
- *direct mail advertisers, for whom colour is an essential tool, cannot expect their recipients to colour-print leaflets of the sort that compromise their standard advertising material (NERA 1997b, p ii).*

Obviously, different types of customers will use different types of communications. Hence, to assess the future needs of postal services to carry messages, it is useful to look at some broad groups of customers. The following sections will address the communications needs of:

- business customers;
- remote area customers; and
- private customers.

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<sup>1</sup> Encryption operates by scrambling messages using a mail program or other software which use 'keys' to ensure only recipients can decode messages.

### 2.1.1 Business Customers

The uptake of technology has been led by business. In particular business is increasing its use of the various types of technologies to transfer messages across businesses, and between businesses and their clients. These technologies are encroaching on the traditional services of mail, particularly in metropolitan areas.

Increasingly e-mail, facsimile and other types of messages can be sent and utilised by business without the need to refer to the hard documentation that may have been needed in the past. For example, a message sent by e-mail can be receipted and proved to have been sent to the satisfaction of a court of law. To this extent, it is possible for electronic messages to substitute for traditional methods of postage.

The Australian Chamber of Commerce and Industry (ACCI) has said:

*With the broadly based and fast moving advance of new information technologies, and their relatively rapid take up in this country, it can be argued Australia Post may well find its niche in the communications market limited to (i) those senders/receivers without access to such technologies and/or (ii) those products which cannot be transferred by electronic means (ACCI, submission 45, p. 13).*

There are some specific examples, however, where physical postal services are more suited to a particular task. For example, in advertising, post may be the best option because the receipt of a letter imposes on the customer no added cost, whereas printing faxes and using the internet incurs another charge of some form. Some recipients do not like 'junk mail' and a greater intolerance can be expected in cases where a customer pays for the 'invitation' to do business. This intolerance may be less for e-mail due to the low cost of receipt and the ability of mailers to accurately target potential customers.

In addition, the increasing sophistication of bulk-mailers, using enhanced products to target recipients more accurately, increases the demand for postal services. The adoption of more developed systems for handling mail at lower costs, particularly for bulk-mailers, will tend to reinforce this trend.

The Major Mail Users of Australia Limited (MMUA) has said:

*Mail is and will remain a major element in the conduct of the business of our members. We believe that increased efficiencies*

*in handling mail, better performance times, (imposed) flexibilities will bring its own growth of market. The issue is will Australia Post be able to become flexible enough with its customers to cope with the pressures of using the hard-copy mail services as an important marketing and commercial tool in the years ahead? (MMUA, submission 33, p. 13).*

Similarly, NERA has said the impact of the World Wide Web on letter traffic is likely to be minimal, although some substitution may occur at the margins (NERA 1997b, p. 36). Importantly for business, substitution is likely to increase as more users are connected to e-mail, technological solutions to congestion problems are found and encryption becomes common place. At present, there is some resistance by big business to send longer documents by e-mail or facsimile. NERA noted that:

*Better software, more reliable transmission of e-mail, and increased familiarity will enable longer, more sophisticated documents to be sent by e-mail. ... Encryption will in time address the problem of security and so allow even more documents to be sent by e-mail rather than in printed format. The impact on business to business mail could be very large indeed. In addition, some business to household mail (e.g. bills) could also be diverted to electronic transmission, though this will clearly depend on the extent of internet penetration in the household sector (NERA 1997b, p. 35).*

It is likely that the take up of alternatives to letter mail will be led by business, particularly bigger business, as larger corporations are arguably more likely to allocate capital expenditure on new systems to take advantage of electronic substitutes. Chapter One notes that the share of postal services in the message market is falling. A large and growing part of this market is business messages. The evidence to this review suggests that this fall is likely to continue. NERA has said:

*The physical letter market can be dissected in terms of destination and origination. Over the last eight years, the business to household segment has more than doubled but letter mail flowing from households, on the other hand, has almost halved. Business to business mail has grown by 23 per cent over that period, but has declined in recent years (NERA 1997b, p. 8).*

But as most predict that the communications market in total will continue to grow quickly, the ability of postal services to significantly increase their volume of business mail will depend on:

- providing quality services to minimise customers' incentives to swap to new technologies;
- capitalising on those areas suited to postal services; and
- exploiting new opportunities.

### 2.1.2 Small Business

The diversity of technologies means that different size businesses will benefit in differing degrees from the uptake of messaging technology. It is likely that some small businesses will be slow to take up technology, for various reasons, whilst others will be well placed to take advantage of emerging technology. In August 1997, Yellow Pages Australia compiled a special report on technology in the small business sector for its Small Business Index. In that special report, Yellow Pages reported that 86 percent of small businesses surveyed had fax machines and predicted:

*...That the usage of both CD ROM and modern technology will grow quite considerably over the next twelve months. In addition, well over 80% of small businesses could be equipped with at least a fax machine, desk top computer and mobile phone. Whether the true growth figures will be as significant as these results suggest remains to be seen, however, given our experience of unrealised expectation over the last year (Yellow Pages Small Business Index 1997, p. 5).*

Ausdoc has said:

*Clearly the communication needs and requirements of Business today are dynamic and continually changing. Technology continues to offer an increasing array of communication options and Businesses are demanding more specialised products and services to meet specific communication needs (Ausdoc, submission 9, p. 7).*

In relation to small business, Australia Post has undertaken some initiatives to prevent it from losing customers as a result of technological development. Australia Post has said:

*There are many products and services which have a specific benefit or purpose for small business - including business centres, the bulk local rate service, mail pick up, on-line franking, credit facilities, mail room software and services, direct mail support and convenience replenishment of office/stationery supplies (Australia Post, submission 8, p. 63).*

The use of e-mail and the internet by small business appears to be growing. In May 1996 the Small Business Index estimated growth in the use and connection to the internet at 18 percent and found in May 1997 the rate of increase in actual connections at 14 percent. Moreover, the Small Business Index found:

*In the latest survey, we have found that 24% of computer users who are not yet connected to the internet expect to connect over the next 12 months. This translates to 18% of all small businesses (Yellow Pages Small Business Index, 1997, p. 9).*

For small business, access to new technology enables these offices to substitute some of the traditional use of letter mail with e-mail and this is likely to increase in the future. Of the 26 percent of computer users who use e-mail, 96 percent used the facility to communicate externally and 53 percent internally. Accordingly it is likely that small business will continue to take advantage of alternatives to physical letters.

### **2.1.3 Rural and Remote Area Customers**

In some respects, the take up of electronic messaging services has been higher in remote areas. In particular, small businesses in remote areas, which have not had the advantage of accessing the breadth of messaging services available in metropolitan areas, have used the internet and other electronic communications to increase business opportunities in markets which had not previously been available to them because of the costs of traditional communications. For example, 81.1 percent of regional businesses in Western Australia have a fax compared with 79.5 percent in metropolitan areas (Boshe Group 1997a, p. 2).

Generally, however, remote area customers do not benefit from the same access to technology as their metropolitan counterparts. This is because often their physical



access to communication is limited. Submissions by remote area businesses and people to the Council have emphasised their continued reliance on Australia Post as a means of meeting their messaging needs. The Isolated Children's Parents' Association stated that:

*Isolated students on Distance Education who live in remote isolated areas depend heavily on the services of Australia Post for the transport of educational materials, including lesson papers. For these people there are no satisfactory alternatives to a regular parcel and letter delivery service by Australia Post. While many residents in these areas have fax machines and their use is increasing, this is largely due to the infrequent and unsatisfactory mail service. While fax machines will work on DRCS telephones they are slow. They are not an alternative to the ordinary mail for receiving and sending data (ICPA, submission 93, p. 2).*

The Boshe Group's audit of the Needs of Regional Western Australia found that there were significant gaps in the provision of communications services between metropolitan and regional areas. That report concluded that:

*In almost every respect, the residents and businesses in regional areas are provided with a lower standard of communications services and have fewer services from which to choose, or simply have none available (Boshe Group 1997a, p. 2).*

For example:

*Regional users of the internet face considerably higher access costs than metropolitan users. There is a need for more local internet service providers and for access to internet service providers at affordable rates (Boshe Group 1997a, p. 8).*

In relation to facsimile and data transfer the Boshe report found:

*While the roll-out of the fibre optic network between exchanges will provide greater capacity and increased speeds, there will still be many who are too distant from the new digital exchanges to benefit from this, including many farmers who will not have*

*an acceptable standard of access to the internet (Boshe Group 1997b, p. 25).*

A significant issue for these outlying regions is that whilst increasing numbers of customers use alternative means of communication in preference to physical mail, there remains practical problems in wide-scale use of electronic services:

*While some owners and managers of remote properties are increasingly able to use new forms of technology as essential tools for business management, many others, such as the elderly, unemployed and those whose telecommunications network is not adequate do not have access to these facilities (NFF, submission 39, p. 2).*

In some rural and remote areas, telecommunications will be unable to substitute for postal services. Problems include:

- absence of sufficient quality telecommunications;
- prohibitive connection fees for one or more lines; and
- absence of adequate quality electricity because of dependence on generators.

Moreover, rural and remote users are required to pay long distance charges for most telephone calls. The Council received a submission from the Country Women's Association (CWA) of Victoria which argued that every effort should be made to provide rural communities with the best possible level of service as regular and reliable mail delivery was essential (CWA, submission 20, p. 3).

While access to technology by remote area customers will continue to grow and potentially provide significant benefits, particularly as the speed of communication alternatives increases, the practical difficulties experienced by some customers are still to be fully addressed. Also, distance and isolation will mean that remote customers will continue to depend on postal services for a significant time into the future.

#### **2.1.4 Private Customers**

This is a broad and significant group and many of the issues raised in the previous section in relation to access to the internet and other electronic means of communication apply equally to private customers. Responses to this review have

indicated that many private customers still rely heavily on physical mail deliveries. Moreover, some groups in the community, including the aged and lower income earners, may not be able to access the technology needed to use electronic messaging services. The Public Interest Advocacy Centre argued that:

*The postal service is often the most affordable means of distance communication for people on low incomes. This economic reality implies that affordable communication services for people on low incomes are a right rather than a privilege, and that this right must be protected. Moreover, affordability needs to be broadly defined to include the initial and ongoing costs associated with accessing various forms of communications services.*

*....While the cost of sending and receiving e-mail may be lower than the cost of sending a letter, affordability measures must also include the cost of access to the technology which makes electronic communication possible (Public Interest Advocacy Centre, submission 23, p. 2).*

Low income and older people are the least likely to spend money on computers. For example, the Bureau of Transport and Communications Economics concluded in its 1996 December quarter survey that only 6 percent of low income households were likely to acquire a computer by February 1998 compared to 40 percent of lower middle income earners, 54 percent of middle and 50 percent of upper middle income earners.

In the future, internet connections will not necessarily be reliant on access to a home computer. The Australian Broadcasting Authority (ABA) expects that digital broadcasting systems, which essentially represent high-capacity, high-speed data links to the home, will begin to become available to the retail market by the end of 1999. The ABA estimated that customers will take up this technology over the next 10-15 years. NERA has predicted that:

*The provision of interactive services over digital broadcasting systems provides an alternative lower cost for internet services to the home. This is potentially of great significance in stimulating the penetration of internet services to the home since television set penetration of homes currently stands at 99 per cent compared to 30 per cent for PCs (NERA 1997b, p. 37).*

But NERA considers that the World Wide Web will have little impact on letter traffic, even though some substitution may occur at the margins (NERA 1997b, p. 36). There will continue to be a need for physical mail services as the reach, reliability and use of technologies cannot be guaranteed for all users. Accordingly, the take up of substitutes will remain important but will not replace the demand for physical mail.

## 2.2 Parcel Market

For ease of discussion, this section examines the transport of both goods and bulky documents. Australia Post faces competition in the market for parcel delivery from organisations such as TNT, Mayne Nickless, DHL and Federal Express. Australia Post has indicated that it hopes to grow its revenue from its parcel business by five percent a year. Its strategies include to:

- continue the emphasis on parcel service reliability;
- continue to lower costs through application of benchmarking and, as for letters, move to a more centralised network structure using improved parcel sorting technology;
- increase the use of the multi-parcel service (an automated receipt service for large customers that verifies and communicates consignment details on lodgement); and
- jointly with Australia Post's Sprintpak division, continue the process of becoming a major supplier to customers requiring logistics services including warehousing, fulfilment and distribution.

### 2.2.1 Business Customers

In the case of some bulky documents, it is likely that electronic document exchange will be increasingly used in trade and commerce as the business community increasingly accepts that physical evidence of delivery is not necessary. However, many bulky documents still need to be mailed because options such as faxing are not practical. Thus, the need for the transfer of some larger documents will remain. NERA has said:

*The labour cost of preparing most documents far exceeds their transmission cost by whatever medium. What matters at this point is not achieving the lowest transmission cost but the suitability and speed of the medium together with the certainty of the message's arrival (NERA 1997b, p. 35).*

Australia Post already faces competition in the parcel market and has demonstrated its ability to maintain a healthy market share with services including Express Post Parcel and prepaid Parcel Post Satchel. Australia Post has said:

*Our domestic parcel service operates in an unregulated market with competition coming mainly from major Australian and international freight and courier companies. In the highly competitive parcel industry, Post delivered, at low cost, more parcels than any other Australian parcel service provider during 1996-97. During the year, parcel volumes remained steady, despite a general downturn in the parcel market (Australian Post, 1997a, p. 16).*

Australia Post argued that its study of the business parcel market has provided it with the ability to grow the business to business parcel market. Australia Post has said it will:

- *increase the use of the multi parcel service. (This is an automated receipt service for large customers that verifies and communicates consignment details on lodgement); and*
- *jointly with Australia Post's Sprintpak division continue the process of becoming a major supplier to customers requiring logistics services including warehousing, fulfilment and distribution (Australia Post, submission 8, p. 71).*

Businesses have better access to parcel delivery services in metropolitan than in remote areas. In metropolitan areas competing parcel delivery operators offer a range of innovative services.

Australia Post's future in this market will depend on its ability to effectively compete with other parcel carriers. Increasing the use of technology in conjunction with parcel delivery is part of Post's strategy to achieve this. Overall, there will be a continuing need for postal services for business customers. However, with significant competition from electronic communications, particularly at the lower (smaller) end of the parcels market, and alternate parcel services, transport of business parcels is likely to remain a highly competitive part of the market that will be well served by Australia Post and its competitors.

### 2.2.2 Rural and Remote Area Customers

Australia Post's parcel services are important to remote customers who do not have the same choice of courier services as people in metropolitan areas. On its visits to rural and remote areas, the Council discussed the importance of parcel services with many groups, and found some dissatisfaction among rural users with the quality of parcel services. A number of people noted that in remote areas courier services are not available; Australia Post's services are the only option.

It has been argued that where a courier service is provided by one of Australia Post's competitors, it may not always be at a price that customers can afford. Technology in this area has not had the same impact, often because the types of parcels transported are not amenable to transportation by other than physical means. Examples of such parcels are parts for farm vehicles, personal and household goods and items often sent by direct mail. The NFF has recommended in its submission:

*That the review recognise that, while new technologies may be increasingly used to supplement traditional mail services as a means of communication, they cannot replace the need for a postal service that offers the capacity for the interchange of physical items (NFF, submission 39, p. 1).*

The ICPA also said in its submission that there are no satisfactory alternatives to a regular parcel and letter delivery service for their children's educational needs. The association, which represents more than 3000 members, argued that:

*School of Distance Education Correspondence lessons are quite bulky and involve many pages and packages containing education aids such as tapes. The papers are not suitable for transmission by facsimile because of their bulk, except perhaps in special circumstances (ICPA, submission 5, p. 2).*

The Mid West Development Commission stressed the important role of Australia Post in rural and remote areas. The Commission noted that:

*While advances in telecommunications, particularly in the flow of information, are providing far reaching benefits to most Australians, no such electronic access is available to many people living in remote Western Australia. Therefore, they rely on a timely, dependable,*

*affordable postal service for physical items of mail (Mid West Development Commission, submission 95, p. 3).*

Further, the Eastern and Central Regional Development Organisation expressed concern about the decline and deterioration of service delivery due to marginal volumes being dispersed amongst competing carriers. For example:

*Anecdotal evidence in the northern Goldfields indicates that the introduction of a number of parcel carriers competing with Australia Post in the region has led to more options for delivery but a decline in the service because of the reduced mass carried by competing carriers and delays in delivery until commercial volumes were assembled (Eastern and Central Regional Development Organisation, submission 28, p. 1).*

The importance of larger parcels to rural and remote areas is accentuated by the inability of some people to conduct business in person. For example many cannot pick up goods from a local shop and need to have them mailed from a regional centre. It is clear from the Council's visits to rural and remote areas that parcel delivery in rural areas will continue to be an important service.

### **2.2.3 Private Customers**

Private customers rely heavily on Australia Post's parcel services, even in urban areas where there is considerable competition from companies such as TNT and Mayne Nickless. In response to increasing competition, Australia Post has indicated in its submission that it will construct new mail sorting facilities in Sydney and Melbourne. Australia Post also has plans to move to a more centralised network structure using 'improved parcel sorting technology'.

The importance of Australia Post's parcel services for private customers will continue, particularly as it enjoys some advantages over its competitors. One issue competitors have raised in this review is the advantage Australia Post has in its ability to indicate to private customers that it has called to deliver a parcel when they were not home and leave a card indicating that the item is awaiting pick up at the local post office. Competitors in the parcel market do not share the same access to the post office network and need to leave items for collection with an agent in the area or return several times in an attempt to deliver the parcel.

For these reasons, private customers are likely to continue to rely on Australia Post for parcel delivery. Further, Australia Post's investment in new technology, across its network, is likely to have a significant impact on its competitors, particularly with its growth into areas such as warehousing, fulfilment and distribution. Still, parcel services will continue to be highly competitive in urban areas, with at least several alternative service providers available.

### 2.3 Banking and Agency Services

The drop in Australia Post's share of the messaging market parallels an increase in focus on other business activities including retail, banking and agency services. The banking and agency services provided by local post offices have also been increasingly important to customers, particularly in more remote areas where banking facilities are not always available due to rationalisation in the banking sector. Australia Post has argued that banking and agency services are of increasing importance to the Corporation and in its submission have said that part of its overall strategy is to:

*increase the scope of involvement in financial services mainly from, but not limited to, the counter network (Australia Post, submission 8, p. 70).*

To meet this strategy:

*The enterprise is now assessing the long term implications of the Wallis Report. In the short term the enterprise will continue to act as agent for major principals both in bill pay and banking. Entry into the banking business as a principal is not contemplated. However where the most appropriate option for a new initiative calls for the enterprise to be involved in either a joint venture, or as principal in its own right, the new business would be conducted through a separate reporting entity, operating without guarantee from either the enterprise or the Government. Such joint ventures would be subject to the Government's new Governance Arrangements for GBEs (Australia Post, submission 8, p. 7).*

The financial services provided by Australia Post include Pay it at Post, TaxPack Express, Money Orders and Key Post. Australia Post has said:



*In 1996-97, the number of giroPost transactions handled through the Electronic Point of Sale (EPOS) system totalled 23 million - a 27 per cent increase on last year. Transaction volumes for the Commonwealth Bank have increased by 21 per cent since the launch of giroPost. Available at 2,627 EPOS-equipped offices, giroPost extends financial accessibility and flexibility for Australians, especially those in rural and remote regions where there are fewer bank branches. Over 40 per cent of the giroPost network is established in rural areas, servicing under 30 per cent of the Australian population. Fifty per cent of transactions were received through metropolitan outlets (Australia Post, 1997a, p. 18).*

Financial services in Australia are most likely to experience rapid change as banks and other major institutions move away from a focus on the provision of over-the-counter services and, instead, encourage customers to use various on-line services including giroPost. Australia Post is likely to play a key role as a provider of financial services. The Corporation's plans in 1997 include adding several new banks and financial institutions to giroPost and establishing Australia Post as Australia's major over-the-counter bill payment, positioning giroPost as an effective retail banking service (Australia Post, 1997a, p. 18).

The increasing importance of these financial services provided by Australia Post has been recognised widely in submissions to this review. The ability of Australia Post to maintain and increase the use by customers of its banking and agency services will be a key issue for the Corporation in a more competitive messaging market.

### **2.3.1 Business Customers**

The banking and agency services that Australia Post provides do not cover all the needs of business. It has been suggested that although post offices provide banking services to private customers, similar services are not available for businesses because Australia Post's security policies place a limit on the amount of money post offices can hold. Australia Post issued the security policy out of a concern to ensure the safety of its staff and contractors.

It appears unlikely that Australia Post will be a significant provider of financial services to the business sector unless it can overcome some of the security problems associated with post offices handling larger transactions.

### 2.3.2 Rural and Remote Customers

The provision of banking and agency services by Australia Post in rural areas where banks no longer operate is critical for rural and remote customers. In some areas, the Post Office is the final significant institution represented in the community when banks and other financial institutions have gone, councils have amalgamated and government agencies have closed. Other technology in these areas does not always reach these customers for the reasons already outlined in 2.1.2.

Australia Post's electronic funds transfer, bill paying and other services are important to rural and remote customers. The Small Business Development Corporation said:

*The established network of Government postal agencies and post offices in rural and remote areas of Australia, many of which already provide a network of financial services, may be able to fill the gap left by the withdrawal of the banks, particularly where there is no direct or unfair competition with private enterprise (Small Business Development Corporation, submission 97, p. 2).*

Ms Ross of Tintagel, Holbrook NSW said:

*This service saves considerable travel and expense for customers and provides commission to the shop owner. These retail services should be maintained under the Australia Post umbrella. They are not in direct opposition to existing services provided in the community (Ms Ross, submission 3, p. 2).*

In meetings with the Council, operators of licensed post offices stressed their reliance on agency and banking services and were keen to ensure that they remained 'on-line' to services such as giroPost. The Fish Creek Licensed Post Office said:

*The rural areas of Australia have been adversely affected by the rationalisation of service industries, notably Banks. Your Council must ensure that any decision it makes does not add to the distress already experienced in these areas (Fish Creek Licensed Post Office, submission 111, p. 2).*

The NFF has also said:

*With more than 40 per cent of Giropost outlets located in rural areas, it extends financial accessibility and flexibility for people in rural and remote Australia. These services are especially important where bank branch closures would have forced people to travel vast distances if not for the facilities offered by Australia Post.*

*The NFF supports the recommendation of the 1996 House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform Inquiry into Australia Post's rural and remote delivery services, that Australia Post upgrade Licensed Post Offices or Community Postal Agencies to include banking services in cases where standard banking services in a rural or remote community are withdrawn. The number of branches throughout Australia fell by 660 between 1992 and 1995, while more than 400 branches have closed in New South Wales alone in the past five years (NFF, submission 39, p. 5).*

Many groups have also argued that the services provided by post offices cannot be replaced by technology. The Combined Pensioners and Superannuants' Association of New South Wales argued that:

*The delivery of financial services in rural and remote areas is an important issue for older people as banks withdraw services from rural and remote communities and replace them with electronic banking. While the ability to use electronic banking would benefit older people, many older people do not want to use these types of service for a variety of reasons (Combined Pensioners and Superannuants' Association of New South Wales, submission 102, p. 3).*

In the medium term phone and internet services may replace the need for physical access to banking services. Telephone banking services currently cover such services as bill payment, balance enquires, and funds transfer. At present telephone banking does not provide access to cash, and some people in remote areas do not yet have a telephone connection. Further, there are costs associated with the use of a telephone. With the introduction of innovations such as smart cash and internet banking, telephone

and internet banking may in the medium term replace the need for a physical banking network. However in the short to medium term, the banking and agency services provided by Australia Post will still be needed, particularly in more remote communities.

### 2.3.3 Private Customers

As mentioned previously in this chapter, access to new technologies varies greatly between regional, remote and metropolitan areas of Australia. Australia Post's services in this area are not a complete substitute for the major financial institutions but will continue to provide a link for private customers who may not otherwise have easy access to those institutions. The Catholic Women's League, New South Wales noted that:

*It is imperative that post office outlets, whether they be licensed post offices or community postal agencies, be available in all areas, not only rural and remote. Suburban areas need to be well served as many people, particularly our senior citizens, have to rely on public transport so easy access is important as post office outlets provide opportunities for payment of so many accounts. Provision of EFTPOS or similar is also a necessity for these reasons (Catholic Women's League, New South Wales, submission 119, p. 1).*

But, increasingly, similar services are being provided by other agencies and institutions not aligned with Australia Post. The Council believes that the operations of the other providers of EFTPOS, and the increasing popularity of telephone banking, may over time reduce the importance of Australia Post agency services in more populated areas. NERA has reported that:

*The penetration of telephony and other electronic communications media in Australia is high relative to other OECD countries. Penetration of relatively new services, such as mobile telephony and the internet, is growing rapidly albeit from a low base (NERA, 1997b, p. i).*

Less advantaged groups also have special needs which Australia Post staff, acting as agents for other institutions, may not always be able to provide. As electronic communications options grow and the wider community is exposed to them, there will be an increase in uptake by private customers of alternatives to Australia Post's

services. The growth in alternatives is likely to come from major institutions supplying increasingly sophisticated on-line financial services. For example, banks now supply various everyday banking needs over the phone including complete deposit and withdrawal statements.

## 2.4 Meeting this Changing Environment

The discussion in this chapter indicates that the pace of change in messaging will only increase over time and that it is difficult to forecast the long-term structure of the market and associated industries. But one thing appears clear - this environment poses both opportunities and threats for postal services. The internet, e-mail and hybrid services will continue to grow and some of these products will compete directly with Australia Post.

Review of the institutional and regulatory framework that Australia Post operates in is timely and necessary given the present pace of change. Australia Post has said:

*In the future competitors will focus on vulnerable and valuable niche markets by 'cream skimming' the low cost densely populated areas and the premium services. There is some indication of this emerging in the fully deregulated postal service in Sweden. At corporatisation, mail sent between businesses was the largest segment of our market. Now its share is declining as business to business mail is replaced by electronic technologies. The potential for further erosion is high. Over the same period the number of private letters posted has halved, many replaced by telephone calls and fax (Australia Post, submission 8, p. 11).*

Building on existing strengths, such as its extensive retail network, Australia Post says it is demonstrating the potential for postal services to become fully integrated within the new communications environment.

However, the relevance of institutional and regulatory arrangements which apply to only some types of communications services, and not others, is at issue. For example, because of Australia Post's monopoly in provision of letter services, it is currently the only entity which can feasibly provide all aspects of a hybrid electronic/physical communications service involving delivery of letters. Further, the question of whether such arrangements provide the most appropriate framework to drive innovation, efficiency and ultimately, consumer benefit, warrants close analysis.

A regulatory framework which promotes the ready introduction of new and innovative communications services would ensure that postal services make the greatest possible contribution to meeting the future communications needs of the Australian community. According to NERA:

*The greatest “shock” to past trends in letter traffic growth will come from the increasing penetration of internet access (be this from a PC or other terminals such as a NetPCs or digital TVs), improvements in the quality and capacity of access networks, and the growth in services offered over internet, the most important of which is likely to be e-mail (NERA 1997b, p. 22).*

The Council, in its September 1997 options paper, sought people’s views on the extent to which postal service providers are constrained from making use of emerging communications technologies and supplying new communications services. The Council also sought comment on the extent to which new communication technologies are reducing or increasing the need for traditional postal services, such as letter and parcel delivery.

Australia Post has recognised that emerging technologies have reduced household to household letters from 16 percent of letters posted to 5.5 percent in the period 1988 to 1996 but, at the same time, also aided growth in the number of accounts issued (Australia Post, submission 99, p 42). It is likely that growth in the letter market will continue; however, it may not always be in traditional segments of the market where growth has been experienced in the past. For example, with competition in telephony, customers may receive accounts from more than one provider whereas, in the past, there was only one provider of services — Telstra. Australia Post has argued that:

*There is no evidence that emerging communications technologies are being constrained by postal regulation. The choice of communications technology depends on a number of factors including the purpose and content of the message, relative cost, speed, quality and reliability of the service. Alternate technologies have never been so widespread as at present. Communications providers can utilise EDI, facsimile, the Internet, telephony, interactive TV, interactive voice response and in addition (to) other more limited channel(s). ... These new communication technologies will significantly reduce the need for individual letter services (Australia Post, submission 99, p 42-3).*

The Council acknowledges that the traditional letter market will be reduced with the impact of the internet. NERA has said:

*It is widely expected that the penetration of internet access will grow very rapidly over the next 10 to 20 years, possibly approaching that of the telephone today (NERA, 1997a, p iv).*

However, the extent of this reduction will depend on postal services being able to exploit all of the opportunities which arise. As noted in Chapter Eight it is extremely difficult for one organisation to provide all of the services customers want. Similarly, the Council believes that competition in emerging hybrid electronic services is likely to be constrained where competitors rely on Australia Post's letter delivery service in order to offer competing hybrid services, and Australia Post has a monopoly in letter delivery.

The changing market is rendering some services less important (especially the letter services) but increasing the importance of other services, such as parcels delivery and agency services, which are mostly provided in a competitive environment. Nonetheless, some groups (especially in remote areas) continue to be heavily reliant on the core letter services. The Crookwell Shire Council has said:

*Telecommunications benefits including mobile phones and internet services are scarcely available in rural areas due to government's failure to provide adequate infrastructure for analogue communications and because set up costs for private operators is prohibitive given minimal profit over vast areas of land to be covered (Crookwell Shire Council, submission 80, p. 1).*

Deregulation, without adequate safeguards, would jeopardise the provision of services in remote regions. Guarantees in the provision of the full range of current Australia Post services to rural and remote areas is therefore a key issue for this review and is discussed further in Chapter Six and Chapter Eleven.

## **2.5 Origins of this Review**

In February 1994 the Council of Australian Governments adopted the principles of the Hilmer report on National Competition Policy (NCP). Under the 1995 NCP package, Australian governments agreed to review and, where appropriate, reform legislation which restricts competition. An example of such legislation is the *Australian Postal Corporation Act 1989* which, among other things, confers a monopoly on

Australia Post for the provision of Australia's standard letter service. On 19 May 1997 the Council received the terms of reference from the Treasurer to undertake a review of the Act.

There are many pieces of legislation in Australia which contain provisions that restrict competition. They constrain people's choice of what they can buy and who they can buy from. While some of these regulations perform a necessary function, such as protecting people from dangerous products, it is desirable to consider periodically whether particular restrictions are still relevant.

Each State and Territory has compiled a timetable which lists when they plan to review each piece of legislation which restricts competition. These timetables include around 2000 pieces of legislation which cover areas like pharmacies, lawyers, and planning and environmental legislation. Governments have agreed to complete these reviews and to implement any reforms by the end of 2000.

The legislation review program is not about automatically removing restrictions on competition. It is, however, about not unnecessarily restricting people's freedom of choice and considering:

- why we have provisions which restrict competition;
- whether the circumstances have changed which reduce the need to restrict competition;
- whether benefits to the community overall of restricting competition outweigh the costs; and
- are there other ways to achieve the objective of the provisions which do not restrict competition.

The Council's terms of reference for reviewing the *Australian Postal Corporation Act 1989* require it to consider each of the components of the NCP package. In addition to the legislation review program, the NCP package includes a range of other measures to promote competition for the benefit of the community as a whole.

For example, governments have agreed to implement competitive neutrality reforms which are designed to ensure that government businesses are treated in the same way as private businesses they compete with. This requires that, where appropriate, Government Business Enterprises be corporatised and that they be subject to the following:

- full Commonwealth, State and territory taxes or tax equivalent systems;



- debt guarantee fees to offset the competitive advantages provided by government guarantees; and
- regulations applying to private sector businesses such as those relating to environmental protection, and planning and approval processes.

Australia Post has already taken some steps towards achieving competitive neutrality. Since corporatisation in 1989, it has been liable for corporate taxes, and has initiated dividend payments to the Commonwealth Government.

In addition, governments have agreed to consider establishing independent oversight of the prices charged by monopoly and near monopoly businesses. Further they have agreed that when considering whether to permit increased competition in areas covered by government monopolies, they will consider also:

- the merits of separating the monopoly elements of the business from non-monopoly elements;
- the best way of separating regulatory from commercial functions of the business;
- community service obligations (CSOs) and how they are funded; and
- financial relationships between the business and the government.

The National Competition Policy package also includes mechanisms in Part IIIA of the Trade Practices Act which set out the conditions under which businesses have the right to use the services of infrastructure owned and operated by other businesses.

### **2.5.1 The Timeliness of this Review**

There has been rapid change in the postal services market and it is anticipated that these changes will magnify in the ongoing through the take up of future developments in electronic communications. As such, the current review of the Australian Postal Corporation Act 1989 is very timely because of the growth in alternative providers and the changes in technology. Australia Post has said:

*Post's services are exposed to direct and indirect competition which is fast increasing with technological innovation, changing communications habits and regulatory change. There is real market place pressure to perform now, and this will increase over the next few years (Australia Post, submission 8, p. 12).*

This changing environment means that there is strong justification for considering the operations of Australia Post in the context of the Commonwealth's competition policy commitments.

# Chapter Three: Current Structure and Operations of Australia Post

*To determine whether any changes are needed to ensure the best is achieved from postal services, it is necessary to understand the current structure and operations of Australia Post. This chapter describes the framework for the operation of Australia Post including the accountability of the Board and the Government's directives to Australia Post. It also describes the postal and other services provided by Australia Post and gives an overview of the operation of Australia Post's activities in mail collection and delivery, sorting and transportation.*

Australia Post needs to be well positioned to continue to meet the current and future needs of users. The previous chapter noted that future communication needs are likely to be continued to be met, at least partly, by physical mail services such as those provided by Australia Post. The current breadth of Australia Post's operations and its level of performance illustrate that Australia Post is in a strong position to respond to the changing market and also has potential to build on that strength.

Australia Post is one of Australia's largest companies. It has outlets in almost every suburb and town in Australia and is very likely to be used by every Australian. There are over 20 000 posting facilities and Australia Post services nearly eight million delivery points. As illustrated in Table 3.1, it ranks among Australia's largest businesses in terms of revenue, profit and employment. Box 3.1 provides a snapshot of Australia Post's business.

Table 3.1 How Australia Post Compares, 1996

Company	Revenue \$ billion	Operating Profit \$ million	Employment <sup>1</sup>
Telstra Corporation Limited	13.4	2 528	68 000
BHP	11.2	790	48 000
Coles Myer	10.8	273	135 000
National Australia Bank	7.5	1 104	48 029
TNT <sup>1</sup>	5.7	127	28 000
Commonwealth Bank	4.8	602	40 000
Qantas	4.1	151	20 812
Amcor	3.2	132	18 100
Australia Post (1995-96) <sup>2</sup>	2.9	237	37 729
Brambles	1.5	117	15 000
Mayne Nickless	1.4	43	39 278
Ausdoc Group	<0.1	3	520 <sup>3</sup>

1. Data from Dun and Bradstreet, Australia's Top 500 Companies 1995-96.

2. Australia Post 1996, pp. 44 and 68. Australia Post's employment includes full and part time employees but excludes casuals and contractors.

3. Ausdoc, submission 9, p. 3 permanent employees only

Source: The Top 500 Profit Earners, Business Review Weekly, 28 April 1997, pp. 66-82.

Box 3.1 Australia Post Today, 1997

Revenue (\$ million)	3 109.7
Expenditure (\$ million)	2 763.1
Profit before Abnormals and Tax (\$ million)	346.6
Total Assets (\$ million)	2 588.6
Cost of CSOs (\$ million)	67.0
Dividends provided for and paid (\$ million)	
(including \$80m special dividends)	219.9
Capital Repaid (\$ million)	50.0
Total mail articles handled (million)	4 205.7
Full time employees	31 111
Posting Facilities (including retail outlets, street post boxes and roadmail contractors)	20 940
Delivery Points	8 210 165

Source: Australia Post 1997a, pp. 52-53, 70-72.

## 3.1 Structure of Australia Post

Australian Postal Corporation is fully government owned and has its activities and responsibilities set out in the *Australian Post Corporation Act 1989*. Australia Post has been corporatised: it operates with a board and has commercial objectives supported by community service obligations (CSOs).

The key elements of Australia Post's governance include the directions provided by the Act, other Government guidelines for its operation, the board's corporate objectives, and the Corporations Law.

### 3.1.1 The Australian Postal Corporation Act

The Act sets out the principal function of Australia Post to supply postal services within Australia and between other places and Australia.

In the 1994 second reading speech supporting the *Australian Postal Corporation Amendment Bill*, the Government noted that the amendments would provide the basis for a more competitive mail system and reaffirm its commitment to provide a mail service reasonably accessible to all Australians at a uniform price.

The details of the Act are outlined in Chapter Four.

### 3.1.2 Other Government Guidelines

The Minister under the Act, currently the Minister for Communications, has several powers. These include the ability to:

- disapprove of changes to the postage rates for standard postal articles. Australia Post has not requested a variation of the postage rate for standard articles for five years;
- direct Australia Post to pay dividends, including interim dividends, to the Commonwealth under sections 54 and 55 of the Act; and
- give directions to the Board relating to general policies of the Commonwealth Government and other directions which the Minister considers to be in the public interest (sections 48 and 49).

The following general policies of the Commonwealth, for the purposes of section 48, currently apply to Australia Post:

- Loan Council borrowing requirements;
- Industrial Relations Policy;
- the Australian Government Traineeship Scheme;
- Procurement and Industry Development Policies; and
- the Construction Industry Reform Strategy.

The Act provides for Australia Post to be reimbursed for any costs incurred in complying with directions under section 49.

### **3.1.3 Corporate Objectives**

Australia Post has a Board of Directors which determines the objectives, strategies and policies of the business. As a government owned enterprise, Australia Post's strategies and policies are agreed with the Government.

#### *The Accountability of the Board*

The Board of Australia Post is also accountable to the Parliament, through the responsible Minister, for its performance. The Act requires the Board to provide the Minister with audited annual reports and financial statements, and to notify the Minister of its significant business activities.

The Board is required to provide the Minister with a corporate plan, and can only vary the strategies and policies of Australia Post and its community service obligations, as well as the relevant performance indicators and targets. The corporate plan is also required to include a financial target<sup>1</sup> and financial strategies, including forecasts of its costs and revenues. Those costs are to include the cost of carrying out Australia Post's community service obligations.

The Minister has limited authority to make changes to the plan. The Minister's authority is limited to variations in the strategies and policies of Australia Post in carrying out its community service obligations, and the financial target under the plan. The Minister is unable to specify service or price performance targets.

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<sup>1</sup> This target must have regard to elements of Australia Post's financial performance including earning a reasonable rate of return, paying the Commonwealth a dividend, maintaining future financial viability and the cost of CSOs as well as other obligations Australia Post is required to meet.

Other government obligations include: pensioner mail redirection (costed at \$ 1.8 million in 1996-97), prices surveillance by the Australian Competition and Consumer Commission, and Freedom of Information requirements (Australia Post 1997a, p. 79). These obligations are discussed in more detail later in this report.

Loan Council arrangements require their approval for Australia Post's borrowings. The Loan Council, for example, recently approved Australia Post's request for new borrowings of \$50 million.

### **3.1.4 Application of Corporations Law**

In response to the Review of the Government Business Enterprise Governance Arrangements, the Government has decided to alter the way in which Australia Post is governed. Under the revised governance arrangements for government business enterprises, Australia Post is to:

- be established as a public company limited by shares and incorporated under corporations law;
- be structured under a joint shareholders arrangements between the Minister for Finance and the portfolio Minister;
- be exempted from statutory administrative law and the Commonwealth's purchasing policies, except where otherwise agreed by shareholder Ministers; and
- have a publicly available statement of corporate intent.

These revised corporate governance arrangements have not yet been put in place and in some cases require legislation to be introduced or amended. Australia Post will be affected by changes to its legislation and its establishment as a public company. Legislation is also required if any aspects of administrative law are to continue to be applied to Australia Post. The arrangements for a joint shareholding arrangement are currently being formalised but are also reliant to an extent on the establishment of Australia Post as a public company. The guidelines for the statement of corporate intent are currently being developed by the Department of Finance and Administrative Services for use by government business enterprises including Australia Post.

### 3.2 Services Provided by Australia Post

The operations of Australia Post can be categorised using two approaches. The first examines the products provided by Australia Post, and the second is based on the business processes which Australia Post uses to deliver those products. Both approaches are important as they provide different insights into the products which are important to Australia Post's customers, the structure and cost of the postal business and the likely impact of different types of competition. This section looks at the types of products and services provided by Australia Post. The following section outlines its business processes.

The proportion of Australia Post's revenue received from reserved services is falling. The Industry Commission (IC 1992) reported that in 1990-91, 61 percent of Australia Post's revenue came from reserved services. This declined to 51 percent in 1996-97 (Australia Post 1997a, p. 83). The continued fall is due to a reduction in the scope of the reserved services and Australia Post expanding away from its traditional mail services into the provision of new services and products which add value to its existing mail collection and delivery systems. Australia Post's services include:

- letter services;
- parcel services;
- international mail;
- retail services;
- financial services; and
- other ancillary services (including joint ventures).

Table 3.2 Australia Post's Revenues by Activity, 1996-97

Activity	Revenue (\$ millions)	Share of Total Revenue (percent)
Mail Services	2 730.9	87.8
Philatelic Products	52.8	1.7
Postal money order services	29.5	0.9
Other	296.5	9.5
Total	3 109.7	100

Note: The percentages do not add up to 100% due to rounding.  
Source: Australia Post 1997a, p. 52



Australia Post's services include, but extend well beyond, the basic postal service. Further, only some of the letter post services are reserved to Australia Post. Australia Post describes its business as follows:

*Australia Post has two core businesses: namely letters (eg standard letters, promotional letters and publications) and parcels. Its two ancillary businesses, financial services (eg bill payment) and retail services (eg greeting cards and packaging) are operated to meet customer needs and/or provide opportunities for maximising the return of network assets (Australia Post, submission 8, p. 108).*

### 3.2.1 Letters and Large Envelopes

Although Australia Post's share of the communications market has decreased, there is still strong growth in the number of articles being sent through the postal system. In 1996-97 Australia Post grew its mail volumes by 3.9 percent. This growth is higher than the historical average of 2.3 percent over the last 36 years (Australia Post, submission 8, p.23). This growth is expected to be higher than the historical average in future. Arthur Andersen has estimated the growth in mail volumes and other items of between 4 percent in 1998 and 3.4 percent in 2005. Post's ability to maintain the growth in mail volumes will partly depend on its ability to compete against other messaging technologies. NERA identifies the growth in the use of the internet and the development of high speed network as key factors affecting the growth of mail volumes (NERA 1997b, p. 41).

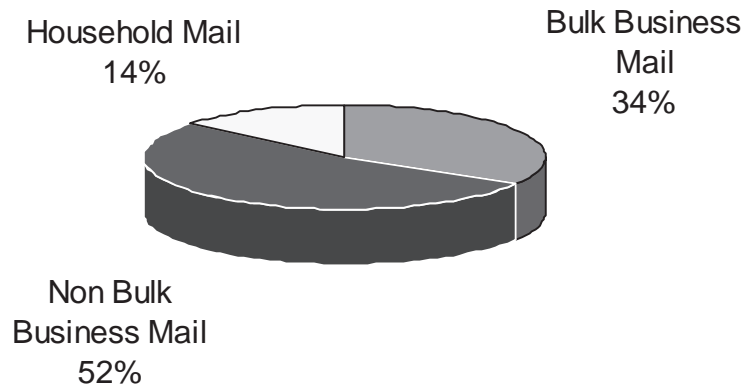
Rising mail volumes have been accompanied by a fall in the real price of a standard letter. During 1995-96 Australia Post announced that it would extend its price freeze on the 45-cent-stamp until June 1998. Standard letter postage rates have been frozen at 45 cents since January 1992, resulting in a 12 percent fall in real prices by mid 1997 (Australia Post 1997a, p. 12). The package of reform suggested by the Australia Post submission includes a proposal to continue the price freeze on the 45 cent standard letter rate until 2002.

There are two main letter market segments based on the source of the mail: the household segment, and the business segment. These segments are presented in Chart 3.1. Household customers rely on the 45 cent standard letter to meet

most of their postal needs. In 1996-97, this segment sent 14 percent of all letters or almost 500 million letters. In 1996-97, 3514.3m (83 percent) of the 4205.7 million articles carried by Australia Post were addressed letters, and 86 percent of these letters were business letters (Australia Post, submission 99, p.47 and 51).

The business segment includes business mail which can take advantage of bulk discounts and that which cannot. Discounts are available for large volumes, presorting and for interconnecting with Post's network close to the point of delivery. Most discounted mail is part of the high volume, business-to-household mail and accounted for 33.6 percent of all addressed letters received bulk presort discounts (Australia Post, submission 99, p. 47). Business-to-household mail has now replaced business-to-business mail as Australia Post's largest mail category (Australia Post, 1997a, p. 14). The volume of letters receiving PreSort discounts grew eight percent in 1996-97, which was slightly down from the nine percent growth achieved in 1995-96, but still above the growth in mail volumes overall.

*Chart 3.1 Australia Post's Letter Volumes, 1996-97*



Total Addressed Letter Volumes: 3,514.3 million

Source: Council estimates derived from information provided by Australia Post.

Australia Post has also increased its focus on the delivery of advertising (or unaddressed) mail to households by establishing a common brand name for a range of services. Post Direct works with business mailers to provide advice on targeted advertising mail campaigns. In 1995-96, Australia Post also introduced a direct mail software package, Desktop Direct.

Australia Post operates a range of other services based on the letter service. Express Post is a next-business-day delivery service, which increased 24 percent in 1996-97, following 12 percent growth in 1995-96. Australia Post also operates AddressPost, an electronic service designed to assist business mailers improve the accuracy of their mailing lists and introduced Messenger Post, which provides courier services and mailroom outsourcing.

EDIPost, an electronic-to-physical mail service, grew by 50 percent in 1996-97 after a 70 percent increase in 1995-96. Australia Post has developed several new services around its EDI Post network using information technology to store, deliver and lodge messages. These include EDI Post STAR (a message storage and retrieval system), EDI Post Direct Fax (fax delivery of a document rather than printing), and PC EDI Post (lodgement of small volumes by computer).

Print Post is a scheme which provides discounts to mailers of authorised periodicals. This unreserved service faces direct competition in the delivery of magazines and other publications from private providers. Some 20 000 titles benefit from the discounts provided by Print Post, which can be up to 16 cents for a small letter lodged at the local delivery office in volumes of 50 or more items.

### **3.2.2 Parcel Services**

Australia Post is Australia's largest carrier of parcels and its parcel business is an important part of its postal services (Australia Post 1997a, p. 16). During 1997 Australia Post reported heavy competition from large service providers with extensive interstate coverage as well as small local providers. Australia Post's parcel volumes have remained steady, though there is little accurate information publicly available on the volumes or revenues of Australia Post's parcel activities. Parcel volumes are likely to be small compared to the number of letters sent through Australia Post's network.

Australia Post offers three parcel services: Parcel Post, Multi Parcels and Express Post Parcels. Some of the services are provided through Australia Post's network of post offices and delivery services, while contractors deliver large parcels.

Parcel Post provides household and small parcel delivery. This service is linked with Australia Post's fulfilment services.<sup>2</sup> Australia Post has arrangements with companies providing direct marketing and home shopping services by which its Sprintpack division provides warehouse services for its clients' products and delivery as required through the postal network.

Multi Parcels is a service for business customers sending parcels to other business customers, particularly for businesses which periodically send parcels to a common set of customers. The Multi Parcels' key feature is that it provides customers with validation of pick up quantities and multi-point delivery using the Electronic Lodgement and Delivery System.

Australia Post introduced an express post parcel service in July 1995, after the success of the Express Post envelope. This service is directed at small business and private customers with urgent parcel post delivery needs.

### **3.2.3 International Mail**

Following a 1992 report by the Industry Commission, the market for outward bound international letters was deregulated in 1994. Consumers can bypass Australia Post completely for outgoing international letters but incoming international mail must still be delivered within Australia by Australia Post.

In 1996-97, Australia Post handled some 160 million articles posted overseas for delivery in Australia (Australia Post 1997a, p. 75). Incoming mail carried by other national postal services is lodged with Australia Post at rates governed by the Universal Postal Union (UPU), while private postal service operators are charged interconnection rates on the same basis as domestic operators (Australia Post 1997a, p. 75).

Australia Post has continued to hold a significant share of the outgoing international letter market handling 157 million articles posted in Australia for delivery overseas in 1996-97. Australia Post has reported increased competition

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<sup>2</sup> Fulfilment services are the storage; receiving orders; and the picking, packing and sending of products.

in this market from international mail, courier and freight companies. There have also been increased international mail volumes during 1995-96, particularly in bulk business mail and express mail.

In response to increased competition, Australia Post has developed a range of international mail services, and often relies on its relationship with overseas postal services to provide those services. Australia Post's 'Business Post International' services involve business air mail, express post international and EMS International Courier to provide a range of express international postage services. Express Post International followed on the success of domestic express post services and grew 18 percent in 1996-97 (Australia Post 1997a, p. 16). Australia Post is continuing to develop 'ePost', an international electronic-to-physical mail service into Europe and the United States.

Australia Post also offers a Direct Entry mail service. This service allows for bulk mail to be delivered directly into the domestic mail systems of other countries, and as such is a form of international postal service interconnection. Australia Post has direct entry arrangements with the UK, New Zealand, Fiji, Philippines, Malaysia, Hong Kong, Singapore and South Africa.

#### **3.2.4 Retail Services**

A range of post and non-post services are provided through the post office network. For example, retail post offices offer:

- access to communications services such as packing containers and fax services;
- access to financial services such bill payment and banking services;
- stationery, greeting cards, and books; and
- other services such as passport interviews on behalf of the Department of Foreign Affairs and Trade.

Australia Post has surveyed its customers for the primary reasons they visit postal outlets. The survey found that 39 percent is postal related and 40 percent is related to the agency services which the outlets provide. It also found that seven percent of the visitors to retail outlets were for retail merchandise and seven percent for banking (Australia Post 1997a, p. 23).

Australia Post's retail modernisation program is now nearing completion. Its aims are to modernise Australia Post's retail presence, meet specific needs of business and private customers and increase profitability. Developments included locating one-stop post offices in accessible shopping areas, positioning business centres in industrial or commercial locations close to customers and training for retail staff. In 1996-97 Australia Post achieved a key five year objective, its retail business became profitable - for the first time - with a small profit of \$18 million (Australia Post 1997a, p. 4).

Part of the modernisation of the retail network has involved an expansion in the number of post offices and post office outlets and the conversion of many corporate post offices to licensed post offices (LPOs). Since 1995 the total number of outlets has increased by 151 to 4468 outlets. Most of the network expansion has occurred with the opening of community postal agencies with more than 170 agencies opened since 1995. This is in addition to the opening of sixty-three new corporate offices and thirty-six new LPOs. During the same period more than 220 corporate post offices have been converted to LPOs. Some 65 percent of all postal outlets are now LPOs (Australia Post 1997a, p. 71). These LPOs and community agencies are run as private businesses.

While the retail network has been expanding and the number of retail outlets increased, some post offices have been closed. Since 1995, 118 post offices have been closed (Australia Post 1997a, p. 71, 1996, p. 63). Post office closures and the availability of services provided by post offices is discussed in Chapter Six on Australia Post's Universal Service Obligations.

Australia Post has also established business centres to cater for the needs of business clients. These Centres are generally post offices located in the vicinity of business districts and set up to meet the specific needs of business users such as improved vehicle access for bulk lodgements and bulk post product purchase. These offices contrast with post shops which cater for private and small business customers. Australia Post has recognised that it needs to adopt different strategies to meet the needs of different customer groups, in order to maintain the viability of the postal network.

#### *Access to Stamps*

In most areas, the demand for stamps is met by corporate and licensed post offices. In rural and remote areas, these facilities are sometimes run in

conjunction with other businesses for example, newsagents and general stores. In remote areas, post offices may not be available and in those circumstances Australia Post has established community postal agencies to sell stamps. In addition to post offices; licensed stamp vendors, vending machines, and Postpoints (stamps and envelope vending machines) provide access to stamps. In 1996-97 there was a total of 15 585 stamp outlets including 4462 retail outlets (compared to 16 277 outlets and 4370 retail outlets in 1995-96) (Australia Post 1997a, p. 72 and 1996, p. 64).

### **3.2.5 Financial Services**

For some time, Australia Post has provided a range of financial services through its retail network. These include banking services, bill payment, electronic lodgement of taxation forms and money orders. Many customers now see these as key services provided by Australia Post. These transactions numbered more than 130 million in 1995-96 and rose to 146 million transactions in 1996-97.

Australia Post introduced banking services with its 'giroPost' service in July 1995. This service provides on-line banking to the customers of ten banks and financial institutions, such as the Commonwealth Bank and Citibank. Australia Post now has 2627 electronic point of sale (EPOS)-equipped offices which handled 23 million giroPost transactions in 1996-97, up 27 percent from the previous year. Australia Post reports that the number of transactions for Commonwealth Bank have risen 21 percent in the last year. These transaction volumes underline the complementary nature of the Australia Post's network with the Commonwealth Bank's own branch network, and the networks of other financial institutions, where those institutions do not have dedicated branches.

Australia Post has announced plans to implement new electronic funds transfer systems in post offices currently equipped with the EPOS system. Australia Post has been reported as saying that the current system processes transactions worth more than \$60 billion annually ("AustPost set for 1m daily system", Australian Financial Review, 1 July 1997). According to the report the new system <sup>3</sup>/<sub>4</sub> a revision of the existing electronic point of sale system <sup>3</sup>/<sub>4</sub> will be implemented by 2000 with the aim of handling one million on-line banking, bill payment and tax receipt transactions daily.

Post offices and agencies also provide the largest over-the-counter bill payment network in Australia. During 1995-96, more than 100 million of Australia's 500 million consumer bills were paid in post offices, representing a 16 percent increase since 1994-95. By 1996-97, this had increased to 123 million bill payment transactions. Major bill payment partnerships have been established with organisations wanting to utilise Australia Post's retail network and technology for payment collection. Some examples of the types of bills that can be paid at post offices equipped with this function include phone bills, insurance and electricity accounts. Twenty seven organisations, including Optus, were added to Australia Post's bill payment system in 1996-97, making a total of 230 organisations.

In 1995-96 more than 114,000 customers lodged their tax returns electronically using TaxPack Express, with this number increasing 54 percent in 1996-97. In that year Australia Post reported that it collected some \$53 billion in Commonwealth Government income tax payments. The demand for money orders also grew by six percent during 1996-97.

Australia Post has also moved to expand its bill payment and messaging services by expanding into electronic messaging services. These include the establishment of 24 hour telephone bill payment by late 1997, and Internet bill payment services during 1998. Australia Post has also continued to develop its KeyPost products. KeyPost uses electronic signatures and encryption techniques to allow confidential information to be sent over public and private electronic networks. Australia Post is currently undertaking initiatives with the Victorian and Commonwealth governments to introduce KeyPost services to the public.

### **3.2.6 Ancillary Services**

#### *Collectibles*

Australia Post develops and retails collectible products to actively promote stamp collecting. During 1996-97, philatelic revenue increased just 3.5 percent after a nine percent increase in 1995-96.

Export sales of philatelic products increased by five percent overall, with stronger growth to Asian collectors. In an effort to increase its share of the collectibles market, Australia Post has doubled the number of its outlets selling Royal Australian Mint coins.



### *Fulfilment Services*

Australia Post's Sprintpak division supplies stamps, philatelic products and retail goods to its retail network and to third parties. The establishment of a national warehousing network and the development of fulfilment systems for direct marketing, telemarketing and home shopping providers were priorities during 1996 and 1997. Fulfilment services include storage, receiving orders, as well as picking, packing and sending products.

Sprintpak also supplies stamps, and it increased revenue from international stamp production by 51 percent in 1996-97, after an increase of 104 percent in 1995-96. Postage stamps and philatelic products were supplied to New Zealand Post, Singapore Post, the Irish Post Office (AnPost), the Indonesian Post Office and the Netherlands.

### *Joint Ventures*

Australia Post participates in several joint ventures in the areas of air freight, information technology, data analysis, financial services and international bulk mail.

Australian air Express Pty Ltd (AaE) is a 50/50 business partnership between Australia Post and Qantas, providing intrastate, interstate and international express air services. AaE's revenue increased by 12 percent during 1996-97 after similar growth the year before. Australia Post received \$7 million dividends from AaE in 1997, but none in 1994, 1995 or 1996.

GEOSPEND Pty Ltd is a 50/50 joint venture between Australia Post and GEOSPEND, a company which develops marketing software. The joint venture is developing sophisticated marketing support software and data analysis services for use by Australia Post in the Australian postal services market. GEOSPEND Pty Ltd supplies marketing support systems to the banking, insurance and direct marketing sectors in Australia and New Zealand. Australia Post did not receive dividends from GEOSPEND Pty Ltd in 1994, 1995, 1996 or 1997.

In 1995 Australia Post formed a 50/50 joint-venture with the Chase Manhattan Bank Australia to establish Austrapay Ltd. The joint venture provides the electronic payment, cheque processing and remittance services used for over

the counter bank and bill payment services. Austrapay processed more than 100 million transactions in 1996-97.

Australia Post has a small share in International Data Post (IDP). IDP is jointly owned by nine international postal enterprises from Europe, the Asia-Pacific and the USA. IDP develops and markets ePost – an international bulk electronic mail system – to postal enterprises. During 1996-97 Australia Post slightly increased its holding in IDP to 7.95 percent.

Australia Post had small retained profits in AaE, Austrapay, and GEOSPEND in 1996. This was up from a small loss in the previous year.

### **3.3 Operations of Australia Post**

Australia Post operates a large network of mail collection and delivery points connected by road, air and sea transport of mail. The coordination of this network and its resources is critical to provide customers with value-for-money products and services.

Efficient operation of its business processes is the means by which Australia Post provides value for money to its customers and profits to its owners. Generally firms can give customers better value for money, and still maintain profits, by reducing costs while maintaining the quality of service relative to competitors. Costs can be lowered by the efficient operation of business processes, as well as by taking advantage of economies of scale and scope.

The key components of the postal network are:

- mail collection and delivery;
- mail sorting; and
- bulk mail transportation.

These components are illustrated in Box 3.2 and discussed below.

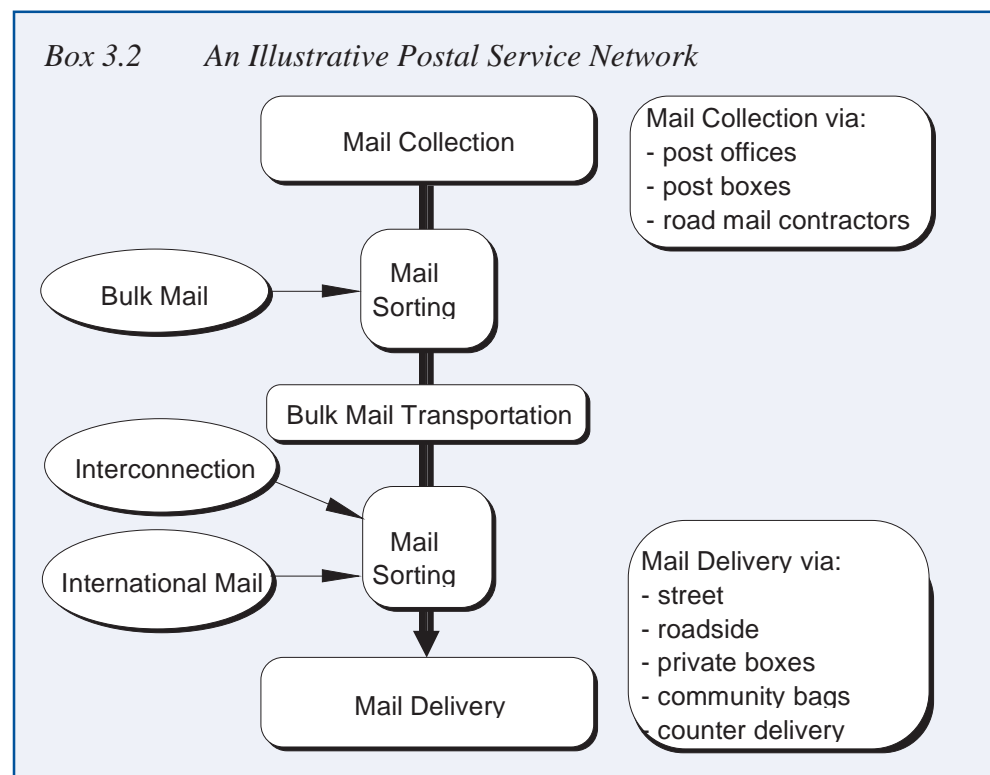
#### **3.3.1 Mail Collection and Delivery**

Mail collection and delivery are key parts of the postal service. Without easy access to both of these services many people would simply stop using Australia

Post and find alternatives or make do without postal services. Mail collection is the pick-up of mail from post offices and other points before sorting and transportation to the intended destination. Mail delivery is the final portion of a letter's journey from the post office to the addressee's letter box.

### Mail Collection

Australia Post collects mail from customers through its posting facilities. These facilities are mainly street post boxes and retail outlets, but also include some collection by roadmail contractors and direct collection from some businesses. Bulk mail is also collected through specific connection arrangements.



Note: this diagram leaves out many of the bulk mail and interconnection access options for simplification purposes.  
Source: Adapted from Panzar 1993, p. 92.

Posting facilities and postal outlets are spread across Australia, and access to the facilities can differ between locations. Table 3.3 shows the differences in access to posting facilities available in different areas of Australia, and access to stamps and postage assessments.

Table 3.3 Mail Collection Network, 1997

Stamp and Postage Assessment Outlets	Metro Areas	Rural Zones	Remote Zones	Total
Total Outlets <sup>1</sup>	7 522	6 989	1 074	15 585
Access to Posting Facilities				
Total Retail Outlets	1 902	2 074	486	4 462
Street Post Boxes	9 566	3 151	277	12 994
Roadmail Contractors	598	2 378	508	3 484
Total Posting Facilities	12 966	7 603	1 271	20 940
Posting Facilities per 10 000 residents	9.2	15.7	20.8	11.3

1. As well as retail outlets providing stamps and postage assessment these include post points, licensed stamp vendors and off-site vending machines.  
 Source: Australia Post 1997a, p. 72

While there are more posting outlets and facilities per resident in rural and remote areas than in urban areas, people in rural and remote areas usually have further to travel to access those facilities. For example, in remote areas 75 percent of households are within ten kilometres of a postal outlet and ninety percent of remote households are within 38.6 kilometres of a postal outlet. This compared with 90 percent of households in urban areas being within 1.1 kilometres of postal outlets in 1997 (Australia Post 1997a, p. 72).

A key feature of the mail collection network is the role of street posting boxes, which make up 62 percent of total posting facilities, and are mainly located in metropolitan areas. The composition of the collection network in rural and remote areas is markedly different to metropolitan areas because of the large proportion of retail outlets and roadmail contractors compared to street posting boxes.

Australia Post encourages the lodgement of large mail volumes by giving discounts for bulk mail and for coordinating bulk mail lodgements with Australia Post's requirements. The terms and conditions applying to bulk mail are determined by Australia Post, and are currently based on the level of sorting

already done, the speed of delivery required and a minimum 1,000 letters in direct bags and trays or 2,500 otherwise. The aggregation of different customers' mail to reach the minimum quantities required is not allowed. Bulk mail acceptance is sometimes located at the large users own mail processing centres. The size of the discount varies from one cent per letter to \$1.16 per letter, depending on the required speed of delivery, and the number and size of the letters.

Australia Post plans to extend these discounts to encourage customers to barcode letters. Australia Post proposed a scheme of pricing to the Australian Competition and Consumer Commission (ACCC) involving the withdrawal of presort bulk mail discounts in 2000. A new set of discounts would be available to those switching to barcoding. These new discounts are slightly higher than the current discounts and involve an average price reduction of 4.4 percent for barcoded letters. The ACCC has decided not to object to the price increases for barcoded letters provided that further information and negotiations are held between Australia Post and its major customers.

Discounts are also available for interconnecting with Australia Post's delivery network. These discounts are in addition to the discounts for bulk mail lodgements, although interconnection discounts are only available to customers lodging bulk mail. The interconnection discount is based only on Australia Post's average transport costs avoided per letter because the customer has transported the letter closer to the final delivery point, as required by section 32A of the Act. The Act also specifies the conditions which a mailer must meet to qualify for the interconnection discount. The requirements include the lodgement of the letters at certain places and sorted in accordance with the terms and conditions of the service set down by Australia Post. Australia Post provides a range of interconnection discounts: for instance small unsorted letters (0-125 grams) delivered off peak receive an additional 0.5 cent discount per item; while the additional discount for extra-large letters (251-500 grams) is 14 cents (Prices Surveillance Authority 1994, Attachment B, p. 6).

### *Mail Delivery*

Australia Post operates five major forms of delivery services, which vary according to the consumer's location and preferences, cost considerations and the presence of transport infrastructure. The services are street mail delivery, roadside delivery, private boxes, community bags and counter delivery. In

1996-97 there were 9816 Australia Post staff involved in mail delivery in addition to 4741 contractors (9878 and 4266 staff respectively in 1995-96) (Australia Post 1997a, p. 76).

- Street mail deliveries are the most common service and are provided in built-up areas where there are: at least 150 delivery points within 1.2 kilometres of a post office; an average of more than 225 articles handled per day; and all weather accessibility. Mail deliveries are provided by a mix of Australia Post employees and contractors.
- Roadside deliveries are provided to more isolated customers when there are at least five households located further than 1.2 kilometres from a post office, subject to weather accessibility and cost considerations. Contractors provide all mail roadside deliveries, often in combination with other services. In some remote areas, aircraft are used to provide mail deliveries.
- Private boxes offer security and earlier availability of mail for a fee at postal outlets and some other locations.
- Community bags are used to provide inward and outwards mail services to a local community where other delivery methods, including roadside delivery, are unavailable.
- Counter delivery (Poste Restante) is a free of charge service where customers may request that mail be held at a post office counter for collection.

In June 1997 Australia Post had 8.2 million delivery points, of which 2.3 million were located in rural and remote areas and 5.9 million in metropolitan areas.

Amongst rural and remote delivery points, 1.7 million (71.5 percent) households and businesses received delivery to the residence (that is street or roadside delivery), a small increase on the previous year. Additionally, approximately 34 800 rural and remote households and businesses receive mail via a community bag delivery service, a reduction of around 1000 households from 1995-96.

Of the metropolitan delivery points 5.3 million, or 90 percent of households and businesses, received delivery to their residence, while 584 400, or around ten percent of households and businesses, collected their mail from post offices.

Table 3.4 The Australia Post Network, 1997

	NSW/ACT	Vic/Tas	Qld	WA	SA/NT	Total
Number of Delivery Points	2 991 395	2 172 745	1 521 198	780 547	744 280	8 210 165
Number of Postal Outlets	1 320	1 308	851	462	527	4 468

Source: Australia Post 1997a, pp. 70-71

### 3.3.2 Mail Sorting

Australia Post has a network of mail sorting facilities located across Australia. This network is made up of mail, parcel and delivery centres which perform different parts of the total mail sorting task. For example, mail centres sort mail to post code while delivery centres sort mail for final delivery by postal delivery officers. Table 3.5 sets out Australia Post's mail sorting facilities. These facilities are also supplemented by some sorting which is done at post offices. During 1996-97 this network processed more than four billion articles.

Table 3.5 Mail Sorting at Australia Post<sup>1</sup>

	NSW/ACT	Vic/Tas	Qld	WA	SA/NT	Total
Mail Centres	12	12	9	1	2	36
Mail Sorting Centres	6	0	0	0	0	6
Parcel Centres	6	5	0	1	2	14
Delivery Centres	103	68	51	28	17	267

<sup>1</sup> Excluding corporate outlets and LPOs.  
Source: Australia Post 1997a, p. 31

Australia Post has outlined a strategy in its submission to restructure the letter network to reduce double handling and introduce sorting to the postal delivery round. In 1995-96, Australia Post outlined a program to increase network capacity and efficiency over a five year period. Nearly \$28 million was invested

in mail processing technology in 1995-96 on equipment such as Optical Character Readers (OCRs) and stacker modules to increase the capacity to process growing mail volumes. OCRs sort mail electronically at the rate of 30 000 letters an hour. Some 77 percent of letters were sorted using this equipment in 1995-96.

Additional equipment used to cancel stamps and pre-sort mail, and other equipment used to sort large letters and packets has been installed in Queensland and Western Australia.

Australia Post has further proposed a \$495 million investment program to introduce new sorting technology, amongst other things. The investments will involve the establishment of two new major processing sites - in Sydney and Melbourne - with barcode reading equipment and high speed sorting machines. The proposed second stage of this project is expected to enable letter sorting to the sequence used for street delivery and thus introduce a one step sorting process. The decision on this second stage will not be made until stage one is nearing completion (Australia Post, submission 8, p. 71).

### **3.3.3 Bulk Mail Transportation**

Australia Post, with 10 500 vehicles, has one of Australia's largest road fleet. While much of this fleet is used to collect and deliver different types of mail, some is used to transport bulk mail within and between states. During 1995-96, Australia Post undertook a fleet improvement strategy to replace its motorcycles, vans and trucks, including an expansion of its bulk road haulage fleet. Australia Post is also a large user of contract road transport for the transportation of bulk mail.

Australia Post is also one of Australia's largest interstate airfreight users. During 1995-96, 37 million kilograms of interstate mail were carried on Ansett and Qantas passenger flights and Australian air Express's dedicated airfreight services (Australia Post 1997a, p. 31). This was a 14 percent increase on 1994-95. The movement of outgoing international mail accounted for 8.7 million kilograms in 1996-97.



### ***The Future of Australia Post***

Australia Post's network supports a large diverse business which offers a range of services. To meet both the needs of customers and compete against other suppliers of communication services Australia Post will need to redefine its role in the communications market. The characteristics and history of its business place Australia Post in a unique position to provide modern mail services. Still, its success will depend on two factors:

- First, the performance of Australia Post and its ability to provide the services customers want.
- Second, the regulatory environment and whether it allows and encourages the development of those postal services.

The regulatory environment is discussed in the next chapter. The performance of Australia Post is considered in chapters five and six.

# Chapter Four: Legislative Environment

*The Australian Postal Corporation Act has undergone significant change in response to various government inquiries. The 1992 Industry Commission Report resulted in amendments to the Act in 1994 which provided for greater competition in the letter market. More recently, the House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform in their report, 'Keeping Rural Australia Posted', made several recommendations in relation to the performance of Australia Post.*

*Key features of the legislation include corporatisation, universal service requirements and maintenance of the reserved letter service which, with some exceptions, provides Australia Post with the exclusive right to carry letters within Australia.*

## 4.1 Recent Australian Postal Reforms

The *Australian Postal Corporations Act 1989* replaced the *Australian Postal Services Act 1975* and implemented a new financial and capital structure that maintains restrictions on competition in certain areas of the postal market. The original restriction on the provision of letter services arose from section 98 of the *Post and Telegraph Act 1901*.

The enactment of the *Australian Postal Corporation Act* (discussed in detail below) introduced a raft of reforms designed to bring the supply of postal services more into line with commercial practice. Australia Post has also been affected by two recent reviews<sup>1</sup>. The first was an inquiry into the mail, courier, and parcel services by the Industry Commission in October 1992<sup>2</sup>. The second

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1 Previous inquiries into Australia Post took place in 1915, 1919, 1954, 1959, 1974 and 1982.

2 Industry Commission 1992. Mail, Courier and Parcel Services. Report No 28, AGPS, Canberra.

review<sup>3</sup> was conducted by a parliamentary committee into the provision of Australia Post's community service obligations (CSOs)<sup>4</sup>. This section discusses these reviews and resulting reforms.

#### 4.1.1 Industry Commission Report

The Industry Commission's 1992 Report made a range of recommendations covering Australia Post's performance, its CSOs, competition and structural reform. The Commission recommended a reduction in protection given to Australia Post, thereby increasing the competitive pressure on the Corporation. The key recommendation was to set a maximum charge for standard letters to replace the reserved letter service uniform charge.

The Commission also made several fall-back recommendations to achieve a reduction in reserved services, should its preferred recommendation be unacceptable to the Government. These fall-back recommendations included decreasing the minimum price other providers must charge to carry standard letters, and expanding the range of exemptions. For example, it was recommended that competition be allowed in the operation of document exchanges and the transfer of mail within an organisation. The Commission also recommended the liberalisation of outward international mail.

In regard to CSOs, the Commission recommended that the Commonwealth Government clearly specify the extent of Australia Post's CSOs and fund those activities directly from the Commonwealth budget. It recommended an increase in the frequency of some services, the review of roadside delivery arrangements for some households, and a review of delivery guidelines.

Other recommendations relating to Australia Post's performance included:

- trial outsourcing of final sorting and delivery arrangements to evaluate the merits of contracting out urban post offices;
- consultation with the community about service standards;
- publication of separate financial data on reserved and non-reserved services; and

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3 House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform (HRSCCTMR) 1996. Keeping Rural Australia Posted: An Inquiry into Australia Post: Rural and Remote Letter Delivery Services. (Vaile report) AGPS, Canberra.

4 The letter delivery CSO promotes the delivery of letters throughout Australia at a uniform rate, thus enabling people of all backgrounds equitable and affordable access to the postal network.

- that general Commonwealth policies, such as borrowings, employment and purchasing, applicable under Section 48 of the Act, should no longer apply.

In 1994, the Government passed the *Australian Postal Corporation Amendment Act* which implemented a number of the reforms recommended by the Industry Commission. These amendments reaffirmed the Government's social objective of making a letter service available to all Australians at a uniform postage rate, while making changes to the reserved services.

The amendments provided for greater competition in the letter market by reducing the reserved services from ten times the standard rate (\$4.50) to four times the standard rate (\$1.80) as well as reducing the weight limit from 500 grams to 250 grams. Also, additional exemptions were given from the reserved services. The new exemptions included the operation of document exchanges, the carriage of letters within organisations, and the carriage of newspapers, magazines, books and catalogues.

The reforms also included:

- new bulk interconnection arrangements. The size of the discount for lodgment of bulk mail is based on Australia Post's avoided costs<sup>5</sup>. The Australian Competition and Consumer Commission (ACCC), previously the Prices Surveillance Authority, was given authority to scrutinise the interconnection discounts; and
- deregulation of outgoing international mail. Consumers were given the ability to choose any service provider for the delivery of mail outside Australia. However, Australia Post retained its monopoly on delivery of incoming international letters.

#### 4.1.2 Vaile Report

At the time of presenting the *Australian Postal Corporation Amendment Act*, the Government foreshadowed a review of CSOs by a parliamentary committee. The House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform (Vaile Report) considered performance

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5 The discounts for bulk lodgment are intended to reflect the costs avoided by Australia Post because the task of mail sorting was performed by the user.

standards for Australia Post's provision of rural and remote letter delivery services in August 1996. The Report made several recommendations about maintaining postal services to communities in remote and rural areas.

The Vaile Report was concerned that any changes to Australia Post should not diminish its capacity to maintain or increase its CSOs. Still, the report recognised that efficiency could be achieved through more competition and, further, that there may be justifiable reasons for reducing Australia Post's reserved services over time. It argued that reserved services could be reduced without disadvantaging rural and remote communities, provided protection was not reduced to a point at which Australia Post's core services became exposed. The committee stated:

*If Australia Post could not cross-subsidise its CSOs, then the ability to provide services to people, including those in rural and remote areas could be put at risk (Vaile Report 1996, p. 147).*

In relation to the services provided by Australia Post, the definition of community service obligations and performance measures, the report recommended:

- provision of a delivery service to those households and communities not currently receiving services;
- Australia Post to consider the effect on the local community of the closure or downgrading of post offices;
- provision of banking services through post offices where no other banking services were offered in the community;
- retention of the cross-subsidy arrangements for paying for community service obligations;
- Australia Post's treatment of heritage buildings to be the same as that allowed for in the private sector;
- Australia Post review operations considered CSOs to determine whether they constitute CSOs;
- development of performance standards using a range of financial and non-financial indicators, and the publication of Australia Post's performance against those standards including the publication of remedial plans;

- performance measures to be developed in conjunction with the Steering Committee on National Performance Monitoring of Government Trading Enterprises; and
- the development of a charter of responsibilities for Australia Post.

Few of the Recommendations from the Vaile Report have been formally implemented although the Department of Communications and the Arts is presently working with Australia Post on drafting a Service Charter and to legislate regulations attached to section 28C of the Act.

Australia Post states that the Service Charter is designed to communicate clearly and simply the main standards and services the community is entitled to expect from Australia Post, the steps that can be taken if those expectations are not met, and sources of information and avenues of redress. The Charter will also briefly outline what customers can do to help Australia Post deliver such services. The Service Charter and regulations are discussed further in Chapter Seven of this report.

Australia Post polling in 1996 of rural and remote areas indicated that a majority of customers was satisfied with service levels. Based on polling responses, Australia Post in 1997 provided new to-the-property delivery to just under 10 000 households and increased mail service delivery frequency to 15 000 households located on 245 mail service routes (Australia Post 1997a, p. 12).

## 4.2 Current Legislation and Related Acts

Australia Post has various obligations under the *Australian Postal Corporation Act 1989* and related legislation. As an agency of government it is currently required to comply with a range of administrative laws such as the *Freedom of Information Act* and the *Privacy Act*. Australia Post is also subject to scrutiny by the Commonwealth Ombudsman and the Administrative Appeals Tribunal. Australia Post estimated that the cost of complying with government administrative laws, including audits by the Auditor General, in 1996-97 was around \$1 million (Australia Post 1997a, p. 79).

As noted in Chapter Three, Australia Post will not be subject to some of these administrative law provisions once the new Business Enterprise Governance Arrangements are introduced.

#### 4.2.1 Obligations and Powers of Australia Post

Sections 14 to 19 of the Act outline the powers and functions of Australia Post. Section 14 of the Act states that:

*The principal function of Australia Post is to supply postal services within Australia and between Australia and places outside Australia.*

Section 15 provides:

*A subsidiary function of Australia Post is to carry on, outside Australia, any business or activity relating to postal services.*

Section 16 enables Australia Post to carry out incidental businesses and functions relating to the supply of postal services.

One of the issues raised in submissions to this review is the scope of the businesses that sections 16 and 18 enable Australia Post to be involved in. For example, the use of the words “capable of being conveniently carried on” in section 16 can be given a broad interpretation by courts and have enabled Australia Post to greatly expand its business. This is particularly evident in the range of services provided through Australia Post’s retail outlets.

#### 4.2.2 Benefits of Corporatisation

Some restrictions which previously applied to Australia Post as a government body no longer apply since corporatisation in 1989. For example, employees are no longer required to be employed under the Commonwealth *Public Service Act*. Australia Post therefore has greater freedom now in the employment of junior and management staff, and its employment arrangements can reflect the demands of the market.

Australia Post has benefited from corporatisation and has described its performance since corporatisation as “outstanding” (Australia Post 1997a, p. 9):

*Since reform began, Post has contributed (on average) more than \$ 1 million a day to Federal, State and local governments*

*[and] Its profitability compares favourably with the better performing companies in Australia (Australia Post, submission 8, p. 9).*

At the same time, Australia Post managers have been employed on individual contracts and working conditions set through enterprise agreements. These arrangements are in accord with the general requirements that Australia Post act in a commercial manner. Australia Post's commercial obligation is set out in section 26:

*Australia Post shall, as far as practicable, perform its functions in a manner consistent with sound commercial practice.*

#### **4.2.3 Other Requirements**

In 1994, section 28C was inserted to allow the Minister to set minimum requirements for Australia Post in providing postal services. Section 28D provides for auditing of these standards and 28E for service improvement plans where prescribed performance standards have not been met. To date, no regulations have been made by government using this power although, as mentioned above, the Department of Communications and the Arts are presently considering draft regulations under section 28C.

Post is also required to comply with notifications made under section 28. Section 28 states that:

*Australia Post shall perform its functions in a way consistent with:*

- (a) any general policies of the Commonwealth Government notified by the Minister under section 48;*
- (b) any directions given by the Minister under section 49;  
and*
- (c) Australia's obligations under any convention.*



Section 48 of the Act provides:

- (1) *The Minister may notify the Board of general policies of the Commonwealth Government that are to apply in relation to Australia Post.*
- (2) *The Board shall ensure that the policies are carried out in relation to Australia Post and shall, as far as practicable, ensure that the policies are carried out in relation to its subsidiaries.*
- (3) *A notification under subsection (1) shall be given in writing.*

Australia Post has been given notice under section 48 of the Act of six government policies that apply to the Corporation and that the Board must ensure, so far as is practicable, are carried out.

Those policies are :

- Loan Council Arrangements;
- industrial relations policy;
- Australian Traineeship scheme;
- procurement and industry development policies;
- release of Commonwealth land; and
- construction industry reform strategy.

Australia Post stated in its 1996-97 annual report that the additional cost of complying with these policies in 1996-97, over and above commercial costs, was not significant (Australia Post 1997a, p. 79). Australia Post is also accountable to the Minister and Parliament for its performance under sections 42, 43, 44 and 45.

#### **4.2.4 Telecommunications Acts**

Section 11 of the Act provides that it has effect subject to the *Radio Communications Act 1992* and the *Telecommunications Act 1991* (replaced by the *Telecommunications Act 1997*). These acts, in so far as they apply to Australia Post's activities, ensure Australia Post complies with government regulation in the communications area.

It is possible that the *Telecommunications Act 1997* (the 1997 Act) applies to some of Australia Post's non-reserved activities, such as EDIPost and ePost.

Section 18(da) of the Act provides that Australia Post has the power to supply telecommunications services as defined in section 5 of the *Telecommunications Act 1991* (the 1991 Act). 'Telecommunications service' is defined as meaning "a service for carrying communications by means of guided or unguided electromagnetic energy or both".

The 1991 Act was repealed by the 1997 Act. There is no definition of 'telecommunications service' in the 1997 Act but the aforementioned definition now appears under 'carriage service'. Also referred to in the 1997 Act is 'content service', which is defined in section 15 as meaning:

- (a) *a broadcasting service; or*
- (b) *an on-line information service (for example, a dial-up information service); or*
- (c) *an on-line entertainment service (for example, a video-on-demand service or an interactive computer game service); or*
- (d) *any other on-line service (for example, an education service provided by a State or Territory government); or*
- (e) *a service of a kind specified in a determination made by the Minister for the purposes of this paragraph.*

Whether or not the 1997 Act applies to services such as EDIPost and ePost will depend on the technical nature of the provision of those services. If such services fall within the definition of 'carriage service' then Australia Post will be a carriage service provider pursuant to section 87 of the 1977 Act and will be subject to quite stringent obligations. However, if such services fall within the definition of 'content service' then Australia Post will be a content service provider pursuant to section 97 of the new Act, and subject to less stringent obligations.

### 4.3 Features of the Current Legislation

A number of features of Australia Post's current legislation are important to this review for two reasons:

- many of the options for reform potentially involve the need to change this legislation; and
- there are a number of areas where the practical interpretation of the legislation is unclear.

For example, the definition of letter appears to have evolved over time without always being scrutinised in the context of what the overall Act seeks to achieve. To provide a basis for discussion in later chapters this section will outline the provisions of the Act in the following areas:

- the meaning of 'letter' and 'standard postal article';
- the community service obligations;
- the reserved services; and
- the exceptions from the reserved services.

#### 4.3.1 Definition of Letter

The definition of a letter is very broad, covering much more than what is traditionally considered to be personal communications between individuals. For instance, the definition given to letter in section 3 would include advertising material, bills or any other documents which are addressed to a specific person.

The definition given to a "letter" in section 3 is:

*any form of written communication that is directed to a particular person or address, and includes:*

- (a) *any standard postal article;*
- (b) *any envelope, packet, parcel, container or wrapper containing such a communication; and*
- (c) *any unenclosed written communication that is directed to a particular person or address.*

A “standard postal article” is defined in section 3 as:

*subject to the regulations, a postal article that satisfies all of the following criteria:*

- (a) it does not weigh more than 250 grams;*
- (b) it is not more than 5mm thick;*
- (c) its other 2 dimensions form a rectangle:*
  - (i) 2 of whose sides are shorter than the other sides; and*
  - (ii) the shorter sides of which are not more than 122mm long; and*
  - (iii) the longer sides of which are not more than 237mm long; and*
  - (iv) the adjacent sides of which are in the ratio of 1 to at least 1.414.*

#### **4.3.2 The Universal Service**

The universal service requirements set out in the legislation only apply to the requirement for Australia Post to carry and deliver letters. It does not cover any of the other services people have come to associate with the provision of postal services (particularly in remote areas).

Section 27 sets out the universal service obligations and states:

- (1) Australia Post shall supply a letter service.*
- (2) The principal purpose of the letter service is, by physical means:*
  - (a) to carry, within Australia, letters that Australia Post has the exclusive right to carry; and*

- (b) *to carry letters between Australia and places outside Australia.*
- (3) *Australia Post shall make the letter service available at a single uniform rate of postage for the carriage within Australia, by ordinary post, of letters that are standard postal articles.*
- (4) *Australia Post shall ensure:*
  - (a) *that, in view of the social importance of the letter service, the service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business; and*
  - (b) *that the performance standards (including delivery times) for the letter service reasonably meet the social, industrial and commercial needs of the Australian community.*
- (5) *In this section:*
  - “Australia” includes Christmas Island and Cocos (Keeling) Islands, but does not include any other external Territory to which this Act extends.*

### 4.3.3 Reserved Services

Section 29 provides Australia Post with an exclusive right to deliver letters within Australia and the exclusive right to issue postage stamps. It only prohibits other companies from collecting letters if they intend to deliver those letters. It states:

- (1) *Subject to section 30, Australia Post has the exclusive right to carry letters within Australia, whether the letters originated within or outside Australia.*
- (2) *The reservation of services to Australia Post under subsection (1) extends to:*

- (a) *the collection, within Australia, of letters for delivery within Australia; and*
  - (b) *the delivery of letters within Australia.*
- (3) *Australia Post also has the exclusive right to issue postage stamps within Australia.*

Section 34 provides Australia Post with immunity from suit “in relation to the carriage of a letter or other article by means of the letter service”. The Council discusses this provision and issues for the consistency of treatment of Australia Post compared with private providers in Chapter Ten.

#### **4.3.4 Exceptions to the Reserved Services**

Section 30 of the Act specifically exempts some articles from those reserved services. That section states:

- (1) *The reserved services do not include any of the following:*
- (a) *the carriage of a letter weighing more than 250 grams unless the letter consists of an envelope, packet, parcel, container or wrapper containing 2 or more separate letters;*
  - (b) *the carriage of a letter relating to goods that is sent and delivered with the goods;*
  - (c) *the carriage of a newspaper, magazine, book, catalogue or leaflet, whether or not directed to a particular person or address and whether or not enclosed in any sort of cover;*
  - (d) *the carriage of a letter otherwise than for reward;*
  - (e) *the carriage of a letter within Australia for a charge or fee that is at least 4 times the then rate of postage for the carriage within Australia of a standard postal article by ordinary post;*

- (g) *the carriage of a letter by the sender or an officer or employee of the sender;*
- (ga) *the carriage of a letter from an office of the individual or organisation sending the letter to another office of that individual or organisation;*
- (h) *the carriage of a letter to or from:*
  - (i) *the nearest office of Australia Post; or*
  - (ii) *another office of Australia Post authorised by it;*
- (ha) *the carriage of a letter to an office of Australia Post where it is then lodged for delivery under a bulk interconnection service (within the meaning of section 32A);*
- (j) *the carriage of a letter on behalf of Australia Post under an agreement with it;*
- (k) *the carriage of a letter that, under the terms and conditions on which Australia Post supplies postal services, is not a postal article;*
- (m) *the carriage of writs, warrants or other documents required or permitted to be served, given or sent under the practice and procedure of any court or tribunal;*
- (ma) *the carriage of a letter, in the course of a document exchange service:*
  - (i) *from one service centre of the service to another service centre of the service; or*
  - (ii) *within a service centre of the service;*
- (n) *the carriage of a letter solely by an electromagnetic or other non-physical means;*

- (p) *the carriage of letters by or on behalf of a foreign country under a convention;*
- (q) *any service that, under the regulations, is not reserved to Australia Post.*

There is considerable debate about what is and is not covered by the exceptions to the reserved services and these are discussed further in 4.4.

## 4.4 Redefining the Letter

A significant issue for the Council in its options paper, and later workshop discussion, was the need to draft a concise letter definition that reflected the intention of the Act. When first drafted, the Act intended that a letter service be reserved to Australia Post to fulfil the commitment to provide all Australians with access to a letter service at a uniform rate.

The exceptions to the reserved service, provided for in section 30, were expanded in 1994 to promote more competition in postal services. The changes to the Act did result in increased competition. However, in the Council's view further changes are necessary to remove uncertainty and promote competition. Competitors in the mailing industry have complained that there are too many grey areas in the legislation and that Australia Post exploits its monopoly in the reserved service area by threatening legal action in the courts.

The Council recognises that legislation enshrining a monopoly in a dynamic messages market will always suffer problems at the fringes from competitors attempting to capture market share in non-reserved areas of the market and the monopolist attempting to minimise that competition. It is appropriate, however, in light of this review to examine problems with the current scheme and consider an alternative legislative scheme that is clearer and promotes competition in contestable parts of the market.

### 4.4.1 Current Legislative Scheme

The Act uses a letter definition that is very broad. Subject to the specific exceptions, the reserved services cover a wide range of written communications and, because of the ambiguity surrounding the definition of a letter and the



definition of several of the exemptions, there is uncertainty about what is and is not covered in the reserved services.

In the Federal Court decision of *Australian Postal Corporation v Streetfile Pty Ltd* [1996] Justice Northrop considered section 3 of the Act and the reserved services. In that case Australia Post sought an injunction and account of profits against Streetfile Pty Ltd for the delivery of CD Packs and Streetfile admitted that “it had engaged in conduct that involved an infringement of Australia’s Post’s exclusive right to undertake the reserved services.”

Justice Northrop said the proper construction and application of paragraph 30(1)(c) “gives rise to difficulties”. Justice Northrop rejected Streetfile’s submissions that some of the CD packs came within the exception in section 30(1)(c) (because they were leaflets) as it was difficult to distinguish between the two types of CD packs. The meanings of the various sections of the Act were not the subject of findings by the court (although Justice Northrop did refuse to grant the injunction sought by Australia Post). Streetfile has made submissions to this review, as have their solicitors in this action, Dunhill Madden Butler.

#### 4.4.2 Need for Change

The principle criticism of the letter definition, and reserved services legislation, has been that it is unclear and leads to uncertainty. The letter definition has been criticised by many in the mailing industry. In their submission to this review, Mayne Nickless Limited has said:

*The meaning given to “letter” in section 3 of the Act is far too wide. If correctly interpreted, ie an item “containing such communication”, it could reasonably be seen to include items which are outside the charter. Clearly, the charter needs updating (Mayne Nickless Limited, submission 14, p. 10).*

Streetfile criticises section 30 as “ambiguous and imprecise, leaving Australia Post able to abuse its market position by interpreting the provisions to its benefit”. In particular, Streetfile and Dunhill Madden Butler have criticised the Act’s failure to adequately define what are leaflets and what are goods.

Dunhill Madden Butler has said:

*... the exceptions to the reserved services were in large measure prepared at a time when there were considerably less options available in terms of delivery, both from Australia Post and from third parties and ... the legislation seems to be premised on a number of assumptions which perhaps no longer apply (Dunhill Madden Butler, submission 41, p. 2).*

Streetfile have suggested the reserved services provisions be repealed by 1 July 1999 and that, in the interim, business mail be excluded from the reserved services. In its submission, Streetfile has said:

*In the past two years the Corporation has threatened Streetfile and its parent, PMP, numerous times and launched Federal Court action seven times.*

*While lobbying litigation at competitors from behind the protection of the Act, Australia Post also spends a great deal of time and resources over the past two decades successfully widening the legislative definition of a "letter" to ensure the greatest revenue and least competition (Streetfile, submission 10, p.15).*

#### **4.4.3 The Council's view**

A number of submissions to the Council's public consultation process were critical of the Council's approach to the definition of 'letter'. The Public Interest Advocacy Centre has said:

*The NCC, appears to be of the opinion that the case referred to in the Issues Paper (Australian Postal Corporation v Streetfile Pty Ltd [1996]) demonstrates that there are objective difficulties with the definition of reserved services in the Australian Postal Communications Act and that the application of these inadequate definitions restricts competition in the provision of these services. Such is not borne out by a close reading of the decision. Whilst it is true that Northrop J. states that the construction and*

*application of paragraph 30(1)(c) of the Australian Postal Corporations Act “gives rise to difficulties”, he goes on to apply it with no apparent difficulty ... Given this, and the innocuous nature of the criticism which Northrop J. did make, existing case law cannot be called upon to justify an argument that there are substantive problems with the current definition of “reserved services” (Public Interest Advocacy Centre, submission 128, p. 2).*

The Council understands that the Federal Court declined to rely on section 30(1)(c) of the Act because it had already found that Streetfile had carried the material in question in contravention of the Act. This decision was assisted by Streetfile admitting it breached the Act in relation to part of the material it delivered. However, Northrop J’s view that section 30(1)(c) was obscure received support in a more recent Federal Court case. In that case, *Australian Postal Corporation v Pac-Rim No. 3 Pty Ltd* [1998], Marshall J noted that:

*It is not until one examines the Senate Debates referred to in these reasons that s 30(1)(c) of the Act is capable of being properly understood. On the face of s 30(1)(c) there is room for confusion and genuine differences of opinion as to its meaning. [Therefore] whilst the breach of the Act is not to be excused lightly, the breach must be viewed against a lack of legislative clarity (Australian Postal Corporation v Pac-Rim No. 3 Pty Ltd [1998], p. 10).*

Australia Post has also criticised the Council’s approach to the definition of letter. Australia Post has said:

*Before attempting to rewrite legislation it is necessary to understand exactly what the legislation seeks to do. Section 27 simply commits Post to provide a universal service for reserved letters, some of which are standard letters by ordinary Post carried at a uniform rate of postage. Section 30 recognises the breadth of the letter definition in section 3 and lists the exceptions to the reserved service that are traditionally outside the monopoly. The reserved service comprises, in large part, financial letters (statements, invoices, payments etc.), promotional letters, other business correspondence, and social letters (less than 5%). Which of these does Council consider*

*are “not traditionally thought of as letters”? (Australia Post, submission 99, p. 51)*

It was clear from the responses in many submissions, however, that there is disagreement about the definition of a letter and the scope of the reserved services. For example:

*The current letter definition creates uncertainty over the scope of Australia Post’s monopoly and is a disincentive to competition (Mayne Nickless, submission 120, p. 5).*

Australia Post itself accepts that there is confusion about the definition of “leaflet” in section 30(1)(c) (Australia Post, submission 99, p. 51).

*One area of contention that has arisen is a consequence of the inclusion of the “leaflet” in the list of exclusions in Section 30(1)(c). This amendment, made in 1995, was intended to aid clarity but because the term leaflet itself was not defined there has been some confusion. This would be assisted if the words “(not in the form of personal correspondence)” were appended to the reference to leaflet in Section 30 (Australia Post, submission 99, p. 51).*

During the Council’s workshop on the definition of a letter it was clear that the concern about the definition was based more on a debate about the extent of the reserved services rather than the technical definition of a letter. Dunhill Madden Butler has argued:

*It is also unfortunate that the broad judicial remedies coupled with the uncertainty of the legislation only exacerbate the problem with the defacto extension of the monopoly held by Australia Post perhaps beyond that which is intended or appreciated. Consideration should be given as to whether the operation of the legislation coupled with the conduct of the various stakeholders is effectively creating an over-reaching monopoly (Dunhill Madden Butler, submission 41, p. 3).*

The Council agrees that it is important that the definition of a letter, the reserved services and exceptions from the reserved services be as clear as possible. This

view is supported by the Australian Chamber of Commerce and Industry (ACCI). The ACCI has said:

*A clear and generally understood definition of a letter is essential to determining the nature and extent of competition in this niche of the postal services market. Such a definition must be objective and universally applied. It should not be subjective - for example the intention of the sender (ACCI, submission 85, p. 12).*

The Council considers that the letter definition and reserved services should be drafted concisely and accepts that there are difficulties with the current definition. The precise wording needed to clarify the definition of a letter and the extent of reserved services will depend on the Council's recommendations on increasing competition. The Council's approach to these issues is discussed in Chapter Eight.

## 4.5 Prices Oversight

Australia Post's reserved services are declared for the purposes of the *Prices Surveillance Act 1983*. The *Prices Surveillance Act* is now administered by the ACCC. The effect of the postal services declaration is that proposals to change prices or terms and conditions must be notified in advance to the ACCC. The conclusions of the ACCC are made public, but its role is advisory only and there is no requirement that it seek public input to its reviews. The power to set and change all postal prices, including prices for the reserved services, is left to the Board (sections 32 and 32A). This includes discounts for bulk and pre-sorted mail.

### 4.5.1 Ministerial Disallowance of Postage Rates

The Minister has a residual power to "disapprove" proposals to vary the basic postage rate. Section 33 states:

- (1) *This section applies to the rate of postage for the carriage within Australia of standard postal articles by ordinary post.*
- (2) *Before making a determination under section 32 fixing or varying rates of postage to which this section applies,*

*the Board shall give the Minister written notice of the proposed determination.*

- (3) *The Minister may, within 30 days after receiving notice of a proposed determination, give the Board written notice disapproving it.*
- (4) *In exercising powers under subsection (3), the Minister shall have regard to:*
  - (a) *Australia Post's obligations under this Act; and*
  - (aa) *changes in the Consumer Price Index as published by the Australian Statistician from time to time; and*
  - (b) *any other matters the Minister considers appropriate.*
- (5) *The Board may make a determination under section 32 fixing or varying rates of postage to which this section applies only if 30 days have elapsed since the Minister received notice of it and the Minister has not, within that period, given the Board a notice disapproving it.*

#### **4.5.2 Bulk interconnection**

Section 32A of the Act requires Post to provide a “bulk interconnection service related to pre-sorted bulk letters lodged at specified offices of Australia Post at rates involving a discount”. The basis of the discount is outlined in this section:

- (1) *This section applies to a service supplied by Australia Post (a “bulk interconnection service”) under which bulk quantities of letters are delivered within Australia at reduced rates provided that:*
  - (a) *they are lodged at an office of Australia Post specified as mentioned in paragraph (2)(a); and*

- (b) *they have, before being lodged, been sorted in accordance with the terms and conditions of the service.*
- (2) *The terms and conditions of a bulk interconnection service must:*
  - (a) *specify the offices of Australia Post at which letters must be lodged for delivery under the service; and*
  - (b) *allow letters to be lodged for delivery under the service at any office so specified; and*
  - (c) *provide for the rate reduction mentioned in subsection (1) to include a component that is Australia Post's estimate of the average transport costs per letter avoided by Australia Post in respect of letters lodged for delivery under the service.*
- (3) *The terms and conditions of a bulk interconnection service are not required to be limited to the matters mentioned in this section.*

Section 32B enables regulations to be made giving the ACCC the power to inquire into disputes arising from the interconnection regime, and to report to the Minister for the purpose of resolving such disputes. Regulations to this effect are currently in force. This issue is discussed further in Chapter Nine.

# Chapter Five: Performance of Australia Post

*The information provided to this review by Australia Post and other parties indicates that, overall, Australia Post's performance has been strong. This does not mean, however, that there is no need for change. First, some specific issues on Australia Post's performance and the way that performance is measured need to be considered. These include the performance of the reserved services. Second, other problems have also been raised with the Council. Many of these, however, appear to relate to shortcomings of the current regulatory environment (and the incentives it creates) rather than deficiencies in the operation of Australia Post.*

The Terms of Reference for the review require the Council to have regard to Australia Post's current and prospective level of financial and service performance and the flow of benefits to the community from that performance.

This chapter will examine Australia Post's service and financial performance (including its costs and prices), and identify the benefits to the community as well as some of the potential costs of the current arrangements.

Under the *Australian Postal Corporation Act 1989* Australia Post has an obligation to perform its functions consistent with sound commercial practice, including the preparation of corporate plans. Those plans set out the objectives of the corporation and its subsidiaries, the strategies which it will follow to achieve those objectives, a statement of strategies and policies that it is to follow to carry out its community service obligations and relevant performance indicators and targets. The plan is also required to include Australia Post's financial strategies and a financial target.

## 5.1 Corporate Objectives

This section outlines Australia Post's corporate objectives and self assessment, to provide a framework to assess whether it is meeting its own expectations of performance.



The corporate objectives of Australia Post are set out in a rolling three year corporate plan. Each year that plan is revised and submitted to the Minister. The plan for the period 1996-97 to 1998-99 has the following principle objectives:

- *complete the final stages of a six year modernisation of the Corporation's retail facilities;*
- *lower the costs of production to the point where profitable operation under progressively increasing competition is ensured;*
- *continue to take up profitable business opportunities and hence increase revenue from improved utilisation of the Corporation's resources; and*
- *deliver Australia Post's CSOs to the required service standards and at least cost (Australia Post 1997a,p. 78).*

The objectives of the current plan are similar to those of previous years. It continues Australia Post's efforts to respond to competition by reducing costs and increasing revenue by providing additional services.

Australia Post's main strategies and policies for 1996-97 were also similar to the plan of the previous year. The main elements were:

- *extending the application of best practice throughout the enterprise;*
- *improving the efficiency of the core letters and parcels businesses by restructuring the national processing networks to take advantage of the latest mail processing technology;*
- *growing the business in the traditional core areas of letters and parcels and in the newly emerging areas of retail merchandise and financial and electronic services;*
- *continuing to encourage participation in workplace relations and skills acquisition through employee training programs; and*

Table 5.1 Australia Post Targets and Performance, 1995-96 to 1996-97

	1995-96 Target	Performance	1996-97 Target	Performance
Increase in basic postage price	0	0	0	0
Labour productivity %	4.8	4	5.2	5.7
On time letter delivery %	94	93.2	94	93.9
Profit before interest and Tax \$ million	359	367.2	355.8	362.3
Return on average assets <sup>1</sup> %	16.7	15.5	14.7	14.6
Minimum dividend of 60% of profit, after tax and abnormals	- <sup>2</sup>	142.6	- <sup>2</sup>	139.9

1 Return on average assets is calculated by Australia Post as profit before net interest, abnormals and income tax divided by average total assets. Performance for 1995-96 has also been reported by Australia Post as 16.5 percent in its 1996-97 annual report.

2 No forecasts of profit after tax and abnormals were available.  
Source: Australia Post 1996, p. 70, Australia Post 1997a, pp. 70 and 78

- *continuing to focus on the distribution of the rewards from performance among the Corporation's stakeholders (Australia Post 1997a, p. 78).*

The objectives for Australia Post are also given as a set of operating targets. The targets set for 1996-97 and Australia Post's performance against those targets, as well as those of the previous year, are set out in Table 5.1.

Australia Post's submission highlights its operational and financial achievements and its provision of a reliable, low cost mail service. Australia Post considers that the key drivers of these outcomes are industrial harmony, productivity growth, improved delivery performance and the freeze on the standard letter rate which has stimulated mail growth over the last eight years (Australia Post, submission 8, p. 9).

These achievements have provided the basis for significant payments to its shareholder. The total returns to all levels of Government between 1989-90 and 1995-96 are estimated to have been \$2.5 billion (Australia Post, submission 8, p. 55). In 1996-97 Australia Post paid the Commonwealth Government a further \$194.6 million in dividends and capital repayments (Australia Post 1997a, p. 54). Australia Post also highlights that it pays all government taxes and charges as well as dividends and capital repayments.

According to its self-assessment against its commercial objectives, Australia Post appears to be performing well. This general conclusion has found some support in submissions. Many submissions noted a high degree of acceptance of Australia Post by the community and the provision of acceptable service quality in most cases.

The environment in which Australia Post operates is also important to understand its performance. Chapter Two noted that the pace of change has been increasing in the messaging market and that mail substitutes like the internet and e-mail will continue to grow and compete directly with Australia Post. Australia Post also competes with mailing houses (such as Salmat and Streetfile), courier services (such as TNT and Mayne Nickless) and document exchanges (such as DX). Of course, competition in the reserved services segment is restricted as pointed out in Chapter Four.

In order to further assess Australia Post's performance, this chapter considers its costs, prices and service quality, and financial performance. The final part of this chapter looks at some of the criticisms of that performance and arguments for reform.

## **5.2 Australia Post's Costs**

This section examines Australia Post's operating costs, capital costs, investments and borrowings. An examination of operating costs can provide information on the efficiency of Australia Post, while capital costs, investments and borrowings can provide information on the underlying funding requirements. A perspective on each aspect of costs is important to understand the corporation's performance.

### **5.2.1 Operating Costs**

Australia Post's operating costs, totalling more than \$2763 million, are summarised in Table 5.2. The major elements are labour costs, and contractors carriage of mail. Labour costs and costs associated with contractors are discussed below. 'Miscellaneous' costs are related to consumables, motor vehicle operations and bad debts. The item 'Merchandise' comprises the cost of printing stamps, philatelic materials, and other items for resale but accounts for only around three percent of operating costs.

Table 5.2 Australia Post's Operating Costs, 1996-97

Operating Item	Expenditure (\$ million)	Share of Total Costs %
Labour	1 580.0	57.2
Restructuring Costs	33.5	1.2
Licensees Fees	146.7	5.3
Contractors Carriage of Mail	222.6	8.1
Accommodation	129.6	4.7
Merchandise	84.2	3.1
Depreciation	147.5	5.3
Interest expense	9.2	0.3
Miscellaneous	409.8	14.8
<b>Total Costs</b>	<b>2 763.1</b>	<b>100.0</b>

Source: Australia Post 1997a, p. 52

### *Labour Costs and Productivity*

Australia Post's labour costs in 1996-97 were some 57 percent of operating costs, slightly reduced from the previous year. The significance of labour costs is even higher than this figure suggests. Approximately eight percent of operating costs are also attributable to contractors carrying mail. These contractors supply only a limited amount of capital equipment, such as vehicles, so that most of the cost of the contract is the labour cost of contractors.

Table 5.3 provides information on the labour costs of other Australian industries and shows that Australia Post is relatively labour intensive. Despite recent large investments, which would generally lead to reductions in the requirements for labour, the provision of mail services remains a labour intensive activity. Highly labour intensive industries do not usually have strong economies of scale. However, the maintenance of a national mail network tends to result in this being the case for Australia Post. Australia Post's labour productivity and industrial relations record will continue to be important to the overall performance of its business.

Table 5.3 Labour Costs of Selected Australian Industries, 1994-95

Industry	% Labour Costs of Total Costs
All Industries	17.9
Manufacturing	18.5
Electricity, Gas and Water Supply	13.0
Transport and Storage	27.6
Communication Services	37.5
Australia Post	66.6

Source: Australian Bureau of Statistics 1995, and Australia Post 1995, p. 44

Australia Post has focussed much of its attention on reducing labour costs and improving labour productivity. Labour productivity has averaged more than 5 percent per annum since 1992, as indicated by Table 5.5. Chart 5.1 shows the employment trends in Australia Post since 1991-92. Overall employment has been rising since 1993-94, around the time of the last contraction of Australia Post's reserved services. Part time and casual positions have increased more rapidly over the period and now make up 18 percent of Australia Post's workforce, while full time employment levels have fallen slightly.

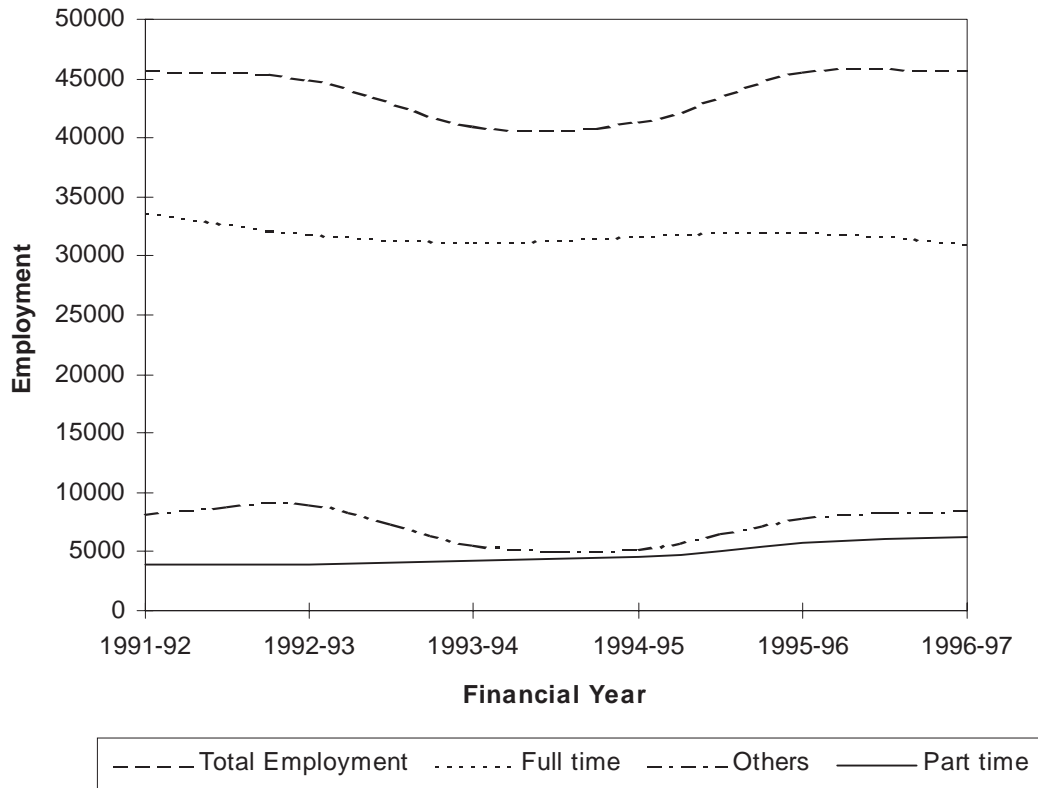
The productivity improvement has been achieved by changes to the way in which labour has been employed as well as capital investments. Labour productivity has increased through union and award rationalisation, productivity-linked pay and bonuses, more flexible workplaces, and best practice initiatives to refine workflows. Labour productivity was also assisted by the introduction of additional mail processing technology. A comparison of labour productivity to the change in the consumer price index shows that productivity has kept ahead of the CPI from 1992 to 1997.

Australia Post has undertaken industrial relations reform. There are now two key unions covering Australia Post employees - The Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (CEPU) and the Community and Public Sector Union. Industrial awards have also been consolidated from 15 to 4.

Australia Post's industrial relations record has shown impressive improvements since corporatisation. Hours lost to industrial stoppages has fallen from 1.5 hours per employee in 1989 to less than three minutes per employee in 1996 (Australia Post 1996, p. 2).

An ability to adapt to changing equipment and labour requirements is important where the needs of the postal market are changing. Australia Post and its employees have

Chart 5.1 Australia Post's Employment, Direct and Indirect,  
1991-92 to 1996-97



Note: The category 'Other' includes those employed by Licensed Post Offices, mail contractors, and post office agents, as well as casuals employed by Australia Post.

Source: Australia Post 1993b, 1994, 1995, 1996, 1997a

shown an ability to adapt to a demanding environment by encouraging change and preparing staff to cope with such change.

This capacity for change is demonstrated by several factors. These include the low level of industrial disputation, the introduction of optical character recognition technology, the changes to Australia Post's retail business, organisational change such the split between delivery and retail, as well as the opening of greenfields sites such as Underwood Mail Center, and the closure or relocation of other facilities.

A key element of the reform proposal Australia Post has presented to this review is the timing of the reform: Australia Post warns that fast paced reform could threaten its viability and its ability to reduce full time employment without industrial disruption (Australia Post, submission 8, p. 103). Yet, Australia Post's capacity to adapt is

demonstrably greater than it was in 1989 given the low level of industrial action and the relationship it has developed with its workforce.

On this relationship, the CEPU has said:

*Australia Post's improved financial and operational performance coincides with its cooperative industrial relations environment. ... This has enabled Australia Post and its employees to negotiate important reforms and achieve performance improvements (CEPU, submission 127, p. 23).*

Australia Post has outlined the possible impact on employment of its proposal for a reduction in the reserved services. It estimates that the combined effect of its network renewal and reform proposal will be an expected reduction in full time employment of between 2 700 and 3 800, or around ten percent of its current full time workforce (Australia Post, submission 8, p. 103). But Australia Post has not separated the impacts of regulatory reform and its own investment plans. Australia Post expects most of the reductions to come from natural attrition, although some redundancies may be required.

## 5.2.2 Capital Costs, Investment and Borrowings

Australia Post's balance sheet is in very sound shape. Total borrowings as at 30 June 1997 were \$367.5 million (until 1993-94 Australia Post had no borrowings)

*Table 5.4 Australia Post's Borrowings, Investments and Returns to Owner, 1991 to 1997*

	1992-93	1993-94	1994-95	1995-96	1996-97	Total
	<i>\$ million</i>					
Borrowings	0	235	57	25	50	367
Investments	184	185	270	302	270	1 200
Dividends (provided for & paid)	62	90	120	143	220	635
Dividend Payout Ratio <sup>1</sup> (%)	49	50	50	60	94	na
Capital Repayments	0	200	125	75	50	450

<sup>1</sup> The Dividend Payout Ratio is the ratio of dividends paid and provided for to operating profit after income tax and abnormal items. This calculation does not include capital repayments.  
Source: Australia Post 1993b, 1994, 1995, 1996, 1997a

against total assets of \$2.59 billion, a ratio of 14 percent. Australia Post was also able to make significant investments over the last five years of \$1.2 billion. The shortfall between borrowings and investment means that most investment funding comes from its retained profits. Also, despite high levels of investment and dividends, capital repayments exceeded borrowings each year between 1992 to 1997. Australia Post's borrowings, investments and returns to the Commonwealth Government (as its owner) are outlined in Table 5.4.

The level of Australia Post's debt has been rising over recent years and in 1996-97 its gearing ratio was 30 percent. The gearing ratio represents the use of borrowings compared to the total funding from both debt and equity. Increased debt can reduce the average cost of capital to Australia Post because lenders will require a lower return on their funds than do owners who carry a higher risk. As such, an appropriate balance of debt and equity can make it easier for some corporations to achieve the rate of return required by investors and shareholders. These strategies are part of the capital planning decisions employed by most private sector firms.

Australia Post's gearing levels are lower than some industry averages. For example, in 1995 the gearing ratio for communications services was around 34 percent<sup>1</sup> and that for transport and storage was approximately 48 percent (Australian Bureau of Statistics 1995, pp. 49 and 53). Australia Post has the capacity to increase its use of debt to fund either higher investment or repay additional capital to the shareholder. However these decisions need to be made in the context of the corporation's overall capital structure.

Australia Post has also made other payments to the Commonwealth based on its borrowings. In addition to the repayments of capital, dividends and interest, Australia Post paid a levy amounting to 0.125 percent of its borrowings under the *Commonwealth Borrowing Levy Act 1987*. This levy is being replaced by debt guarantee fees in accordance with the Competition Principles Agreement to offset the competitive advantages provided by government guarantees.

### *Investment*

As a large corporation, Australia Post needs to make large investments in facilities and equipment to ensure that it can operate as efficiently as possible and continue to provide its core services. These investments also position Australia Post in a changing

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1 This average would also include Australia Post.



environment and affect its ability to take up emerging opportunities. To these ends Australia Post invests in additional property, plant and equipment, joint ventures and in new activities.

Australia Post has stated that its mail network is now nearing its processing capacity limits (Australia Post 1996, p. 27). These limits are being addressed by investments in barcoding technologies, and network renewal. Australia Post began to make large investments in its network after 1993-94. In that year, investments totalled \$185 million, but rose dramatically to reach \$302 million in 1995-96. In 1996-97 Australia Post's investments totalled \$270.4 million. Most of this investment has been in post offices, operational support activities and purpose built mail facilities. A major investment project for Australia Post is the investment required to support the network renewal project, described in Box 5.1

To support its large mail collection, sorting and delivery network Australia Post has large investments in land, buildings and equipment. In the last year, Australia Post completed the relocation of the Perth Mail Centre and made property purchases in Rydalmere, Strathfield, Dandenong and Sunshine as part of the network renewal

*Box 5.1 Network Renewal*

This \$495 million five year investment project launched in October 1995 aims to significantly upgrade Australia Post's letter and parcel networks.

The project has two stages. The first stage involves the establishment of high speed letter processing facilities in Sydney and Melbourne. These facilities will be equipped with barcoding and optical character recognition equipment enabling Australia Post to sort mail directly into the order needed for delivery. At this stage postal delivery officers will still need to sort mail for actual delivery but productivity gains will be made elsewhere. The new mail centres in Sydney and Melbourne are expected to be operational by July 1999. New systems will be also installed in Sydney and Melbourne to allow further automated sorting of parcels. The network for handling parcels will be centralised.

A decision to introduce stage two will be made when stage one is almost complete, and is currently expected to commence in 1999. It extends the investment made in stage one by sorting mail in the delivery sequence required by each postal delivery officer's round. The stage will also involve an additional mail facility in Sydney and Melbourne.

Source: Australia Post 1996, 1997a, and Submission 8

project. In 1996-97, property, plant and equipment represented approximately \$1.5 billion of Australia Post's \$2.6 billion total assets. Land and buildings alone accounted for around \$940 million of those assets (Australia Post 1997a, p. 67).

Much of this investment is self-funding. In 1997, Australia Post spent more than \$130 million on such properties, and added plant and equipment of around \$150 million, while disposing of \$240 million of property and equipment (Australia Post 1997a, p. 67).

A large number of Australia Post's properties have been earmarked for development and resale. These properties were valued at \$249 million in 1996, about one quarter of the Corporation's total land and building assets (Australia Post 1996, p. 53). In the same year, some \$13 million was spent on improvements and additions to these properties. The subsidiary Postcorp Developments Pty Ltd handles the development and sale of properties. One recent project includes the development of a residential property in Redfern, Sydney. Australia Post also successfully leased the Sydney GPO for a 99 year period for conversion to an office and hotel complex.

### *Joint Ventures*

Australia Post has investments in a number of joint venture companies and new divisions of Australia Post. The investments in subsidiaries include Postcorp Developments Pty Ltd and Sprintpak Pty Ltd, and Australia Post's joint ventures include Australian air Express Pty Ltd, Austrapay Ltd, Geospend Pty Ltd and International Data Post (IDP). These joint ventures and shareholdings are outlined in Chapter Three.

The combined value of these investments in 1997 was \$12.9 million (excluding IDP), an increase of \$6.8 million since 1995. While this increase was mainly due to Australia Post's investment in Austrapay, there are significant variations in the value of its investments. For example, in 1995-96 Australia Post's investment in AaE was devalued from \$4.4 million to just \$0.9 million (Australia Post 1996, p. 59). In 1997 AaE paid \$7 million in dividends to Australia Post (Australia Post 1997a, p. 67).

There are a number of reasons why commercial entities like Australia Post enter new markets. Two reasons advanced by Mayne Nickless are the benefits gained from spreading fixed costs across a greater range of services, and the ability to provide a service superior to that of existing providers (and thereby achieve greater profits than competitors) (Mayne Nickless, submission 14, p. 9). Another reason is to

reduce a firm's reliance on a narrow product range. Where Australia Post expands activities to take advantage of economies of scope, rather than to maximise profits from individual activities on a stand alone basis, Australia Post may have a significant market advantage.

Mayne Nickless criticises the range of activities in which Australia Post is involved, and in particular, the potential for cross-subsidisation. It questions Australia Post's involvement in its different businesses, as well as the corporation's ability to generate profits by participating in a wide range of activities:

*To do so may also be foolish business practice, as most successful firms' results are not achieved by serving every market segment (Mayne Nickless Ltd, submission 14, p. 10).*

Similar issues were raised with respect to New Zealand Post's involvement in a range of transport and communication activities during consideration of reform of New Zealand Post. There were claims that funds for diversification came from the profits earned through the reserved services. New Zealand Post subsequently divested itself of many investments and is now focusing more on its core mail services (NERA 1997a, p. 60).

These issues are considered in Chapters Nine and Ten.

### 5.3 Australia Post's Prices

Australia Post is able to set its own prices for the services and products it provides. Section 32 of the Act provides for the Board of Australia Post to set out the terms and conditions of the carriage of letters and other postal articles. However, this authority to set the terms and conditions is subject to the *Prices Surveillance Act 1983*, which requires Australia Post to notify the ACCC before increasing the prices of its reserved services, and the ability of the Minister to disapprove variations to postage rates on standard postal articles.

Australia Post has not sought increases in the rate for standard postal articles since January 1992, but has sought price changes for other services. In 1994 Australia Post notified the ACCC of its proposal to change its bulk mail pricing structure and interconnection discounts. In 1997 Australia Post notified the ACCC of changes to the prices for pre-sort bulk mail, reply paid letters and ordinary large letters. The

changes mean an increase in prices for pre-sort bulk user customers while there would be additional discounts on the pre-sort bulk rate for those barcoding letters, the withdrawal of the bulk local rate from metropolitan areas, price changes to reply paid mail and large letters. One reason for the changes was to face increasing competition, particularly from electronic media.

### **5.3.1 Pricing Performance**

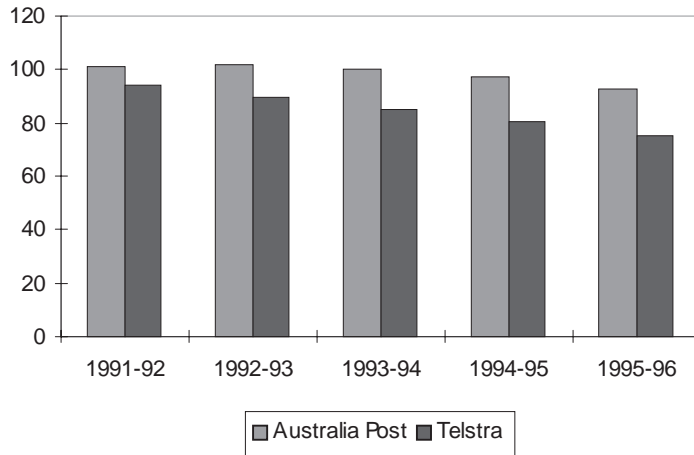
In the reserved services, prices for standard postal articles have been held at 45 cents since 1992. This has led to a fall in the real cost of standard postal articles of 11.7 percent, and Australia Post expects the freeze to amount to a 15.1 percent real reduction in the standard letter price by mid 1998 (Australia Post 1997a, p. 12). After adjusting for inflation and a pricing restructure, full-rate mailers and pre-sort bulk mailers have received price reductions averaging 12.8 percent and 12.7 percent respectively since 1992-93 (Australia Post, submission 8, pp. 54-55). Over the same period, Australia Post's revenues have risen around 34 percent from \$2.4 billion to \$3.1 billion, and the number of postal articles have risen more than 23 percent from 3.4 billion to 4.2 billion articles (Australia Post 1997a, p. 70).

Some information is available on price movements for standard letters and this is provided in Chart 5.2. In that chart Australia Post's prices are compared to the average price movements for Telstra's products. Such comparisons need to be treated with some caution, however, due to the different operating environments of Australia Post and Telstra. The prices of the services provided by Telstra are relevant in some areas, especially where mail services compete with telecommunications, for example in business to business messages. Chapter Two concluded that the share of the messaging market held by the internet and e-mail will continue to grow and some of these products will compete directly with Australia Post. Hybrid services, such as those combining a letter with electronic messaging, will be sensitive to relative changes in the prices of letters compared to non-hybrid services.

Since postal services and telecommunications services are increasingly competing against each other, the fact that the relative prices of telecommunication products are falling suggests that these products are becoming increasingly attractive, therefore reducing the attractiveness of the letter mail services provided by Australia Post.

The price freeze on the standard letter rate is an informal arrangement between the Government and Australia Post. Consequently, the authority of the Minister and the ACCC to review proposed price increases has been redundant, since there have

Chart 5.2 Australia Post's and Telstra's Real Price Index, 1991-1996



Source: Steering Committee on National Performance Monitoring of Government Trading Enterprises 1997, Vol. 2, p. 412 and 420.

been no proposals to increase the price of standard letters. The current price freeze is effectively a voluntary price cap.

### Price Levels

The Council noted in the Options Paper that it was inclined to the view that prices on reserved services should be immediately reduced with further phased price reductions. The Council noted that it would recommend such action if it found that the benefits of Australia Post's performance were inadequately shared with consumers under the current arrangements.

Some submissions commenting on this issue noted the good performance by Australia Post in providing services and its strong financial performance. Other submissions had already noted that the current price of the standard letter is too high.

Australia Post has recorded strong profit performance and good productivity gains over recent years. In competitive markets these benefits would tend to be shared with customers, for example through reduced prices.

The Treasury suggested that the reduction in real prices via the price freeze may not have fully shared the benefits of Australia Post's strong performance with customers.

The Treasury submission noted that the main aim of a price cap is to ensure that a firm does not charge higher prices than would occur in a competitive market. Treasury notes that the price cap is in effect a CPI minus X arrangement, where X equals the CPI. To the extent that Australia Post has achieved higher productivity growth than inflation, then it will have made gains in revenue (The Treasury, submission 52, p. 19).

As noted in Table 5.5, Australia Post's total factor productivity has generally kept ahead of the CPI, and labour productivity seems to be responsible for most of those improvements. The average total factor productivity for the three years for which comparable data is available was 4.37 percent compared to an average CPI increase of 2.7 percent. According to the argument posed by Treasury, Australia Post is likely to have made gains in retained revenue because productivity gains are greater than the rate of inflation. This implies that prices may have been able to fall an additional 1.7 percent and Australia Post would have maintained its revenue.

*Table 5.5 Australia Post's Labour and Total Factor Productivity, 1992-1997*

	1992	1993	1994	1995	1996	1997
	<i>percent</i>					
CPI	1.2	1.9	1.7	4.5	3.1	0.3
Labour Productivity	4.3	4.6	6.1	6.4	4.0	5.7
Total Factor Productivity	1.5	3.84	4.27	5.00	n.a.	n.a.

Source: Industry Commission, submission 58, p. 60, Australia Post 1995, pp. 62-63 and Australia Post 1997a, pp. 70 and 72

The Treasury advocates consideration of the immediate lowering of Australia Post's reserved services prices followed by a price cap administered by the ACCC (The Treasury, submission 52, p. 20).

Streetfile also had concerns that Australia Post's prices, and specifically the 45 cent standard letter rate, were originally too high. Streetfile noted that:

*Australia Post has returned record profits while not increasing prices, therefore Australians must have paid too much (Streetfile, submission 10, p. 31).*

Streetfile goes on to estimate this cost at \$135 million.

The Industry Commission (IC) also had concerns with the current pricing arrangements. The IC submission pointed out that the current uniform price involves a cross-subsidy from the business segment to the household segment. This means that the business segment is likely to be overcharged for the services that it buys, while the household segment is likely to be undercharged for the postal services that it buys. The effect of the cross-subsidy is that business and household segments are charged a price different from the relative benefit that each receives.

The IC's analysis concluded that Australia Post is likely to be receiving a far higher benefit from a uniform price than it needs to provide its CSO ( it estimated that Australia Post is likely to gain \$238 million in revenue above the cost of providing the universal service, which could account for its high profits.<sup>2</sup> The IC estimated that an additional 340 million business letters would be sent if the price was equal to the long run marginal cost of a business letter - estimated at about 30 cents (IC, submission 58, pp. 51-53).

This analysis points to the high cost of postal services to business consumers and the brake this places on business use of mail. Further, this analysis indicates the potential gains which can be achieved in business mail volumes if prices are allowed to adjust according to the costs of providing the service. As business customers are likely to more options to use telecommunications based services, price of postal services to business will affect the extent to which new electronic services erode the use of traditional postal services. The funding of CSOs via the cross-subsidy arrangements is an important constraint on the ability of business users to access lower mail prices. Alternatives for funding the CSOs are discussed in Chapter Seven.

Australia Post argues that there are several reasons why the basic postage rate should not be reduced. These are:

- *the basic postage rate has been frozen since 1992; and under our package will remain so until 2002;*
- *Australia's basic postage rate is the third lowest in the Western world;*
- *the profitability of full rate standard letters is low and not increasing (Australia Post, submission 99, pp. 17-18).*

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<sup>2</sup> Overall, the IC estimated that Australia Post gained around \$305 million in extra revenue to support the community service obligation estimated to cost \$67 million.

Australia Post argues that Australia's postage rates are already low by world standards and has provided a comparison of the postage rates in Australia with other countries using the purchasing parity method. It found that in a basket of sixteen developed countries, only Spain (AUD \$0.22), New Zealand (AUD \$0.36), and the United States (AUD \$0.43), had a lower basic postage rate than Australia. Other countries were found to have higher rates: Canada (AUD \$0.50), Netherlands (AUD \$0.52), UK (AUD \$0.52), Finland (AUD \$0.63), and Sweden (AUD \$0.68) (Australia Post, submission 8, p. 132).

In respect of the New Zealand example, the price of a standard letter fell from 45 cents (NZ) to 40 cents (NZ) during 1996, a fall of 11 percent, in response to a changing regulatory and competitive environment (NERA 1997a, pp. 60-61).

In Australia Post's second submission, it argued that successive Australian Governments have not demonstrated concern over the prices set by Australia Post. Further, it claims that the Government has refrained from using its powers to modify Australia Post's financial targets as part of the corporate planning process, indicating that it endorses Australia Post's current prices. The Council does not agree with this line of reasoning. The Council notes that the Government has little direct leverage over the prices set by Australia Post. While the ACCC has some authority to act in certain circumstances, that authority is limited to price increases, as opposed to price reductions.

Arthur Andersen has examined the expected future performance of Australia Post without any changes to its regulatory environment. While those results are discussed below, it is worthwhile to note that Australia Post's strong financial performance is expected to continue for many years. Arthur Andersen also found that the level of profitability on full rate standard letter was gradually declining but would only affect Australia Post's profits after 2003. The reason for these falling margins was the price freeze itself in the face of gradually increasing costs in providing that service.

While the Council agrees that prices should relate to the costs of providing the service, it considers that the best environment for the provision of mail services is one where Australia Post has a competitive incentive to share its efficiencies with customers through lower prices or better services at the same price. With no regulatory reform of the legislated monopoly, there appears to be a *prima facie* case for a fall in the standard letter rate. However, the appropriate price for the standard rate is influenced by what type of mail is covered by that rate and the average cost of carrying that mail. Many of the possible recommendations discussed in the Options Paper could



affect the cost and volume of the mail. A recommendation for price reductions depends on the scope of other recommendations. This issue is therefore discussed further in Chapters Six and Eight.

### *Changing the Price of a Stamp*

Any decision to decrease or increase the price of standard letters would need to consider the practical effects of a change. Three separate but related issues were raised with the Council: the cost of selling single stamps is relatively high, the effects on the income of post office agents and concerns that Australia's system of rounding transactions could encourage some customers to increase their purchases of single stamps.

### *Discounts*

Chapter Three noted that Australia Post provides discounts to mailers lodging large volumes of mail into the Australia Post network. These discounts are based on the volume of mail, the level of sorting undertaken by the sender and the point of mail lodgement (either close to the receiver or to the sender). Some discounts are calculated according to Australia Post's methodology (for example bulk mail) while other discounts are calculated according to legislated guidelines (for example bulk mail interconnection).

The Major Mail Users of Australia (MMUA) have raised several issues on the way discounts are provided. These concerns include:

- *no discounts are based on the national business provided by major mail users;*
- *the inability of mailing houses to consolidate mail from more than one mail user and receive a discount from Australia Post on the resulting total mail volume;*
- *no formal recognition of the return mail generated by the activities of mailing houses;*
- *no discounts based on the mail volumes provided by major mail users (as distinct from mailing houses) when some volumes are passed through mail houses while other mail is lodged directly with Australia Post; and*

- *discounts based on reductions to the standard letter rate rather than the actual cost to Australia Post of providing the service (MMUA, submission 121, pp. 7-8).*

The IC, as noted above, found that business mail users may be disadvantaged by uniform prices. The MMUA's concerns reflect the lack of incentives on Australia Post to lower prices (say through broader discounts) or increase the quality of postal services to business.

## 5.4 Financial Performance

Financial performance can be measured in a number of ways. It can be judged from the profits an organisation makes and the dividends returned to shareholders. Performance can also be considered relative to the assets invested and an organisation's ability to invest in its growth. In addition a company can be compared to similar enterprises, competitors and its clients perceptions of its performance.

The following section considers Australia Post's overall financial performance and the relative performance of the reserved and non-reserved services.

### 5.4.1 Overall Financial Performance and the Reserved Services

*Table 5.6 Australia Post's Financial Performance, 1992-93 to 1996-97*

	1992-93	1993-94	1994-95	1995-96	1996-97
Revenue \$ million	2 399.1	2 550.8	2 754.6	2 890.4	3 109.7
Profit (before abnormals and tax)* \$ million	249.4	287.1	331.6	344.1	346.6
Return on Revenue (%)	10.4	11.2	12.0	11.9	11.1
Total Assets \$ million	2 016.8	2 102.7	2 327.3	2 382.0	2 588.6
Return on Assets (%)	11.1	12.3	14.8	15.5	14.6
Total Equity \$ million	945.1	827.9	860.4	880.1	855.5
Return on Equity <sup>1</sup> (%)	13.3	21.7	27.7	26.9	27.3

<sup>1</sup> Return on equity has been calculated as net profit after tax and abnormals (NPAT) divided by total equity, calculated by the Council.

Source: Australia Post 1993, p. 38, Australia Post 1995, p. 44, Australia Post 1997a, pp. 52 and 70.

As a commercial business, Australia Post generates strong profits and a high return on assets and shareholder's investments.

Australia Post's revenues have increased from \$2.3 billion in 1991-92 to \$3.1 billion in 1996-97, an increase of 34 percent over five years. Profits records were broken in each year between 1994-95 and 1996-97: \$331.6 million, \$344.1 million and \$346.6 million respectively. Australia Post's performance is set out in Table 5.6.

A large part of Australia Post's improved performance since 1992-93 comes from a turnaround in the losses associated with its retail activities. In 1991-92 Australia Post's retail business lost \$85 million. By 1996-97 this had changed to a small profit of \$18 million. The turnaround of approximately \$100 million per annum appears responsible for a large proportion of the increase in profits since 1991-92. A key part of Australia Post's future strategies is to further improve the performance of its retail business to achieve commercial returns.

Several licensed post offices (LPOs) raised concerns in submissions that the improvement in Australia Post's performance has come at the expense of the viability of LPOs. Those concerns were based on Australia Post shifting costs to LPOs by providing non-commercial returns for the provision of CSOs and work done by the LPOs. This is further discussed in relation to contracting out in Chapters Seven and Eleven.

Increases in letter volumes and investments to reduce operating costs associated with the network have contributed to increased profits. Since 1992-93, letter volumes have increased by around 23 percent and profits nearly 40 percent in spite of a reduction in the extent of the reserved services.

These results have enabled Australia Post to provide significant dividend and capital payments to the Commonwealth Government. Since 1992-93, Australia Post paid or provided for dividends of \$635 million and capital repayments of \$450 million (most of which was paid during the three years to 1997).

#### *Investments, Returns on Assets and Equity*

Australia Post's strong performance is reflected in its ability to undertake major investments. Table 5.4 sets out the investment undertaken by Australia Post since 1992, amounting to \$1.2 billion. Investment in plant substantially increased since 1994. At that time, Australia Post announced that it would focus on profitability and investment in new technology and the Network Renewal project.

*Table 5.7 Return on Assets<sup>1</sup> of Certain GBEs, Australia Post and the Communication Services Sector*

<i>year ended 30 June</i>	1992	1993	1994 <i>percent</i>	1995	1996
Commonwealth GBEs	8.3	12.0	13.4	12.1	15.4
<b>Australia Post</b>	11.6	11.5	13.6	16.8	17.6
Airservices Australia	6.6	9.9	13.2	-3.9	7.1
ANL Limited	-2.0	4.0	-36.1	-8.9	0.6
Federal Airports Corporation	8.1	7.4	7.4	8.4	8.4
Telstra Corporation	8.2	12.7	14.8	12.9	16.4
All GBEs	6.3	7.2	7.0	6.2	6.9
Communication Services <sup>2</sup>	13.1	10.9	12.2	10.8	11.5
All Industries <sup>2</sup>	7.3	7.4	7.4	7.4	7.5

1 Return on assets has been calculated by dividing EBIT after abnormals by average total assets.

2 Return on assets has been calculated by dividing EBIT after abnormals by total assets.

Source: Industry Commission, submission 58, p. 58, ABS 1995, pp. 15 and 53, and ABS 1996, pp. 9 and 19

Note: These methods calculate return on assets differently to what Australia Post provides in its Annual Reports. They are used here to allow direct comparison with other GBEs.

Australia Post's return on equity has shown dramatic improvement between 1992 and 1996 despite partial deregulation of the reserved services in 1994. By 1996-97, Australia Post's return on equity had reached approximately 27 percent in three consecutive years.

The IC has examined Australia Post's performance on a return on assets basis compared to other governments business enterprises. Table 5.7 sets out those returns.

The IC concluded that Australia Post's return on assets - at 17.6 percent in 1996 - is higher than considered appropriate. This was because Australia Post's return on assets was above the current long term bond rate plus a margin for risk inherent in the provision of mail services. In its submission, the IC noted that the long term bond rate, a relatively risk free investment, was less than 7 percent (IC, submission 58, p. 59) (and in February 1998 was around six percent) and that Australia Post is likely to have only a small risk premium above the long term bond rate due to the protection provided by the reserved services. Other reasons why Australia Post's risk premium may be only a couple of percentage points are because it sells into a mature and relatively stable market, and the investment needed to meet the growth in demand

for letter services is neither large nor lumpy. This contrasts with, say, electricity generation where decisions to expand capacity result in large long term investments. Consequently, the appropriate rate of return on a business such as Australia Post could be closer to 8 or 9 percent. The Corporation's returns on assets significantly exceeds this rate of return.

The results generated by Australia Post are also higher than returns in the communication services sector and industry generally. The view that Australia Post is generating returns clearly above the norm is confirmed by a review of the earnings on shareholder funds and returns on assets recorded by the Australian Stock Exchange. Between 1992 and 1995 Australia Post's returns on assets<sup>3</sup> ranged between 8.9 percent and 15.8 percent. The results for companies listed on the stock exchange were as follows:

- The average return on assets across all listed companies ranged between 6.3 percent and 8.3 percent.
- The average return on assets for the retail sector varied between 8.3 and 11.4 percent. The maximum for the sector was 16 percent.
- The return on assets for the transport sector was between 3.8 and 6.5 percent. With a sector maximum of 11 percent.

Between 1992 and 1995, Australia Post's returns on equity<sup>4</sup> ranged between 13.3 percent and 27.7 percent. The results for listed companies over the same period were as follows:

- The average return on shareholder funds across all listed companies ranged between 3.6 and 8.9 percent.
- The return on shareholder funds for the retail sector ranged between 3.8 and 15.8 percent. The maximum for the sector was 30 percent.
- The return on shareholder funds for the transport sector varied between -2.5 and 6.9 percent. The maximum for the sector was 16.6 percent.
- The return on shareholder funds for the banking sector was between -3.7 and 15.9 percent. The maximum was 22.8 percent (ASX 1996, Vol. 4, pp. 3.5 and 4.5, Vol. 5, p. 1.2 and Vol. 8, pp. 1.1 and 1.5).

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3 Australia Post's return on assets is calculated by dividing EBIT by total assets for consistency with the method used by the Australian Stock Exchange.

4 Australia Post's return on equity is calculated by dividing NPAT by total equity for consistency with the method used by the Australian Stock Exchange.

Arthur Andersen, in its report on the impact of deregulation of the reserved services, has also considered Australia Post's performance compared to other GBEs and the private sector. It found that Australia Post is currently performing at a level above what a private corporation could expect to achieve in a competitive market and has continued to improve its return on capital over the past five years.

Australia Post's submission also notes that its return on assets of 15.4 percent in 1995-96 was higher than that achieved by similar businesses (Australia Post, submission 8, p. 110). The returns achieved by Australia Post are above those generally earned in the communications service sector, as can be seen in Table 5.6. These results also appear high by international standards, and are discussed below.

### *Dividends*

Dividends are the return to shareholders on their investment in an organisation and are the result of many trade-offs between competing demands. Over the last five years Australia Post has paid \$635 million to the Government in dividends, as indicated in Table 5.4.

There are differing points of view as to how a dividend target should be set. The Vaile Report was concerned as to the nature of Australia Post's dividend target. It noted that, as the target was a percentage of profit, "the only way the target cannot be met is if there was no profit after tax and abnormals" (The Vaile report, p. 102). It noted that a more ambitious target would be one set in money terms, equal to or greater than the previous year's result. However, the Review of Government Business Enterprises Governance Arrangements (GBEGA) recommended that benchmarks be set based on the percentage of profit to provide for a degree of flexibility (Humphry 1997, p. 49).

There are concerns as to the efficacy of such dividend targets. While dividend targets are relatively simple to apply, they may be too strictly applied in changing market conditions. The Industry Commission recommended in 1992 that Australia Post adjust its dividend policy to provide a total return closer to comparable private organisations, and this approach would allow for dividend payout ratios to change as business conditions alter. The GBEGA recommended that because the level of dividends will be the residual after agreeing a capital structure and the future level of capital expenditure, the dividend policy should be driven by the need to maintain the

appropriate capital structure (Humphry 1997, p. 51). The rate of dividend payments also requires consideration of the:

- organisation's investment needs and opportunities in earning a rate of return;
- corporation's liquidity and financial viability requirements;
- availability and cost of debt finance;
- amount of shareholder funds invested and the likely future returns; and
- other obligations, such as the funding of community service obligations and the need to maintain a reasonable level of service.

Section 38 of the Act sets out a number of issues which Australia Post should have regard to when setting a financial target. The section includes the expectation that Australia Post will pay a reasonable dividend, as well as considering those other factors mentioned above.

The Government has traditionally had a key role in establishing the level of Australia Post's dividends but it is not clear that this participation will improve Australia Post's ability to meet the demands placed upon it in a competitive market environment. Over the last several years, Australia Post has been required to maintain a dividend payout ratio of 60 percent of profits after tax and abnormals. In its 1997-98 budget, the Commonwealth Government instructed Australia Post to make additional dividend payments of \$80 million per annum in each of the following two years, in addition to the expected 60 percent payout ratio. This approach is likely to significantly raise the final dividend payout (as illustrated in Table 5.4) depending on the level of actual profits, but it is not clear whether the appropriate capital structure for Australia Post has been established nor whether funds should have been retained to meet other demands.

Australia Post's dividend target may be relatively easy to achieve given the large profits which are being generated. A deregulated environment is likely to provide a better mix of signals as to when profits should be distributed to shareholders, particularly where normal returns are more likely to be generated. In a private sector environment, firms are able to set dividend policy according to the goal of maximising shareholder wealth while meeting the needs of the firm. In some cases firms may even forego distributing dividends so as to improve their competitiveness by reinvestment in, for example, new equipment. While dividend payout targets seem to be more appropriate for corporations with highly stable revenues, say from

monopoly markets, they may be difficult to maintain in the dynamic conditions of open markets.

*Table 5.8 Financial Results - Reserved and Non-Reserved Services, 1997*

	Reserved Services	Non-Reserved Services
Revenue \$ million	1 587.2	1 527.0
Expenses \$ million	1 467.0	1 302.4
Operating Profit \$ million	120.2	224.6
Return on Revenue %	7.6	14.7
Average Assets \$ million	1 239.4	1 138.2
Return on Average Assets %	9.7	19.7
Est. Equity <sup>1</sup> \$ million	445.7	409.8
Est. Return on Equity <sup>2</sup> %	18.3	36.0

1 Equity in the reserved and non-reserved services is estimated in the same proportion as average assets.

2 Return on equity has been calculated by dividing estimated equity by estimated net profits after tax and abnormals for the reserved and non-reserved services. NPAT in the reserved and non-reserved services has been estimated in the same as operating profit (NPAT totalled \$233.2 million in 1997).

Source: Australia Post 1997a, pp. 52 and 83

### *Reserved and Non-Reserved Services*

The previous section considered Australia Post's performance across all of its activities and aggregated the performance of the reserved services and the non-reserved services. Given the information Australia Post provides in its annual report it is possible to examine some aspect of the relative performance of the reserved and non-reserved services. This is set out in Table 5.8.

These figures reveal the significance of non-reserved services for Australia Post's overall performance:

- non-reserved services provide some two thirds of operating profits while using fewer assets than the reserved services; and
- the returns on assets and equity for non-reserved services are far higher than the reserved services.



The importance of the non-reserved services to Australia Post's overall profitability suggests that it may be possible to make some changes to the extent of the reserved services without undermining the overall viability of Australia Post.

Table 5.9 Performance of the Reserved Services, 1992-93 to 1996-97

	1992-93	1993-94	1994-95	1995-96	1996-97
Share of Operating Profits (%)	57.0	50.1	46.6	38.6	34.9
Return on Revenue (%)	9.4	9.0	10.0	8.7	7.6
Return on Assets (%)	11.2	11.8	13.2	11.5	9.7

Source: Australia Post, 1993b, 1994, 1995, 1996, 1997a.

At the same time, the high performing non-reserved services may make it difficult for other providers to compete in some of these markets. The results in Table 5.8 *could* imply that some non-reserved services are being cross-subsidised from the reserved services. Alternatively, the performance of the non-reserved services may partly reflect that a greater portion of its fixed costs are being borne by the reserved services.

The estimated results for the reserved and non-reserved services can be compared to the performance achieved in previous years. Table 5.9 sets out the performance of the reserved services since 1993. The results in 1992-93 show that the reserved services operating profit was 57 percent of total profit, yielding a return on reserved services revenue of 9.4 percent and a return on average assets of 11.2 percent.

The performance of the reserved services has since declined. The reserved services have experienced falling profit and return on assets as well falling return on equity performance in most years. These figures suggest that Australia Post is now less reliant on the reserved services for its profit than in the past.

However, while Australia Post is now less reliant on the reserved services, the viability of the reserved services are critical if Australia Post is to continue to cross-subsidise its community service obligations. The above analysis indicates that the profitability of the reserved services is relatively low. The Arthur Andersen report also notes that the margins on overall letter business, which is the bulk of Australia Post's business, will continue to decline (Arthur Andersen 1998, p. 47).

Australia Post's second submission confirms this analysis:

*the profitability of full rate standard letters is low and not increasing (Australia Post, submission 99, p. 18).*

A key reason for gradual decline in profitability of the reserved services is that the standard letter rate has been fixed at 45 cents since 1992 (Arthur Andersen 1998, p. 47), and which is expected to remain fixed until June 1998. This difficulty is likely to increase in the future as competition increases from the internet and other electronic message substitutes.

However, there is some doubt as to the accuracy of the relative performance of the reserved and non-reserved services. Amongst other things, Table 5.8 shows that the performance of the reserved services appears to be highly sensitive to the methodology used to allocate revenues and expenses between the categories of service. The revenues of the two services differ only by \$60 million, or less than two percent of total revenues. A variation of ( 5 percent from the estimated costs and revenues could result in large variations to the reported performance.

The attribution of costs is important where economies of scope are significant. Australia Post employs statistical and sampling methodologies to apportion shared costs between the reserved and non-reserved services. These methods used by Australia Post may need be more robust to ensure that cost are properly allocated. This would also ensure that costs are properly allocated between reserved and non-reserved services. Accounting separation is further discussed at Chapter Nine.

#### 5.4.2 Australia Post's Comparative Performance

*Table 5.10 Financial Ratios for Selected Post Offices, 1996*

Country	Return on Operating Assets	Return on Sales	Return on Equity
Finland	18.1	7.0	na
Australia	15.4	12.6	26.9
UK	15.4	9.1	na
Netherlands	15.0	11.8	na
New Zealand	14.3	9.7	24.8 <sup>1</sup>
Sweden	0.8	6.1	12.6*

<sup>1</sup> Information sourced from NERA 1997a, pp. 61 and 80.  
Source: Australia Post, submission 8, p. 133

This chapter has considered Australia Post's corporate objectives, its costs, prices and overall financial performance. The central conclusion was that Australia Post has performed strongly in the past and has been able to generate strong profits and returns to the shareholder.

The following sections consider Australia Post's performance in relation to international experience with mail services, local competitors and industry, and comments from submissions.

### *International Performance*

Australia Post has provided information on the financial performance of a number of post offices around the world based on international benchmarking studies. Selected countries from the study are set out in Table 5.10.

Most of the post offices in Table 5.10 show approximately the same return on assets, but differ substantially in respect of their return on sales. Return on sales indicates the organisation's effectiveness in selling goods and services at a profit. The table indicates that Australia Post is very effective at returning profits on its operational activities. This result could be influenced by higher prices or lower costs compared to other post offices.

Australia Post's returns on equity are much better than some other postal services. While each postal service operates under different arrangements, the figure for New Zealand is particularly relevant as that country has significantly reformed its postal services and is soon expected to permit full competition.

The conclusion that Australia Post is a high performing postal services provider is confirmed in the World Bank report *Redirecting Mail: Postal Sector Reform*:

*It is evident that Australia Post has benefited tremendously from its reform efforts. It is now ranked among the world's better performing postal enterprises (Ranganathan and Dey 1996, p. 241).*

### *Comparisons with Local Competitors*

Another means of considering Australia Post's performance is to compare it to private sector organisations which operate in a similar market. For this purpose the performance of Australia Post's closest competitors are useful indicators. These

companies include Ausdoc, Mayne Nickless and PMP Communications (Streetfile is a division of PMP). While those companies carry out a range of activities, consistent out-performance by Australia Post of its rivals could indicate that prices not cost-reflective. One common way of comparing different companies is by returns on sales. This measure indicates how effective different companies are in generating profits from revenue.

The return on sales achieved by Australia Post has been substantially higher than for private companies operating in similar markets: for example, Ausdoc (8.6 percent return on sales), PMP Communications (7.1 percent) (BRW 1997, p. 92). However, in the communications sector overall the ABS reported returns on sales of 14.2 percent in 1995 (ABS 1995, p. 53).

Returns on sales in other sectors have also been usually lower than Australia Post's. In the transport industry (an activity which makes up a large part of Australia Post's business), rates include: Mayne Nickless (3.96 percent), TNT (2.14 percent), and a transport industry average of 3.97 percent (ASX Vol. 4 1996, p. 4.7). The ABS reported a transport and storage industry return on sales for 1995 of 4.1 percent (ABS 1995, p. 49). The average for all listed companies on the Australian Stock Exchange was 7.7 percent in 1995 (ASX Vol. 8 1996, p. 1.7).

Australia Post's better performance in return on sales is also consistent with its better performance in returns on assets and on shareholder funds, as noted above.

#### *Submissions Comments on Australia Post's Performance*

Many submissions provided support for Australia Post and the continuation of the services being provided under the current regulatory arrangements. The following comments from submissions are typical of the support for Australia Post's performance:

*The improvement in reliability and overall performance of Australia Post in recent years is a credit to those responsible, who have done so through efficiency gains rather than price increases to the consumer (Crookwell Shire Council, submission 80, p. 2).*

*Australia Post is performing well, it is meeting its CSOs and giving a good return to the Government. This return is improving*

*every year and will obviously continue to do so (Licensed Post Officers of Australia Ltd, submission 88, p. 19).*

*Currently Australia Post generates good returns for the government and has the funds available to reinvest them in new Plant and Equipment, the benefits of which flow to all Australians (M. J. Green, submission 106, p. 1).*

The CEPU, the trade union which represents many employees within Australia Post, has commented on the success of Australia Post. It said:

*In terms of price, profitability and return on assets, productivity, delivery performance, international benchmarks, existing levels of competition, industrial relations, service modernisation and expansion to services to rural and remote Australia, Australia Post has demonstrated its improved performance (CEPU, submission 127, p. 9).*

The CEPU has offered some reasons for this success. It noted that the improved financial and operational performance can be ascribed to a cooperative employment relationship and the changes in the workplace which that relationship allowed (CEPU, submission 121, p. 23). The ACTU agrees with the CEPU that the industrial relations arrangements have been crucial to the performance of Australia Post's employees (ACTU, submission 130, p. 16).

Other submissions, however, were more ambivalent about Australia Post's performance. The Australian Chamber of Commerce and Industry (ACCI) asked:

- *would consumers get better satisfaction and service if Australia Post operated in a more competitive environment; and*
- *are the performance requirements challenging and robust, and how do they compare to international best practice and comparable private sector outcomes (ACCI, submission 85, p. 3).*

The ACCI went on to identify key problems as the distortions caused by cross-subsidies and the absence of price differentiation for various classes of customers (eg bulk/business mail).

The submission from the MMUA considered that Australia Post could further improve its performance:

*Australia Post is seen not to be able to provide the right mixture of flexibility, support and co-operation that modern day business requires of its partners and suppliers. On the other hand, Australia Post is strongly endorsed by our members as providing a good delivery network and is seen to be an integral part of their own systems (MMUA, submission 121, p. 5).*

The MMUA went on to express concern over the lack of performance auditing of bulk presorted mail and the lack of recognition of a broader relationship between the major mail users and Australia Post. MMUA argue that Australia Post should provide discounts which recognise the relationship between them and major mail users including mailing houses. The concerns of MMUA were considered further in Section 5.3.1.

The MMUA is also critical of the lack of coordination of decisions within Australia Post of mailings from single customers which take place in different states. MMUA report these as occurring mainly around the time of accepting mail. The MMUA is also concerned that Australia Post's operating hours for the lodgement of mail is limited to its own convenience rather than allowing more flexible lodgement times which could be used to maximise plant usage (MMUA, submission 121, p. 9).

Mayne Nickless' submission has commented that while Australia Post has sought to invest additional funds into its network:

*it offers no specific objectives as to how it will improve its customer performance from a satisfaction level of about 93%, which is commercially unacceptable in a transaction based business (Mayne Nickless, submission 120, p. 1).*

Several other criticisms can be made of Australia Post's performance. These criticisms include prices which may be too high and a lack of transparency in the operating and financial arrangements governing the reserved services. Without detailed information describing the actual costs and revenues of the reserved and the non-reserved services, there will always be the suspicion that cross-subsidisation is taking place.

The lack of transparency in the arrangements governing the reserved services also suggests that the benefits from structural reform of Australia Post should be considered. These issues are addressed in Chapter Nine.

### 5.4.3 Australia Post's Future Performance

The Terms of Reference require that the Council have consideration for the future performance of Australia Post. The Council engaged Arthur Andersen to assess the financial impact on Australia Post of reducing the letter monopoly. The terms of reference for the consultancy and the Report's Executive Summary are set out in Appendix Three. Arthur Andersen's results and conclusions reported in this review are its own, not Australia Post's.

The Arthur Andersen report covers a number of scenarios for reducing the reserved services by a number of price multiples, open competition and setting out a 'base case' to estimate Australia Post's performance if there was no change the regulatory arrangements. This base case covers Australia Post's projected performance over the period 1998 - 2005.

The base case includes several initiatives which Australia Post is already implementing. These are the network renewal, barcoding, and Australia Post's '123' pricing initiative to simplify pricing for retail consumers. The base case forecasts incorporate the following key assumptions:

- no deregulation over the period of the projections (1997 to 2005);
- volume adjustments generally in accordance with Forecast GDP movements;
- cost adjustments generally in accordance with Forecast CPI movements;
- prices held constant;
- no strategic changes within Australia Post (eg no competitive reaction to, or preparation for, competition);
- current initiatives proceed as planned (eg barcoding and 223 pricing); and
- no unusual external factors influencing performance.

Arthur Andersen has developed its base case model on information provided by Australia Post and discussions on Australia Post's own model. The outcomes of the base case are presented in Table 5.11.

The key observations from the base case can be summarised as follows:

1. Australia Post is forecast to continue to make record profits up to 2002. These profits are accompanied by strong dividend payments and additional

*Table 5.11 Forecast of Australia Post's Performance, 1997-98 to 2004-05*

	1998	1999	2000	2001	2002	2003	2004	2005
Operating Revenue \$million	3201.53	3382.84	3553.65	3688.49	3834.46	3994.92	4153.87	4319.89
EBIT Margin %	11.24	10.32	11.86	12.97	14.23	13.11	12.41	11.66
Dividends \$ million	135.80	123.12	132.56	159.66	186.46	195.83	189.94	186.14
Special/Capital Payments \$ million	80.00	80.00	-	40.00	100.00	120.00	120.00	120.00
Return on Total Assets %	14.02	12.79	14.65	15.93	17.75	16.61	16.09	15.48
Return on Equity %	25.62	21.75	24.35	26.62	29.90	28.43	27.81	27.10
Return on Capital %	27.76	25.37	30.64	34.75	39.64	38.07	37.46	36.60

Source: Arthur Andersen 1998, pp. 53-54



special or capital payments. By 2005 special dividend payments are expected to rise to \$120 million per annum. Australia Post's profitability, returns on assets and equity remain strong and decline marginally after 2002. Overall, Australia Post is likely to remain a very strong performing operation.

2. Australia Post is subject to gradually eroding profit margins. This erosion is evident in the falling earning before interest and tax (EBIT) margin during the years 2003 and 2005. This is due to mail prices being largely fixed while costs are rising. Australia Post's performance is therefore based on the rate of increase in the use of mail services being above the increase in its costs less productivity gains. The rise in the EBIT margin to the year 2002 is due to the investments which Australia Post is currently undertaking and which are due to have its full impact between 1999 and 2002.
3. The investments and other initiatives which are being put in place by Australia Post are likely to lead to slightly lower profitability until the full impact can be felt after 1999. From 1999 profits are forecast to rise strongly to 2002 but are again forecast to fall gradually thereafter. This implies that Australia Post will need to introduce new strategies by 2002 to further improve its performance.

One of the key observations from the base case is that while Australia Post is forecast to continue to be a strongly performing business, it will need to achieve further cost reductions or increase its revenues if it is to increase profitability. As this need is present in the base case it will also be present in each of the deregulation scenarios. The results of several scenarios forecasting the impact of a reduction in the reserved services on Australia Post are considered in Chapter Eight.

#### **5.4.4 Australia Post Performance Summary**

Australia Post performs very well against its corporate objectives and against comparable organisations including overseas postal services and similar corporations. It has also been able to consistently improve its internal efficiency, provide large dividend payouts, capital investments, and has been able to make significant investments in its network primarily from internal sources.

Australia Post's strong performance is forecast to continue in the Arthur Andersen report. The Corporation's performance reflects good management which Australia Post has experienced since corporatisation as well as the reservation of services to

Australia Post. The resulting high profits have enabled Australia Post to make large dividend and capital repayments and may indicate that the Government, under the current arrangements, has benefited from Australia Post to a greater extent than customers. The Government has already announced that it will require continued dividends at 60 percent of after-tax profits plus additional special dividends of \$80 million per year for the next two years.

While the reserved services are a source of advantage to Australia Post these services face declining profitability over the long term. Australia Post will need to take action to either reduce its costs or change the way in which it responds to market needs if it is to maintain its current high performance regardless of changes in the broader regulatory environment.

The course of this review has raised a number of specific problems about the operation of postal services. Some of these have been identified above and relate to Australia Post's current performance and how that performance is monitored. The major areas identified include:

- the declining viability of the reserved services and the need for Australia Post to constantly extend its revenue base;
- the flexibility of Australia Post when dealing with its major customers;
- performance measures on delivery which do not cover business mail;
- the cost and quality of services in rural and remote areas including frequency of delivery, costs of post boxes for those who do not receive a delivery and the reliability of services in outback areas;
- whether it would have been feasible for Australia Post to reduce prices rather than merely freeze the basic postal rate; and
- whether Australia Post cross-subsidises between reserved and non-reserved services.

These issues indicate that there are some difficulties arising from the current regulatory arrangements.

## **5.5 The Need for Reform**

The preceding discussion illustrates that against the current requirements Australia Post is performing well. It has met most of its corporate objectives, provides a good return to the government shareholder, performs well compared to the best postal authorities overseas and achieves high results in reliability of delivery of non-bulk mail.

Many of the issues raised with the Council appear to result from the fact that the obligations imposed on Australia Post do not extend to the particular areas of concern, or that the framework Australia Post is operating in does not give it the incentives to address those areas of concern. For example, why do large businesses believe that Australia Post is not flexible in meeting their needs? Both Australia Post and businesses are aware that there are often few alternatives to accepting the services offered by Australia Post.

The most frequently raised concerns include:

- whether Australia Post is advantaged by having an exclusive right to provide some services.
- whether opportunities for the private sector to provide new innovative services are being lost.
- whether current inter-connection discounts appropriately calculated.
- what services should be provided as part of the community service obligations?

These issues raised with the Council go beyond the profitability and financial performance of Australia Post. While high profits and dividends benefit the shareholder, the sole pursuit of those objectives can disadvantage those customers who have no choice but to use Australia Post.

Mandating that Australia Post be more flexible in the way it meets customer needs is unlikely to be effective. An environment is required which makes it in Australia Post's best interests to respond to those needs.

To effectively address these problems this review will need to do more than simply suggest what Australia Post should do to provide additional profits, products and services. It will need to look at the regulatory framework which will carry postal services into the future.

Chapter Four examined Australia Post's legislation which is the most critical part of the regulatory framework. The rest of this report addresses specific aspects of that framework and then draws specific recommendations together as a package of reform.

# Chapter Six: Universal Service Obligation

*This chapter examines the nature and scope of Australia Post's obligation to deliver standard sized letters at a uniform price throughout Australia. It assesses the adequacy of Australia Post's performance in providing the letter delivery USO, and whether there is a need to better define Australia Post's obligations. The chapter also considers whether there is a case for extending Australia Post's obligations into other areas besides letter delivery.*

Successive Commonwealth Governments have placed a high value on providing a universally accessible and affordable system for delivery of written communications. Under the *Australian Postal Corporation Act 1989*, the Commonwealth Government requires Australia Post to provide letter delivery Australia-wide at a uniform price (currently 45 cents). This requirement is known as Australia Post's Universal Service Obligation.

A small percentage of deliveries cost more than the uniform rate to provide. These loss-making services form the basis for identifying the Community Service Obligation (CSO) provided by Australia Post. Letter delivery services can be considered as a CSO in those cases where private companies would not be prepared to provide them except for a charge greater than the uniform rate.

## 6.1 Australia Post's current Universal Service Obligations

There has been considerable debate about the relationship between Australia Post's commercial and social obligations. In general, Australia Post is free to choose what services it will offer, and offers services if and only if they are profitable. For example, services such as giroPost banking, and delivery of express post parcels are offered by Australia Post on the basis of their profitability. Nearly half Australia Post's revenue is earned from services offered on a commercial basis in competition with other businesses.

There is only one significant exception to Australia Post's freedom to offer services on the basis of profitability. Under section 27 of the Act, Australia Post is required to deliver standard sized letters to all but the most remote parts of Australia even if the costs of delivery exceed revenue. This obligation to deliver almost universally within Australia is known as Australia Post's letter delivery Universal Service Obligation (letter delivery USO).

The USO relates to letters which are "standard postal articles". A standard postal article is defined in the Act as an article which is under 250 grams, has dimensions not exceeding 5 mm thick by 122 mm broad by 237 mm long, and where the length is at least 1.414 times the breadth of the article. These dimensions equate with an envelope just over one-third the size of an A4 sheet of paper. The text of the definition is set out in Chapter Four.

The 'letter delivery USO' consists of three elements:

- Australia Post must provide a letter service to all parts of Australia at a single uniform price (price element);
- it must make the letter service reasonably accessible to all Australians (access element); and
- it must meet reasonable performance standards in the delivery of letters (performance element).

Importantly, there is no USO in relation to the delivery of letters larger than the standard size, parcels, express post articles, courier services, the maintenance of post offices in particular locations, or the availability of financial services such as giroPost, bill-payment, and money orders.

This chapter examines a number of issues related to the letter delivery USO. These issues are:

- the justification for maintaining the USO;
- the justification for maintaining a uniform rate for postage;
- Australia Post's performance in delivery of letters;
- the definition and framework for provision of the letter delivery USO; and
- whether Australia Post should be required to deliver additional USOs.

Chapter Seven examines Australia Post’s CSOs, those deliveries that a private company would not provide for the uniform rate of 45 cents.

## 6.2 Social Justification for the Letter Delivery USO

The letter delivery USO has traditionally been supported on the basis that it assists in the “social, industrial, and commercial needs of communities and the development of the nation” (Vaile Report, 1996, p. 27). The Industry Commission (1992) nominated a number of benefits flowing from the USO, including social cohesion, equity, efficient national and regional government, and the facilitation of commercial transactions.

These justifications of the letter delivery USO contain a number of different themes. The Council considers that there are four arguments in support of the USO.

First, the existence of the USO promotes the creation of an Australia-wide postal network. If there was no USO in relation to postal services, people might be reluctant to use the postal system because they might not be confident of being able to post a letter anywhere in Australia. Providing the service at a uniform price (which assists affordability and, therefore, usage in rural and remote areas), and providing it on an Australia-wide basis, increases the attractiveness of the service to all Australians, whether they are located in city or rural areas.

Second, the USO promotes social cohesion by giving people in rural and remote areas a sense of connection through the ability to communicate cheaply and easily with their fellow Australians. As the Vaile Report noted:

*Rural and remote communities face pressures of isolation and poorer access to a range of goods and services compared to the urban community. The postal service helps to break down this sense of isolation (Vaile Report 1996, p. 35).*

Third, the existence of the USO opens up business opportunities for both country and city people. It assists country-based businesses wishing to do business in the city and city-based businesses wishing to do business in the country to communicate cheaply in written form without the need for relocation or extensive travel. The USO facilitates an effective means of marketing products and services beyond a business’s local region and enables businesses to take advantage of national opportunities.

Fourth, the USO is consistent with the broader regional development aims of governments, and enables the delivery of information and materials (such as health and educational materials) vital to remote communities, and without which remote communities would be significantly disadvantaged.<sup>1</sup> Without the ability to communicate in writing, some people and businesses may consider leaving rural and remote areas.

An issue in this regard is whether established and emerging forms of communication such as the telephone and the internet are reducing or replacing the need for a universal letter delivery service. Chapter Two examined this question. It concluded that postal services would continue to play an important role in the communication needs of Australians, even in the face of the increasing availability of phones, faxes, and e-mail. In the context of this chapter, the question then becomes whether it is more efficient to meet the communication objectives underlying the USO by funding Australia Post or by funding alternative forms of communication such as providing a subsidy for telephone charges in rural and remote areas.

A number of submissions argued that there was a strong need to maintain a letter delivery service to rural and remote areas. These submissions argued that telephone, fax, and e-mail services are not realistic substitutes for a postal service for a number of reasons:

- for rural and remote users, and for people writing to them, the cost of alternatives is significantly higher;
- alternative communication services may not be available in some rural and remote areas because of: the cost of specialised equipment such as computers, modems, facsimiles; the cost of training to use of this equipment; poor quality telephone lines to rural and remote properties; and unreliable power supply; and
- particular aspects of letters remain unique. For example, letters provide a written version of the communication, an original copy, and a better quality and more legible copy than a fax. Some of these advantages of letters over facsimiles and e-mail print-outs will continue to be significant in the short and medium term.

Further to these reasons, the USO creates a rural delivery network, which Australia Post contractors can also use to deliver parcels, perishable food, spare parts,

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<sup>1</sup> Some of these materials are parcels, which do not come within the definition of the USO. However, the existence of the letter delivery USO creates a delivery network through which it becomes economic to offer parallel parcel delivery services. The mutually supporting nature of letter and parcel delivery is examined at greater length in the section later in this chapter discussing a possible Parcel USO.

educational materials and health materials. For people living in rural and remote areas, these services may be as important as the letter delivery service.

Overall, the Council considers that communication by letter will retain unique characteristics that make it attractive - especially for rural and remote users - for a considerable time into the future. The USO can be justified on the basis that it is the most efficient way of promoting this essential form of communication.

In 1996-97 the letter delivery CSO cost \$67 million out of total revenues in the letter delivery market of \$1587.2 million, or less than 4.3 percent (Australia Post 1997a, pp. 73 and 83). (The breakdown of CSO costs is discussed further in Chapter Seven.) The Council considers that the costs incurred in providing the letter delivery USO are modest compared to the social benefits generated by it, and that therefore the USO should remain.

***Key Recommendation***

**The Council recommends the retention of the letter delivery USO because the CSO costs incurred are fully justified by the social benefits, and there is no effective alternative means of providing the social benefits.**

### **6.3 Why maintain a Uniform Rate for Postage?**

The terms of reference of this review request the Council to have regard to the Government's commitment to provide a standard letter service to all Australians at a uniform price.

Many of the submissions received by the Council have recommended the retention of the uniform rate, noting that the uniform rate is an important part of the Australia Post service. Others noted that an affordable service for all Australians is important. The Eastern and Central Regional Development Organisation argued:

*...that Australia Post must retain responsibility for the provision of the standard letter service at uniform costing to all Australians. That Australia Post should continue to provide a community service obligation in the provision of postal services*



*at an equitable and affordable cost to all Australians (Eastern and Central Regional Development Organisation, submission 28, p. 1).*

Australia Post argued for retention of the uniform rate:

*A uniform letter price is a feature of the postal system of most modern economies, and it has applied here since 1911. Our surveys show that the 'fairness' of this policy is strongly supported by the vast majority of Australians, whether urban or rural dwellers. It was also supported by the 1996 Federal parliamentary review of our rural and remote delivery services (Australia Post, submission 8, p. 12).*

Australia Post also noted other benefits of a uniform price:

*The pricing system delivers simple outcomes to consumers and an administratively simpler system for Post to operate; that is, the current system has low transactions costs for all parties. The social cost of such benefit could well be lost in the absence of regulation to support it (Australia Post, submission 8, p. 78).*

On the other hand, TNT has argued that a uniform rate has not been a feature of regimes for other utilities (such as Telstra) which have a Universal Service Obligation:

*There is a real question to be asked as to whether a single uniform price represents a genuinely equitable approach and whether it genuinely optimises the net economic and social welfare of Australians. In any case, the imposition of a uniform price should not become the implicit or explicit rationale for maintaining the reserved services (TNT, submission 43, p. 6).*

It is clear from the views provided to the Council that there are significant social benefits from ensuring that small customers have access to affordable postal services. These benefits include:

- guaranteed access to basic communications services for all Australians; and
- lower transactions costs for both Australia Post and postal users.

The Council recognises that there is strong community support for the uniform rate.

Recognising this, it is necessary to define more precisely what the legislative requirement to offer a uniform rate actually means. Does the requirement mean that Australia Post cannot offer discounts below 45 cents if it wishes? In this regard, Streetfile has noted that:

*Australia Post has various rates for a standard letter. It offers bulk, off-peak, pre-sort and other discounts (Streetfile, submission 10, p. 21).*

While Australia Post charges most users 45 cents for the standard letter service, it only charges 40 cents postage on Christmas cards, and offers discounts on some local deliveries and bulk mail deliveries (where 1000 or more letters are lodged with the post office at the one time).

Consistent with current practice, the Council has interpreted the uniform rate as meaning that Australia Post must charge the same rate of postage irrespective of the region of posting and destination. It means that Australia Post must charge the same rate for a letter from Thargomindah to Fitzroy Crossing as it charges for a letter from Sydney to Melbourne.

However, a uniform rate does not prevent Australia Post from offering discounts so long as those discounts are not offered on a regional basis. Australia Post is able to offer discounts for Christmas cards because it offers the same discount to any person posting Christmas cards. There was support in the submissions for the view that Australia Post should be continue to be free to offer such discounts below the uniform rate. For example, the Mid West Development Commission argued that:

*Uniform letter rates should be maintained. However, Australia Post should have the freedom to negotiate discounts with bulk users for large volume, pre sorted mail etc. (Mid West Development Corporation, submission 95, p. 2).*

Some parties have also suggested that changing to a maximum affordable charge would ensure that postal services remained affordable while allowing for greater levels of competition than may occur under the uniform rate. A maximum affordable rate would cap the maximum amount that Australia Post could charge for postage at a rate that is affordable to all Australians, but permit Australia Post to offer any type of discount.

Streetfile has suggested that:

*...the uniform price [be] replaced by a maximum affordable price. A maximum affordable price should be set on the basis of various economic and consumer formulae.....the Australian Government could follow the New Zealand example, using Australia Post as a benchmark on service and pricing, thereby keeping other providers competitive (Streetfile, submission 10, p. 39).*

The Council has considered the proposal to permit Australia Post to offer all forms of discounts to both businesses and households. In relation to business mail, the Council considers that while it is important for business, and particularly small business, to have access to affordable postal services, this does not necessarily mean that Australia Post should be restrained from offering discounts. Businesses are already eligible for a wide range of discounts, including in relation to the speed of delivery, envelope size, number of items lodged, and degree of pre-sorting. The use of mail services differs between businesses and therefore, the type of discounts they receive varies considerably. Further, businesses eligible for discounts tend to be located in the cities, and therefore, far more city based businesses would be eligible for discounts. The submissions to, and discussions held by, the Council as part of this review stressed that there would be significant gains to business from a more flexible discount structure. The Council considers that in the business segment of the letter delivery market, Australia Post should be permitted to offer any type of discount but prices should be capped at the uniform rate.

The Council has considered whether it should also permit Australia Post to offer a full range of discounts to households, while capping prices at a maximum charge. The Council has received no submissions from the community advocating for a change from the uniform rate for household mail, and notes that the Council's terms of reference request that it have regard to the Government's policy to maintain the uniform rate. From a theoretical point of view it would appear that there are gains from removing the uniform rate for individuals sending letters, and allowing for a range of rates. However, from a practical point of view these gains are likely to be modest and only affect a small proportion of the household segment of the letter delivery market. On balance, the Council considers that there may be some advantages to moving to a maximum affordable charge but at this early stage it is difficult to predict the effects this would have on mail sent by individuals. Therefore, the Council recommends that the desirability of moving from a uniform rate to a maximum affordable charge should

be reviewed in 2005, which, if the Council's recommendations are accepted, would be about 5 years after the introduction of competition in business letter delivery. At this time there would be more information on the practicality of moving to a maximum affordable charge in the household segment of the letter delivery market.

***Key Recommendation***

**The Council recommends that the uniform rate of postage apply to individuals and households posting standard size letters. Australia Post should be allowed to offer discounts to business customers, but no business should be charged more than the uniform rate for posting a standard size letter. The Government should review the possibility of introducing a maximum affordable charge for household letter services in 2005.**

Arrangements for business letter services are discussed further in Chapter Eight.

## **6.4 Australia Post's Performance in Letter Delivery**

A submission from the Isolated Children's Parents Association (ICPA) sums up the attitude of many of the parties who made submissions or talked to the Council about Australia Post's performance in letter delivery:

*Up until approximately 2 years ago there was a substantial degree of dissatisfaction in the isolated areas regarding mail services. There had in particular been a steady decline in frequency of mail services over the past 10-20 years. There were many responses from rural residents and organisations to the Industry Commission's Inquiry and its meetings were well attended. Since then [1992] there has been a gradual and exceedingly welcome change of attitude. Residents who had no mail service now usually receive one. Those who had one mail service a week now often receive two (ICPA, submission 93, p. 3).*

The general consensus which emerged from the submissions was that Australia Post has significantly lifted its performance this decade, and that its performance in letter

delivery is now reasonably good. However, some significant concerns remained in relation to:

- no delivery to some remote households (about 80 000 Australia-wide in 1996 according to the Vaile Report 1996, p. 41, but less now), or infrequent delivery, such as only once a week;
- delivery to an inconvenient point, such as only to the town post office or to a roadside box that is some distance from the addressee's house;
- the speed and reliability of delivery; and
- some shifting of costs of delivery onto other organisations such as local Councils.

Australia Post's performance in letter delivery can be assessed against the three elements of the USO specified in section 27 of price, access, and delivery performance. Delivery performance in turn consists of three sub-elements: frequency of delivery; time taken to deliver mail; and the reliability and security of delivery.

Australia Post has developed guidelines to measure and report on its performance against these elements. These guidelines divide Australia geographically into metropolitan, rural, and remote areas. Australia Post provides a different level of service in each of these areas, and therefore has different performance measures.

The pricing of Australia Post's letter delivery service is discussed in Chapters Five and Eight; this chapter therefore assesses Australia Post's performance in relation to the access and delivery performance elements of the USO.

### **6.4.1 Access**

Section 27(4)(a) provides that Australia Post shall ensure that the letter delivery service is "reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business". Access to a letter service may be measured in terms of postal users' access to the postal network to:

- receive letters; and
- post letters.

### *Access to postal network to receive letters*

In June 1997, Australia Post delivered to 8.21 million delivery points, of which 2.35 million were located in rural and remote areas (Australia Post 1997a, pp. 11 and 70).

Delivery may be to a number of different types of points, depending on the addressee's preferences and the comparative costs associated with each type of delivery. The types of delivery points are: street delivery; private boxes/locked bags; private and community bags; roadside delivery; and delivery over the counter in post offices. Street delivery is by far the most common and usually the preferred form of delivery, and, apart from delivery to private boxes, other forms of delivery generally occur only in rural and remote areas. Chapter Three discusses these types of delivery.

Table 6.1 sets out deliveries to each type of delivery point for households.

*Table 6.1 Types of Delivery*

<b>Household Deliveries (in thousands)</b>	<b>Metropolitan</b>	<b>Rural</b>	<b>Remote</b>	<b>Total</b>
Delivery to residence via:				
• street delivery	4 864	1 200	96	6 159
• roadside delivery	94	271	15	379
Delivery via private boxes and bags	287	305	67	659
Counter delivery	31	98	21	150
Delivery to intermediate points via community bags	7	27	6	39
<b>Total Delivery points</b>	<b>5 283</b>	<b>1 901</b>	<b>205</b>	<b>7 387</b>

Source: Australia Post 1997a, p. 73

Total delivery points increased in 1997. Whereas in June 1996, Australia Post delivered to 7 131 000 delivery points, by June 1997 it delivered to 7 386 900 delivery points, an increase of 3.6 percent. The number of household delivery points in rural and remote areas also increased between June 1996 and June 1997, from 2 000 700 to 2 105 300 delivery points, an increase of 5.2 percent.

The composition of deliveries remained total deliveries. For households, street delivery fell from 83.6 percent of total deliveries to 83.4 percent. Roadside deliveries increased as a proportion of total deliveries. For households, roadside delivery increased from 4.8 percent of total deliveries to 5.1 percent of total deliveries. This meant that

roadside relatively stable between 1996 and 1997. marginally as a proportion of delivery increased at the expense of delivery to private boxes and bags, community bags, and counter delivery.

The NSW Farmers' Federation was concerned about what it saw as the increasing shift from street delivery to roadside delivery. Arguing that roadside boxes were often long distances from where people live, its submission stated:

*Throughout rural New South Wales, this is an increasing phenomena, with mail boxes often located up to ten kilometres from the homestead. ... All efforts should be made to allow the placement of the mailbox at the closest accessible point to the homestead (NSW Farmers' Federation, submission 31, p. 3).*

These problems were also common in remote Aboriginal communities. Some Aboriginal people have to travel long distances to collect mail. The Aboriginal and Torres Strait Islander Commission submission to the Vaile Committee observed that where mail services are provided to small, remote Aboriginal communities, the delivery point might be as far as 100 kilometres away (ATSIC, submission 186 to Vaile Committee, p. 4). The Vaile Committee's recommendation that Australia Post establish community postal agencies in 51 remote Aboriginal communities may partially alleviate this problem.

#### *Access to postal network to post letters*

Over the last few years access to posting facilities had been reducing because of the removal of street posting boxes in some areas. This fall was reversed in 1996-97 and by June 1997, the total number of posting facilities had risen marginally from 20 137 the previous June to 20 940 due to an increase in posting facilities in rural and remote areas.

The number of posting facilities for 1996 and 1997 are set out in Table 6.2.

People's ability to post letters is also related to their distance from postal outlets (which includes licensed stamp vendors and vending machines, as well as post offices). However, there is no specific requirement under the letter delivery USO for access to post offices per se, only to posting facilities and to stamps.

*Table 6.2 Australia Post's Posting Facilities, per 10 000 Residents, 1996 and 1997*

Year	Metro Zone	Rural Zone	Remote Zone	Total
1996	9.2	15.0	19.0	11.0
1997	9.2	15.7	20.8	11.3

Source: Australia Post 1996, p. 64 and 1997a, p. 72

Australia Post reports that, in June 1997, 90 percent of metropolitan households were within 1.9 km of an outlet. In rural and remote areas the distance from postal facilities was much higher - in rural areas 90 percent of households were within 8.7 km of a postal outlet, while in remote areas 90 percent lived within 38.6 km (Australia Post 1997a, p. 72). This represents a disturbing increase on the position in June 1996. At that time, 90 percent of rural households lived less than 7.5 kilometres from a post office, and 90 percent of remote households lived less than 30 kilometres from a posting point (Australia Post 1996, p. 64). This means that, on average, people living in rural and remote households must now travel significantly further to reach a posting point.

In remote areas, Australia Post facilitates access by picking up letters from delivery points, and by arranging for contract deliverers to sell stamps. These arrangements assist greatly in meeting Australia Post's access obligations.

On the basis of the above data it is not possible to come to a definitive conclusion about the degree of satisfaction with present access arrangements. However, based on submissions and discussions with interested parties, the Council understands that there is general satisfaction with current accessibility to the postal network, but that postal users would not want to see access standards decline.

The issue of access to post offices is further considered in the section below on whether Australia Post should carry a Post Office USO.

## **6.4.2 Delivery Performance Standards**

### *Frequency of Delivery*

Australia Post does not provide the same frequency of delivery service to all parts of Australia. Delivery frequency varies between metropolitan, rural and remote areas.



In metropolitan areas, Australia Post delivers five days a week. In order to determine the frequency of services to rural or remote areas, Australia Post uses the Rural Delivery Frequency Guide (RDFG). The RDFG is based on the annual cost of delivering letters averaged over all metropolitan addresses.<sup>2</sup> For the current financial year, the cost associated with metropolitan delivery is estimated to be \$96.

For rural and remote areas, the RDFG provides that:

- if the cost of delivery to a delivery point is less than two times the cost of metropolitan delivery (up to \$192), the area will receive five delivery services a week;
- if the cost is between two and three times the cost of metropolitan delivery (between \$193 and \$288), the area will receive three delivery services a week;
- if the cost is over three times the cost of metropolitan delivery (over \$288), there will be between zero and two delivery services a week (as explained below); and
- if infrastructure (such as a passable road, or an airstrip or wharf serviced by an existing service) does not exist, and the property is very remote, no service is provided. In 1996, 5 000 households fell into this category (Vaile 1996, p. 37).

If delivery services are less than three times a week, local Australia Post managers have some discretion to increase the frequency of service in special circumstances from zero or one delivery to two deliveries a week. These circumstances would include health and educational needs, the availability of telephone or equivalent services, and where roads are impassable for part of the year.

Table 6.3 shows the average frequency of delivery per week for metropolitan, rural, and remote areas as at June 1997.

It is important to note that Table 6.3 only covers households that receive at least one service a week. It does not cover houses that do not receive a service. Australia Post's performance would fall marginally if it was measured across all households.

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<sup>2</sup> Metropolitan addresses typically include addresses in capital cities, suburbs, and nearby towns. In the case of Sydney, this would include addresses in the area bounded by Katoomba, Newcastle, and Wollongong.

Table 6.3 Frequency of Service

Frequency of service per week	Metro Areas (% of total services to that zone or area, and of total services)	Rural Zones	Remote Zones	Total
One	0.0	0.1	0.5	0.0
Two to Four	0.3	5.8	6.0	1.9
Five or more	99.7	94.1	93.5	98.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Australia Post 1997a, p. 73

### Views on the RDFG

It is difficult to assess whether Australia Post's performance is adequate in terms of the number of deliveries that it provides per week, since it has recently introduced the RDFG and introduced, in accordance with Government direction, the option of a twice weekly service to all areas where the infrastructure is present to support it and the community votes in favour of it.

There are, however, a number of concerns with Australia Post's use of the RDFG:

- the potential for metropolitan costs to fall due to efficiencies that are not available in rural areas. If the cost of metropolitan delivery were to fall for this reason, then the number of deliveries in rural and remote areas would be stripped back. To meet this concern, Australia Post has recently expanded the definition of metropolitan to include more outlying areas, thus broadening the base over which costs of delivery are calculated, but it is not clear that this fully meets concerns;
- the RDFG does not take account of revenue earned on deliveries in particular areas. If remote areas receive more mail than metropolitan areas, and consequently provide Australia Post with greater revenues, then lower rates of delivery may not be justified; and
- Australia Post's use of community polling to determine the number of services where there are less than three services a week may be flawed (as discussed below).

***Recommendation***

**The Council recommends that the application of the new RDFG formula should be monitored to assess whether it is equitable in determining the number of deliveries to rural and remote postal users.**

*Households that receive less than three services a week*

It is important to focus in particular on households that receive less than three deliveries a week because these households experience a significantly lower level of service than the majority of households.

The latest figures available in relation to the number of households not receiving a delivery service come from the 1996 Vaile Report. According to it:

*At July 1996, Australia Post advised that there were 80 000 delivery points 'which under existing service policies are not eligible for/do not receive a 'to the property or roadside' delivery service' ... . Of this number, 5000 delivery points are residents in areas where the infrastructure is unavailable or where the cost of delivery is above the policy cost threshold. The remaining 75 000 are residents in small clustered localities, of up to 150 houses, within walking distance of a postal outlet ... (Vaile Report 1996, p. 37).*

Australia Post previously had a policy that if a town has less than 150 delivery points within 1.2 kilometres by road of the local post office or handled less than 225 mail items a day, it would not deliver mail to the households (Mayfield, submission 75 to Vaile Committee, pp. 2-3). Instead, households could elect to collect mail over the counter of the post office during office hours, or rent a private post box at a concessional rate.

In 1996, the Vaile Committee recommended that the 80 000 households without a delivery be polled by Australia Post, and that where a majority in local communities voted in favour of a street delivery service, they should be provided with one (Vaile Report 1996, p. 42). Further, in August 1997, the Minister for Communications and the Arts announced that communities currently receiving a once-a-week service could vote by poll for a twice-weekly service (Minister for Communications and the Arts

press release, 30 August 1997). This effectively raised the entitlements of *all* households to a twice weekly service (where they vote for one).

The Council considers that the implementation of this policy is likely to meet concerns about the number of deliveries offered to households. However, some problems have been raised with Australia Post's community polling methods undertaken subsequent to the Vaile Report.

Australia Post reported that in 1995-96 it polled 180 000 households and businesses in 2 500 communities. It reported that as a result of the polling, 9 600 households and business received a new street delivery service, and a further 13 500 addresses received upgraded services (Australia Post 1996, p. 10). Only about 13 percent of households voted to receive an additional or upgraded service. This low percentage could indicate a number of things: that people are happy with the delivery to the town post office; that they are concerned about the wider implications of voting for more frequent delivery (such as that the local post office could close because of diminished income from rental of private boxes); that the polling method was not satisfactory; or a mixture of these reasons.

The Ombudsman's 1996-97 Annual Report, and submissions made to the Vaile Committee, suggested that Australia Post's methods of polling local communities was not satisfactory. The Ombudsman described the polling method as follows:

*Currently, when canvassing the level of support for changes to mail delivery arrangements (for example, for private post boxes to street delivery in outlying areas), Australia Post conducts a poll of affected residents. All eligible households are provided with a voting slip, on which it is indicated that if the household fails to lodge the completed slip by the close of polling, their vote will be treated as a vote in favour of the retention of existing postal arrangements (Commonwealth Ombudsman 1997, p. 218).*

The Ombudsman expressed concern that the fact that abstentions were counted as votes against an upgraded service. It stated that the:

*... present system obscures the distinction between those voters genuinely opposed to a proposed change, those who have no particular preference, those who fail to return a vote in them,*

*and those who are absent or do not receive the ballot papers. Inaccurate voting rolls and vacant properties included in the distribution of ballots can result in the no vote having a significant boost from the start (Commonwealth Ombudsman 1997, p. 218).*

The Ombudsman reported that Australia Post responded by arguing that “because of potential financial and service costs ... (for example, loss of eligibility for concessional private box rates and possible impact on the viability of the local licensed post office)” [it considered that] the onus was on communities to “actively support such a change” (Commonwealth Ombudsman 1997, p. 219).

Local communities may not want street delivery. However, the Council would be concerned if people voted on the basis of incorrect beliefs about the potential effect of their vote.

Voting for a street delivery should not have a harsh or unreasonable impact on local Licensed Post Offices (LPOs). The concern is that if street deliveries were commenced, LPOs would lose the considerable income associated with sorting mail into private boxes and therefore could close. However, it should be noted that Australia Post has put in place some mechanisms to ease concerns about the closure of LPOs. It has offered licensees three options: running the delivery service for five years; receiving 50 percent compensation for any ‘loss’ resulting from commencement of delivery services, or surrendering their licence on payment of a termination package, whereupon Australia Post would tender the licence (Vaile Report 1996, p. 67). These measures are likely to significantly lessen (without totally eliminating) the likelihood of post office closure.

The concern about loss of eligibility for concessional boxes refers to the fact that if mail is delivered, Australia Post charges the full rate if people wish to rent private boxes, whereas it offers a concessional rate (about 25 percent of the full rate) if delivery is less than twice weekly (Australia Post correspondence to Council, 16 January 1998). (It is not clear if this policy will change in the context of the Minister’s announcement to lift people’s eligibility to a minimum of two services a week.) If a community votes for street delivery, residents would lose the right to concessional private box rates. The Council recognises that this could influence the vote in some communities.

The Council considers that the costs associated with non-delivery are likely to be greater than the costs associated with delivery. Arguably, therefore, the onus should

be on those who oppose an extension of delivery arrangements rather than on the community to 'actively support it'. The Council agrees with the view of the Ombudsman that abstentions should not be counted. On this basis, the Council considers that Australia Post should repoll areas where, if abstentions had been ignored, the vote supporting an extension of delivery would have outnumbered the vote against.

***Recommendation***

**The Council recommends that Australia Post re-poll communities where, if abstentions had been ignored, the vote supporting an extension of delivery would have outnumbered the vote against extension. If a community vote is in favour of street delivery, people should have the option of requesting over-the-counter delivery at no cost to themselves.**

*Community Bag delivery*

Australia Post delivers letters via community bags where it judges that other delivery methods, including roadside delivery, are not feasible within the cost constraints of the RDFG. Under this form of delivery, community bags are delivered to a central point within a community, and the community is expected to undertake final sorting and delivery.

In 1997, 0.53 percent of household deliveries were via community bags, a marginal fall from the June 1996, when community bag delivery constituted 0.57 percent of all household deliveries (Australia Post 1997a, p. 73, and Australia Post 1996, p. 65). However, it should be borne in mind that this percentage needs to be adjusted to take into account that each community bag serves a number of households.

Representatives of the Local Government Association of the Northern Territory (LGANT) and ATSIC argued that, in some cases, Australia Post shifted the costs on to remote local communities, such as Aboriginal communities where it delivered mail via a community bag. LGANT said that community bag delivery occurred even to relatively permanent and well-established communities numbering over one thousand. If the community did not have a Community Postal Agency (CPA) or an LPO, as many Aboriginal communities do not, then someone within the community was required for sorting and delivering the mail. In some cases, Australia Post has postal agency

arrangements with these communities under which it pays the person responsible for receiving the mail a small amount towards the costs of sorting and final delivery. However, in the cases cited by LGANT, these payments accounted for only a small part of the costs of sorting and final delivery.

For example, Australia Post paid \$10 000 in agency fees to the Nguuu Community Government, a community of about 1 200 people on Bathurst Island north of Darwin. A report by Coopers and Lybrand estimated that the true costs of performing the postal agency work were likely to be in the vicinity of \$48 000 - salary costs alone were \$19 800 (Coopers and Lybrand, 1997, pp. 36 and 42). LGANT supplied the Council with survey results from a number of communities on the amount paid and the estimated cost of sorting and delivery. These results indicated that the problem of under-compensation for agency services was common in Northern Territory Aboriginal communities.

The Council notes that the Vaile Report recommended that Australia Post establish CPAs in 51 Aboriginal communities that were greater than 50 kilometres from an existing Australia Post retail service. Implementation of this proposal may go some way to alleviating concerns in relation to the standard of delivery to those communities. However, the Council still has some concerns about the level of remuneration received for performing some parts of the service.

***Recommendation***

**The Council recommends that Australia Post ensure that the level of remuneration paid in respect of postal agency arrangements established in remote communities that receive mail by community bag is comparable to the remuneration that Australia Post would pay to a CPA/ LPO and/or a contract deliverer to perform similar services.**

*Speed of Delivery*

Australia Post determines the time that it should take for a letter to be delivered according to the place at which it is posted and its destination. Table 6.4 shows Australia Post's delivery targets.

Since 1993, Australia Post has commissioned KPMG to audit its delivery performance in delivery of non-bulk letters. In the 1996-97 financial year, KPMG found that

Table 6.4 Australia Post's Delivery Schedule

Posted for delivery	Delivery by
<i>Intrastate</i>	
within metro areas of capital cities or within the same city or town	next business day after posting
between metro areas of capital cities and country locations	2nd business day after posting
between country locations	2nd business day after posting
<i>Interstate</i>	
between metro areas of capital cities	2nd business day after posting
between metro areas of capital cities and country locations	3rd business day after posting
between country locations	4th business day after posting

Note: Letters to and from remote country areas, including those without a daily service, may take more than the number of days indicated above.

Source: Australia Post 1997a, p. 74

93.9 percent of these letters were delivered early or on-time compared to the above schedule, while 98.7 percent were delivered within one further day. This represented a slight improvement on delivery performance standards in the 1995-96 financial year (KPMG 1997, p. 68).

Business has expressed concern about Australia Post's failure to audit the speed of delivery of bulk pre-sorted business mail (MMUA, submission 33, p. 15). This type of mail represents 27.6 percent of all letters, a significant share of the total mail stream. Australia Post argues that it would be very difficult for various operational reasons to audit this mail, and that the 72.4 percent of mail which is audited "provides an adequate measure" of its overall performance (Australia Post, submission 99, pp. 47 - 48). It says that it is exploring technological advances which may make it possible to audit bulk pre-sorted mail. As bulk pre-sorted mail is an important component of letter services, the Council considers that auditing, if possible, is important. Therefore, all reasonable efforts should be made when new technology is introduced to devise a method of auditing bulk pre-sorted letters.

The Council considers that Australia Post should introduce, as soon as feasible, measures to audit the time taken to deliver pre-sorted bulk mail.



A number of submissions made complaints about delays in delivery in rural and remote areas. For example, in discussions with the Council, the Pastoralists' and Graziers' Association said that letters posted in Fitzroy Crossing for delivery to Derby (250 kilometres away) were often sent to Perth (more than 2 200 kilometres away), sorted, and then sent back to Derby for delivery. This was because sorting has been largely centralised in the State and Territory capital cities. The Bulloo Shire Council, based in Thargomindah, Queensland, said that some mail from Thargomindah to nearby Innamincka in South Australia, took two weeks to be delivered, because it went via Adelaide for sorting. The NSW Farmers' Federation complained about delivery times of two weeks in relation to letters from interstate posting points sent to addresses in rural NSW (NSW Farmers' Federation, submission 31, p. 3). There is potential for this problem to deteriorate because Australia Post has plans to further centralise mail sorting.

The problem of delivery times for postal services between rural and remote areas may not be easy to solve, although the Council expects that such a problem may arise relatively frequently. The only apparent solution would be to institute some type of local sorting practice, such as a post box dedicated to the local area. However, the Council cannot verify that such a practice would be efficient in terms of time or money saved, particularly given the cost savings Australia Post expects from centralised sorting. This is an issue which needs to be addressed in the context of developing USO service standards.

Another problem arises where the arrangements for mail delivery 'piggy-back' on other arrangements. King Island Council complained that Australia Post had put in place unsuitable arrangements for mail delivery to and from King Island which were causing long delays in mail dispatch and delivery. According to the King Island submission, Australia Post has awarded the contract for mail and parcel delivery to an airline company which also provided passenger transport, and that mail was frequently offloaded to make way for more passengers, resulting in long delays:

*The community of King Island and particularly business that rely on spare parts etc are greatly inconvenienced and often wait for a week before the parcel arrives (King Island Council, submission 74, p. 1).*

The Council considers that this problem can be solved through better monitoring by Australia Post of contract performance by its appointed contractors.

### *Reliability and Security of Delivery*

Reliability of delivery is a measure of the extent to which mail arrives at the correct address. It is an important measure of the quality of Australia Post's delivery service. Misdirection may exacerbate the problems associated with infrequent delivery:

*Misdirected items are a common phenomena across rural New South Wales. ... Inaccuracy at the mail sorting centre whilst it may affect all consumers, particularly impacts on rural people given that some areas of NSW only receive one mail delivery per week (NSW Farmers' Federation, submission 31, p. 3).*

The submission by the Eastern and Central Regional Development Organisation stated that industry and commerce in Kalgoorlie were concerned about "lengthy and erratic delivery times taken by surface mail to Perth and the Eastern States which was causing them to use costlier but quicker commercial services" (Eastern and Central Regional Development Organisation, submission 28, p. 3).

The NSW Farmers' Association specifically suggested that performance measurement of misdirected items should be included in Australia Post's service charter (NSW Farmers' Association, submission 31, p. 5). The Council agrees that misdirected mail should be considered when looking at Australia Post's performance against the USO.

Security of mail is another important issue. Security encompasses the vulnerability of mail left for collection. It generally arises as a problem in relation to mail left in roadside boxes and community bags. Although section 27 does not specifically mention security as an element of the letter delivery USO, it is arguable that 'security' of delivery up until the time of collection is an aspect of reliability of delivery. The Council considers that this should be clarified in regulations relating to performance measures.

The NSW Farmers' Federation submission expressed concern about the security of mail left in roadside boxes:

*... downgrading of services may necessitate the placing of a mailbox kilometres away from the place of residence or work. Throughout New South Wales, this is an increasing phenomena, with mail boxes often located up to ten kilometres from the*

*homestead. This situation can create implications for security of mail ... (NSW Farmers' Federation, submission 31, p. 3).*

The Council notes that Australia Post offers postal users who collect mail from community bags the option of private or locked bags. With private bags, mail is sorted separately in a private bag from a community bag. Locked bags are lockable versions of private bags.

There is a charge in respect of private and locked bag services. If a resident wishes to obtain a private bag service, he or she must pay a charge of \$50 per year (or \$100 if he or she receives 4 or more services per week). Further, the resident must pay an additional annual charge of \$165 in order to obtain a locked bag service. This additional charge is waived if the resident receives less than two services a week.

The Industry Commission in 1992 recommended abolition of the private bag annual fee in all cases where households received less than three services a week, because this was part of the service of letter delivery, helped to improve the security of mail, and did not cost Australia Post significantly more (Industry Commission 1992, p. 57). The Council agrees with this view.

***Recommendation***

**The Council recommends that the annual fees in relation to private bags and locked bags should be abolished for all postal users receiving a delivery service less than three times a week.**

*Complaints handling*

One overall measure of service quality and reliability is the number of complaints received by Australia Post, and its responsiveness to these complaints.

Australia Post reports that its customer service centres received a total of 131 000 complaints during the 1996-97 financial year (Australia Post 1997a, p. 34). Unfortunately this figure is not disaggregated to enable identification of the number of complaints in relation to letter delivery. Some complaints would be about other services offered by Australia Post, such as giroPost services.

Australia Post reports that it annually surveys consumers, and its performance has lifted against a range of measures of customer satisfaction. In relation to the question “has [Australia Post] recently improved its overall performance”, 81 percent of customers agreed in 1996-97, 15 percent more than in 1991-92 (Australia Post 1997a, p. 34).

A number of complaints about Australia Post’s performance go to the Commonwealth Ombudsman. The Ombudsman has appointed a Senior Assistant Ombudsman to hear complaints about Australia Post. In the 1996-97 financial year, the Ombudsman’s office received 654 complaints about Australia Post, a rise of 27 percent from 1995-96. The Ombudsman’s Office investigated 44 percent of these complaints, resolving 78 percent of the complaints investigated in favour of the complainant (Commonwealth Ombudsman 1997, p. 213). The Ombudsman reported that new measures introduced in 1996-97 had “significantly reduced the number of complaints reaching our office for lost and damaged postal items” (Commonwealth Ombudsman 1997, p. 215).

Australia Post has attempted to put in place arrangements to resolve complaints expeditiously. While several submissions raised concerns as to Australia Post’s delivery performance, the Council notes that some groups have difficulty using existing complaints resolution arrangements. It is important that the service charter publicise information on Australia Post’s complaint handling mechanisms and the public’s right to complain to the Commonwealth Ombudsman’s Office.

### **6.4.3 Conclusions about Australia Post’s Performance in Delivery of Letters**

In general, it would appear that most postal users judge Australia Post’s performance as reasonable, although there are shortcomings in some areas.

To address these shortcomings, the Council considers that it is appropriate to make some broad recommendations about the areas in which change is required. It considers that these recommendations should be developed and implemented as performance standards by an independent postal regulator after consultation with Australia Post. The Council considers that the performance standards should have the following characteristics:

- they should be outcome-oriented;
- they should enable a postal user to understand his or her rights under them;

- they should be administered and monitored by the postal regulator;
- they should incorporate some flexibility, eg the regulator, after consultation with Australia Post and affected parties, should have the power to waive them in justifiable circumstances;
- the regulator should report annually to Government on Australia Post's performance against them;
- the regulator should report any instances of waiver; and
- Australia Post should publish annually its performance as assessed by the postal regulator.

The Council considers that more detailed service standards should be developed to cover the letter delivery USO. These standards should include measures which:

- allow more accurate monitoring of the standards for delivery service, including the distances that rural and remote users must travel to pick up and post mail from their place of residence or business; and
- assess standards for the speed of letter deliveries to, from, and between rural and remote areas.

The next section discusses the need for better definition of Australia Post's USOs and mechanisms for doing so.

## **6.5 Definition of the Letter Delivery USO**

A number of parties have suggested that the letter delivery USO should be better defined to ensure that Australia Post meets its obligations as envisaged under the Act.

Section 27 of the Act does not specify the obligations of Australia Post in great detail. Australia Post has the task of translating the USO into an operating policy, for example by determining what is meant by the term "reasonably accessible". In order to do so, Australia Post has adopted the policies noted above to determine the different levels of service that should be delivered in different regions of Australia. These policies are contained in internal Australia Post documentation: "operational

manuals, internal staff instructions and the like” (Australia Post, submission 8, p. 91). This raises the question of whether Australia Post should be controlling these decisions when the universal service is a Government commitment to the Australian community.

Australia Post argues that it is sufficiently accountable for the way in which it interprets the meaning of what is ‘reasonable’:

*Since 1989, Australia Post has been required to reach agreement with the Minister on the goals or performance targets, including service targets, and the strategies and policies for the fulfilment of the CSOs as part of the corporate planning process. Currently, Australia Post submits to the Minister every year, a corporate plan with a three year time horizon. ... under section 40 of the Act the Minister, if necessary, has the power to direct changes to the strategies and policies proposed in the corporate plan for the achievement of the CSOs (Australia Post Opening Submission to the Vaile Committee, p. 51).*

However, a number of submissions argued that Australia Post should not be given discretion to decide on what is reasonable. The Isolated Children’s Parents’ Association contended that:

*The term “reasonably accessible” is imprecise, ambiguous and capable of many interpretations. ICPA (Aust) would like to see as part of the Act a much more precise definition similar to the definition of the Standard Telephone Service (a view shared by the Industry Commission in its report also). ICPA (Aust) considers it essential that a charter for Australia Post be established setting out its obligations and responsibilities (ICPA, submission 17, p. 5).*

The Commonwealth Treasury expressed concern that Australia Post had considerable discretion to vary the standard of delivery services and affect the cost of delivery.

The confusion caused by the lack of understanding in the community about the nature of Australia Post’s USOs may lead in some cases to the non-delivery of services that Australia Post should be obliged to deliver. This may cause little complaint from customers because they are not aware that they have a right to expect a higher standard of service. If USOs were better defined then customers might feel confident to insist on the maintenance of a particular standard of service.

Another problem which arises when Australia Post is left to define the scope of the USOs it must deliver is the danger that it will concentrate on its commercial objectives at the expense of its USOs. It is clear that these objectives do conflict to some extent, since Australia Post can earn a greater profit if it provides a lower level of service. Australia Post has acknowledged this fine balance between commercial objectives and the USO:

*Sections 26, 27, and 28 of the Act impose concurrent commercial, general, governmental and community obligations on Post. Compliance with CSOs is therefore influenced by other obligations - in particular, Post's requirement to perform its functions, as far as practicable, in a manner consistent with sound commercial practice (section 26) (Australia Post 1996, p. 71).*

The question therefore arises whether it is reasonable to impose a requirement on Australia Post to internally balance the objectives of the USO against commercial goals.

The Bureau of Industry Economics (BIE) has highlighted problems associated with trying to balance commercial and social objectives within the one organisation. It contends that a requirement to balance competing commercial and non-commercial objectives may lead to a loss of efficiency and may reduce the quality of USOs delivered to consumers. During a general discussion about the reasons for the historically poor performance of government business enterprises, the BIE stated that loosely specified objectives were a factor:

*GBEs often had conflicting goals such as a requirement to act commercially while at the same time to deliver services below cost to certain users. Typically, GBEs were left to translate such broad government objectives into something at the operational level and to reconcile the conflicts that invariably existed (Bureau of Industry Economics 1995, p. 2).*

In the BIE's view, it is governments, rather than GBEs such as Australia Post, which should be required to reconcile (as far as practicable) conflicts between commercial and non-commercial objectives (BIE 1995, p. 3). The Council agrees with this view. It considers that the Act puts Australia Post in a difficult position by requiring

it to act commercially while at the same time determining the scope of its social responsibilities. The risk is that one or both goals will not be achieved.

The Council's view is supported by the recently released *Review of GBE Governance Arrangements* (the "Humphry Report"). This report examined the interrelationship between the operation of GBEs (including Australia Post) and the delivery of CSOs. The Humphry report considered that GBEs perform best when CSOs are explicitly defined, and the roles of the Government and the GBE are made clear. It considered that problems can arise when the GBE is left to interpret the CSO.

Finally, the Council notes that under Clause Four of the Competition Principles Agreement, the Commonwealth Government agreed to review the most effective means to separate regulatory functions from commercial functions in relation to reform of public monopolies. The interpretation of the USO is a regulatory function because it relates to how Australia Post should respond to its legislative charter. In keeping with the Competition Principles Agreement, it is appropriate to separate regulatory decisions about the interpretation of the USO from commercial objectives. Better definition of the letter delivery USO will reduce the scope for Australia Post to exercise a residual regulatory role in the interpretation of its USO responsibilities.

In summary, the Council considers that the USO functions of Australia Post should be better defined because this will:

- enable people to understand what they have a right to expect from Australia Post;
- give people some standard which they can point to if they are dissatisfied with the level of service they receive from Australia Post;
- be likely to improve the operating efficiency of Australia Post by clarifying its objectives. The Council considers that to effectively deliver postal services Australia Post needs a clear understanding of what the Government expects of it; and
- comply with the spirit of the Competition Principles Agreement for the separation of regulation from commercial operations.

The next question that arises is how the letter delivery USO should be defined.

### **6.5.1 Possible Ways of Defining the Letter Delivery USO**

The Council considers that the mechanisms for defining Australia Post's obligations need to be:



- flexible enough to take account of Australia Post’s broad range of customers and to adapt to changing needs;
- open to community input; and
- sufficiently clear to provide reasonable certainty.

As noted above, until now Australia Post has clarified the USO in operational manuals and internal guidelines. Under section 36, Australia Post is required to seek approval annually from the Minister for Communications and the Arts for the broad strategies and policies behind these guidelines, and the Minister has power to require Australia Post to vary the broad strategies.

The problem with this approach is that the Minister is not required to call for views from the public when considering whether to require Australia Post to vary its plans on how to deliver USOs. Further, there is little formal monitoring of whether Australia Post meets the guidelines. Another problem is that measures chosen to indicate whether the USO is being delivered efficiently and effectively may not always be fully informative or appropriate.

Two current developments are relevant to the definition of the letter delivery USO. First, Australia Post is developing a service charter in consultation with interested parties to explain its USO responsibilities to the community. Second, the Department of Communications and the Arts is in the first stages of drafting regulations under section 28C to more explicitly define some of the matters to be covered under the service charter. Section 28C provides that the Commonwealth Government may make regulations, called “prescribed performance standards”, covering the frequency, speed, and accuracy of mail delivery, and the availability and accessibility of both posting points and post offices, which, under section 28D, the Auditor-General is required to audit and report on. One difference between the regulations and the service charter is that the regulations will be enforceable while the service charter will not.

The Council’s Options Paper raised a number of ways of defining the letter delivery USO. Feedback indicated, however, that most approaches did not meet the objectives of being flexible, open, and clear.

For example, defining the USO more precisely in legislation is unlikely to be flexible. The USO needs to be reasonably flexible to respond to changes in population, and the needs of the community. It would be difficult to define these matters precisely in legislation. Further, it would be difficult to change the legislation when circumstances required.

Similarly, the suggestion to permit local area managers to administer the delivery of USO standards within particular areas is unlikely to provide sufficient certainty. It could result in wide variations between standards of service in different regions.

The approach that received the most support was to continue with the current developments by defining the letter delivery USO under a service charter in conjunction with overarching regulation under section 28C.

This raises two issues:

- whether the service charter is sufficient to define the USO, and regulation under section 28C is unnecessary; and
- if regulation under section 28C is considered necessary, the appropriate relationship between the service charter and the regulations.

The NSW Farmers' Federation considered that:

*to ensure adherence to them, standards should be included in Regulations under section 28C of the Postal Corporation Act. Regulations may then be amended as necessary (NSW Farmers' Federation, submission 124, p. 2).*

At the workshop convened to discuss Australia Post's USOs, there was support for the view that it was important for the regulations to include all the performance standards, rather than leaving some of them to be defined in the service charter. According to this view, the regulations should deal with all the matters necessary to define Australia Post's obligations, while the service charter presents these obligations in a clear and concise way to the public.

According to Australia Post, the service charter it is currently developing in consultation with the community:

*... is designed to communicate clearly and simply the main standards and services the community is entitled to expect from Australia Post, the steps that can be taken if those expectations are not met, and sources of information and avenues of redress. The Charter will also briefly outline what customers can do to help Australia Post deliver such services. (Australia Post, submission 8, p. 92).*

It would appear that Australia Post does not intend the service charter to precisely define the USO. The current charter seems to be more a vehicle for, in a general way, describing the legitimate rights and expectations of consumers. As such, it is clear that the service charter is intended to complement rather than replace regulation under section 28C.

The Council concludes that the letter delivery USO is best defined under regulations under section 28C, complemented by a service charter which presents a public or ‘user-friendly’ face to the regulations.

The next question is what should be included in regulation under section 28C. As it presently stands, section 28C confers on the Government a broad power to make regulations covering Australia Post’s performance standards into relation to:

- frequency, speed, and accuracy of mail delivery; and
- the availability or accessibility of post boxes or other mail lodgment points and post offices.

Under section 28D, the Auditor-General is given responsibility for monitoring and reporting to Government on Australia Post’s performance against these standards.

According to the Department of Communications and the Arts, the present draft of regulations under section 28C largely codify Australia Post’s internal operating guidelines. The regulations are intended to consist of two types: high level and broad regulations relating generally to standards, and more specific regulations that may be changed from time to time that cover specific areas of performance.

The Council considers that the regulations should cover all of the matters stipulated under section 27 in relation to the letter delivery USO, that is access, price, and performance. More specifically, the regulations should cover matters such as access to stamps and posting points; speed; frequency; reliability; and security of letter delivery. The service charter should explain in clear terms Australia Post’s obligations under the regulations, including clear guidelines on how to complain about its performance in relation to delivery of letters.

The Council considers that a postal regulator should play an on-going role in monitoring the effectiveness of the regulations, and identifying any changes which may be necessary. In this way, the regulations can maintain the necessary flexibility and responsiveness to community expectations about Australia Post’s performance in delivery of letters. The Council considers that the final draft of the service charter

should be approved by a postal regulator to ensure that it properly conveys Australia Post's obligations under the regulations. The Council notes that these views are generally in accordance with those of the Vaile Committee.

### ***Recommendation***

**The Council recommends that the regulations being developed under section 28C cover all aspects of Australia Post's letter delivery USO. The regulations should be developed jointly by the postal regulator and the Department of Communications and the Arts.**

**The Council considers that the role of the service charter should be to make Australia Post's obligations under the regulations clear to the public.**

**The Council recommends that a postal regulator should monitor and report to Government on Australia Post's performance against the regulations, and recommend amendment as necessary. Australia Post should publish its performance against these measures annually.**

## **6.6 What USOs Should Australia Post Provide?**

There is some confusion in the community about the USOs that Australia Post should provide. In meetings with the Council and in submissions, organisations raised a number of examples of services which they thought Australia Post should be obliged to provide (or, in some cases, mistakenly thought Australia Post was already obliged to provide). This section examines whether Australia Post should be required to provide other universal services in addition to letter delivery.

A number of submissions argued that services such as banking and parcel delivery were extremely important to people in rural and remote areas. They suggested that Australia Post's rural and remote network could provide the means to deliver these services.

In its first submission to the Council, Australia Post argued that the community's expectations extended to:

- *preservation in postal use, and restoration, of general post offices, and other post offices which have local historic significance;*

- *provision of a parcel delivery service Australia-wide; and*
- *provision of access, preferably through a retail outlet, to services such as full postage assessment (for example, for domestic and international mail); bill payments; banking; money orders; passports; stationery; packaging etc. (Australia Post, submission 8, p. 90)*

The preservation of heritage post offices is more in the nature of a CSO than a USO, and is therefore considered in Chapter Seven.

On the basis of the above submissions, this Chapter now considers the need for, and feasibility of, the following additional USOs:

- a requirement to provide financial services in all post offices;
- a requirement to deliver parcels Australia-wide; and
- a requirement to keep post offices open.

### **6.6.1 Financial Services USO**

Chapter Two noted the trend towards the closure of bank branches in rural and remote areas, which deprived country people of easy access to a number of banking services, such as withdrawal and transfer of funds. It argued that to some extent, financial services offered by Australia Post have helped to fill the void left by the closure of these branches. As outlined in Chapter Three, Australia Post offers a number of financial and banking services through its post office network, including money orders, bill-payment, and giroPost.

Australia Post has commercial incentives to offer financial services at most post offices, and generally has rolled out these services throughout its post office and agency network. However, in some rural and remote areas, electronic financial service are not offered because there are too few transactions to make them economic. At present, only about half of all LPOs provide electronic banking services; the remainder only offer manual banking services. As a rule, the community postal agencies do not provide any form of banking services. Australia Post estimates that a post office would need to process 210 transactions per week or 11 000 transactions per year to support electronic banking facilities (Vaile Report 1996, p. 69).

The National Farmers' Federation has described the value of Australia Post's role in the provision of banking services to rural people:

*Australia Post is another significant player, although the range of services it offers is considerably more limited than that offered through branch outlets [for example, not loan service]. ... There are over 2300 Australia Post retail outlets in rural and remote areas and, by extrapolation from statistics provided, between 1300 and 1400 of them have giroPost services (Australia Post 1996). Australia Post advised NFF that there is a giroPost outlet within five kilometres of 72 percent of country and 60 percent of remote households (NFF 1997, p. 48).*

As the Local Government and Shires Associations of NSW submission indicated:

*... the availability of these services is becoming increasingly important to these [rural and remote] communities and Australia Post's decision [to roll out financial services in some post offices] has been welcomed (Local Government and Shires Association of NSW, submission 47, p. 4).*

and the NSW Farmers' Association submission noted:

*Consumers in general tend now to rely more heavily on the Post Office to conduct transactions through giroPost such as the payment of bills (NSW Farmers' Federation, submission 39, p. 3).*

The Post Office Agents Association Limited argued that:

*... all LPOs should be provided with electronic counter services, including EFTPOS, by Australia Post. The provision of this service could be classified as a CSO due to the reduction or elimination of other services in these small communities, eg removal of shire sub-office, closure of bank branch, closure of police station, closure of electricity sub-office (POAAL, submission 84, p. 19).*

On the other hand, Australia Post did not consider that the demand for a access to financial services in rural and remote areas was overwhelming. In its submission to the Vaile Committee, Australia Post argued that the level of unmet demand in rural and remote Australia was low. To support this argument, it cited figures on the

volume of transactions at licensed post offices. It claimed that of the 1400 LPOs not connected to an electronic point of sale system, 435 did no banking transactions, 564 did between 1 and 500 per year, and the remainder did between 500 and 1000 transactions per year (Vaile Report, p. 68-69). It also pointed to the significant costs of upgrading some LPOs to provide electronic banking services. It estimated that the capital costs of upgrading the services at LPOs from manual to electronic would be \$19.1 million, with on-going annual costs of \$9 million. The capital cost of upgrading CPAs to LPOs (presuming a significant proportion of these costs would relate to the provision of new banking services) would be \$7.5 million, with an on-going annual cost of \$4.5 million. Australia Post considered that it would have to meet almost all of these costs, as the off-setting revenue from additional transactions would be low (Australia Post submission to Vaile Committee, submission 218, p. 814).

On balance, the Council accepts that the delivery of financial services in rural and remote areas is important, and that Australia Post's network is one way that some of these services can be offered in regional Australia. The question for the Council is whether such an obligation should be introduced *as the responsibility of Australia Post*.

#### *Possible implementation of a Financial Services USO*

As noted above, some submissions argued that it was important for financial services to be available through Australia Post, both in order to make such services readily accessible to rural and remote residents, and to make such services more widely available in metropolitan areas. However, other submissions noted difficulties in imposing this obligation on Australia Post.

A submission from the Regional Financial Services Taskforce in the Ministry of Fair Trading, WA, raised a number of potential barriers to the introduction of a financial services USO:

*The taskforce would like to see possible federal government intervention to try and convince the major five banks to accept giroPost as a substitute agency in regional communities...*

*Presently the major banks [apart from the Commonwealth Bank of Australia] are reluctant to come on board to the giroPost network and only want selected localities which would be a waste of resources for Australia Post who want all giroPost locations*

*to have access to all banks similar to that which already exists for financial institutions on the giroPost network...*

*The future expansion of the giroPost network is limited by poor telecommunication exchanges in certain country locations. These exchanges are analogue based and are capable of only taking data traffic at 14.4 kp, which is the minimum facsimile data speed. Because of the speed of software and the fast processing requirements of giroPost and other agencies there is a need to handle data traffic at speeds of 28.8 kp and above, the maximum speed currently available is 57.5 kp with the industry standard moving from 28.8 kp to 33.6 kp (Regional Services Taskforce, Ministry of Fair Trading, WA, submission 32, pp. 1-2).*

It may be possible that some of the major banks are reluctant to participate in the giroPost scheme because:

- they would only wish to participate in giroPost in rural and remote areas; and
- Australia Post is not prepared to open giroPost services just in rural and remote areas because it wishes to offer a uniform range of services in all post offices where such services can be commercially justifiable. Australia Post considers that customers would come to expect that such services would be offered in metropolitan areas if they were offered in rural and remote areas.

Australia Post expressed concern in meetings with the Council that the introduction of a financial services USO would decrease its bargaining power with banks and other financial institutions. It argued during the USO workshop that banks could force it to accept lower agency charges for their services if they knew that Australia Post was obliged by Government to offer such services. The Council accepts that this is a significant concern.

Another consideration is whether it is reasonable to impose a financial services USO on Australia Post when Australia Post has only ever acted as an agent for the provision of financial services, and has little institutional experience in the financial services market. A financial services USO would require Australia Post to offer services outside its core business. The Council considers that there is little rationale for imposing a financial services requirement on Australia Post considering it only occupies an agency role.



The House of Representatives financial institutions and public administration committee, chaired by Mr David Hawker MP, is currently conducting a review (the Hawker review) of access to financial services in rural and remote areas. This inquiry is an appropriate forum for examining whether there should be an obligation to provide access to financial services in rural and remote areas. However, the Council considers that any such obligation should not be part of Australia Post's USO and that if Australia Post is contracted to deliver these services then it should be compensated for its costs of delivery. The Council considers that any such CSO should not be funded from profits raised through higher charges on the postal industry, which could reduce the affordability of postal services and lead to lower use of the postal network.

The Council considers that a financial services USO should not be part of Australia Post's obligations.

### 6.6.2 Parcel Delivery USO

Currently, Australia Post does not have a specific obligation to deliver parcels throughout Australia. It offers this service on a commercial basis, and charges a sliding scale of cost for parcel delivery depending on the weight, size, and destination of the parcel rather than a uniform rate. Parcels posted to remote areas cost significantly more. Some submissions advocated a Parcel Delivery USO under which Australia Post would bear an obligation to deliver parcels anywhere in Australia, perhaps with a concurrent obligation to charge a uniform price.

A submission by the NSW Farmers Federation supported the creation of a broadly based Parcel Delivery USO. It observed that:

*... on most other services [besides letter delivery], postal charges in Australia are very high by world standards (submission 31, p. 4).*

The submission from Reader's Digest also supported a Parcel Delivery USO, arguing that there was currently little competition in the market for delivery of parcels from businesses to consumers. It argued that, "to introduce a parcel CSO would appear to have benefits for the rural sender or receiver" but added that, "[t]he make up of a parcel CSO would need to be clearly defined" (Reader's Digest, submission 116, p. 2).

On the other hand, some submissions expressed concern that a Parcel Delivery USO would impair competition in the parcel delivery market. The parcel market is

currently fully open to competition. It might be that a Parcel Delivery USO would amount to favouring Australia Post because it would receive funding to carry some parcels, while funding might not go to competitors.

SALMAT, a major mailing house, expressed concern about the prospect of a Parcel Delivery USO. It considered that a parcel delivery CSO would distort the market in a similar to that in which the letter delivery USO distorts the letter market (SALMAT, submission 118, p. 9). Similarly, Mayne Nickless considered that:

*the CSO should be limited to letters. Private suppliers are active in the provision of other services and the inclusion of additional CSOs would raise further funding and competition issues (Mayne Nickless, submission 120, p. 20).*

All competitors in the parcel delivery market cross-subsidise their operations to some extent. They attract extra business by offering some parcel deliveries on a loss-making basis. If Australia Post were funded for all loss-making deliveries, it may have a significant advantage over competitors. Australia Post may also gain an advantage from using the existing letter delivery network to deliver parcels. This will allow it to spread its costs over a wider base.

Further, while the Council recognises the importance of parcel services in rural and remote areas it considers that the existing letter delivery network is adequate to meet the needs of these regions for parcel delivery. The Council considers that the letter delivery USO sustains a rural and remote delivery network which in turn enables the delivery of parcels. The National Farmers' Federation provides support for this view:

*It is important to note that in order to meet these [letter delivery] obligations, Australia Post must maintain an extensive infrastructure network which in turn allows it to provide a range of additional services such as bill paying and banking services (NFF, submission 126, p. 2).*

The Vaile Committee also recognised that the network created to deliver letters facilitated the delivery of parcels:

*The committee supports the need for a minimum weekly delivery service so as to effectively supply education and health materials in rural and remote areas. At this stage, the need to extend*

*Australia Post's community service obligations (CSOs) to include health and education materials is not supported. ... The minimum postal requirement to ensure effective supply of educational and health materials is a weekly service (Vaile Report 1996, p. 47).*

At the USO workshop organised by the Council to discuss the Parcel Delivery USO, this view was strongly supported.

The Council concludes that the existing letter delivery network adequately meets the requirements for the delivery of parcels. On this basis, there is little justification for an additional USO and additional funding in relation to delivery of parcels. Further, the Council is concerned that a Parcel Delivery USO could undermine existing competition in the parcel delivery market by favouring Australia Post over competitors.

#### *Health and Educational Materials*

A number of submissions that did not support a general Parcel Delivery USO nonetheless supported a USO related to the carriage of health and educational materials.

The Isolated Children's Parents' Association and the School of Isolated and Distance Education in Western Australia indicated support for a USO relating to delivery of educational materials, arguing that present rates were very high. The NFF in their publication, *Trends in Delivery of Rural Health, Education and Banking Services*, advocated a USO relating to delivery of both health and educational materials.

In its submission to the Vaile Committee, Australia Post opposed the creation of a USO relating to health and education materials. It considered that the parcel delivery service would become 'content based', requiring it to verify the contents of parcels in order to assess eligibility for the discounted rate, and possibly encouraging senders to engage in deceptive behaviour (cited in Vaile Report, 1996, p. 45). The Council considers that this fear is exaggerated. It would be possible for particular specially marked parcels to be used for these services. Similar arrangements already exist in relation to materials for the blind posted through the mail.

However, the broader question remains of whether it is appropriate that specialist parcel services should be part of an obligation carried by Australia Post. The Council considers that if such a USO were created, the costs should be paid by the relevant Education or Health Department rather than all postal users. This is because not all

postal users stand to benefit from a Parcel Delivery USO restricted to educational and health materials.

Further, the costs associated with the carriage of educational and health materials is only one issue in terms of Governments' consideration of how best to deliver these services. It may be that a subsidy in relation to health and educational materials may constrain the most efficient way of delivering the total package of educational and health services. Introduction of a specialist USO would reduce the flexibility to provide health and educational services in the most efficient and effective manner. It would be more appropriate for State and Territory Governments to balance these conflicting priorities when they are deciding on the best way to provide services.

The Council does not support the introduction of a Parcel Delivery USO, or a USO relating to delivery of educational and health materials.

### **6.6.3 Post Office USO**

A number of submissions raised the issue of post office accessibility. The Consumer Affairs Division of the Department of Industry, Science, and Tourism (DIST), in discussions with the Council, said that some people had to drive up to 200 kilometres to reach post offices. The submission by the Aboriginal and Torres Strait Islanders' Commission (ATSIC) to the Vaile Committee referred to round-trips, on outback roads, of up to 1 400 kilometres (ATSIC, submission 186 to Vaile Committee, p. 4). As noted above, in rural and remote areas the average distance from the nearest post office increased in 1997.

Under the letter delivery USO, Australia Post is required to provide a letter service that is reasonably accessible to the community. However, this does not mean that Australia Post must provide the community with reasonable accessibility to post offices. Instead, the commitment is measured in terms of accessibility to stamps and to a posting point. These two facilities may be provided in a variety of ways. For example, in remote areas, postal deliverers sell stamps on their rounds and accept mail from community bags and other delivery points. On this basis, it can be concluded that the letter delivery USO does not require Australia Post to provide access to the general services provided by post offices.

Post Office services include financial services, parcel assessment (calculating the price of postage of parcels), and retail services (for example, stationery). Many of

the submissions argued that post offices were important to the economy of rural and remote areas. They suggested that maintenance of a network of post offices should be a significant USO.

There are international parallels for a post office USO. For example, the Council notes that the New Zealand Government has negotiated a Deed of Understanding with NZ Post under which NZ Post will agree to maintain its current post office network unless there is a significant change of population or other strong reasons to close a post office. Canada has announced a moratorium on post office closures (Vaile Report 1996, pp. 58-60). Under section 1 of the Swedish Postal Services Act, Sweden Post is required to maintain “nation-wide counter services enabling everyone to effect and receive payments at uniform prices” (NERA 1997a, p. 77).

Post offices offer varying levels and ranges of services, depending on their type. The different types of post offices, and the services they offer, are referred to in Chapter Eleven.

The Post Office Agents’ Association Limited (POAAL) also argued that country post offices provide a range of services beyond traditional mail functions. These included “witnessing documents, [being a] contact point for various community activities such as Meals on Wheels, Red Cross, Health Visitors; Justice of the Peace or Commissioner for Declarations; often office bearer ...”. Their submission also stated that the “post office is often the hub of the community - sometimes the only business apart from residences in the area” (POAAL, submission 84, p. 5).

Australia Post is aware of the importance of access to post offices and has introduced measures to take account of the accessibility of post offices to rural and remote communities. As noted earlier, it measures the distance of people in metropolitan, rural, and remote areas from post offices. Further, it provides “top-up” payments to LPOs in rural and remote areas that would not otherwise remain viable. As the Licensed Post Office Agents Limited submission noted, this top-up payment is important to the continued existence of these predominantly rural LPOs:

*... there are 700 LPOs receiving the top-up payment at an average of over \$7000 each. (ref: Australia Post opening submission to NCC, para 7.13) ... We would anticipate that there has been a substantial decrease in top-up payments as many rural LPOs have changed hands during this period of time and many LPOs have been converted to CPAs and/or CMAs. ... The top-up payment ceases once an LPO is sold, unless it is sold*

*to certain family members of the LPO.... If this top-up payment were to be removed and not replaced with some other of payment hundreds of rural LPOs would be forced to close down ... (LPOAL, submission 88, p. 26, order of sentences rearranged).*

It would seem that the top-up payments will disappear over time as LPOs are sold. It could be expected that in time the LPOs which depend on a top-up payment will be downgraded to CPAs or will possibly disappear if the loss of the top-up payment affects their viability.

There are a number of arguments against introducing a Post Office USO, in particular:

- it could be very expensive to maintain post offices, particularly full service post offices, in some rural and remote locations;
- there is a lack of demand for such services. If demand was significant then the post office would be viable; and
- a Post Office USO may be too inflexible to keep pace with population shifts and changes in consumer needs.

Underpinning the arguments against the introduction of a Post Office USO is the point that it makes little sense to require Australia Post to bear such a USO without specifying the particular services that post offices would be required to offer. On this basis, a better approach is to specify the particular postal services that should be provided in rural and remote areas, and permit Australia Post commercial freedom to assess the most efficient way to provide them.

The Council considers that the primary function behind Australia Post's presence in rural and remote areas should be to provide services that underpin the letter delivery USO. These services are stamp sales, postal assessment, and a point for collection and delivery of mail. As stated above, it is clear that these functions do not necessarily require a stand-alone post office. The Council considers that the service charter and related regulations under section 28C should include appropriate minimum standards of access to stamp sales, postal assessment, and the postal network. Specification of these standards is likely to result in the maintenance of Post Offices where they are the best way of delivering the services.

The Council considers that a post office USO is not justified.

## 6.7 Regulatory Mechanisms to Monitor USO Performance

A number of regulatory functions have been identified in this Chapter. These include:

- monitoring Australia Post’s performance in delivering letters;
- better defining the scope of the letter delivery USO by administering regulations issued under section 28C; and
- handling complaints that cannot be resolved satisfactorily by Australia Post.

Chapter Seven also raises a number of related regulatory functions, including some independent assessment of the cost of the CSO, and administering the system of CSO funding. Other Chapters also refer to regulatory functions.

The Council considers that it is appropriate for these regulatory tasks to be performed by an entity other than Australia Post. In signing the Competition Principles Agreement, Governments agreed, among other matters, to the separation of operational and regulatory functions of a public monopoly wherever they intend to introduce competition to a market traditionally supplied by that monopoly.

There is significant support, particularly among rural groups, for assigning regulatory oversight of the letter delivery USO to a body such as the Australian Communications Authority. For example, the Isolated Children’s Parents’ Association (Australia) argued that there is “a requirement for a watchdog to overview [Australia Post’s] performance and whom consumers can approach when they feel performance standards are not being maintained” (ICPA, submission 93, p. 3).

Cowra Shire Council argued that:

*We are concerned that currently monitoring of service standards and dealing with complaints are performed by Australia Post. Whether there are other service providers or not, but most importantly if there are, an independent monitoring authority or ombudsman is essential. ... This is extremely important in dealing with such issues as complaints about mail losses (Cowra Shire Council, submission 94, p. 2).*

The Council accepts the need for regulatory institutions with the functions listed above. The creation of a regulator can be justified on three grounds: to justify expenditure of public moneys on CSOs (that is, to ensure that governments gets value for moneys); to prevent unfair competition; and to ensure the delivery of services, particularly in rural and remote areas where there is little competition from other companies to provide such services.

Chapter Nine considers the most appropriate regulatory arrangements for overseeing the effective provision of the letter delivery USO.



# Chapter Seven: Community Service Obligations

*Chapter Six discussed Australia Post's obligation to deliver letters almost anywhere in Australia. If Australia Post was released from this responsibility, it might choose not to deliver some letters (eg between remote locations) unless it could charge considerably more than the uniform rate. By delivering these letters at the uniform rate in accordance with the Government's direction, it is performing a Community Service Obligation (CSO); that is, it is providing a service which a private company would not normally elect to provide. The size of the CSO relates to the number of letters that cost more than the uniform rate to deliver.*

*Currently, Australia Post funds the CSO out of the profits earned on parts of the network where letter delivery costs less than the uniform rate (eg between inner city addresses). Other companies are not permitted to deliver letters because of the concern that they would undermine Australia Post's profitability, leaving it without profits to fund the CSO. For this reason, Australia Post opposes open competition in letter delivery.*

*This Chapter analyses the nature and cost of the letter delivery CSO. It then considers whether it is feasible to open up competition in letter delivery in a way which is compatible with maintenance of the CSO.*

Under section 27 of the *Australian Postal Corporation Act 1989*, Australia Post is required to deliver letters at a uniform charge to almost anywhere in Australia. Without the Universal Service Obligation imposed under section 27, Australia Post would almost certainly want to charge more than the uniform rate to deliver some letters. For example, a private company would probably charge much more than 45 cents to deliver a letter from Thargomindah in Queensland to Fitzroy Crossing in Western Australia. Australia Post satisfies a Community Service Obligation where it only charges the uniform rate for those deliveries in circumstances where a private

company would charge more or not deliver a service at all. The measure of the CSO is the difference between the uniform rate and the commercial rate that a private company would charge for these deliveries. Box 7.1 defines the term ‘CSO’ and elaborates on how Australia Post’s Universal Service Obligation gives rise to a CSO.

It is clear that the Australian community supports the retention of Community Service Obligations in relation to delivery of letters. As Chapter Six made clear, the letter delivery USO promotes the delivery of letters throughout Australia at a uniform rate, thus providing people of all backgrounds with equitable and affordable access to the postal network. The CSO arising from this USO also serves Australia’s regional development and business needs. The Council considers that the letter delivery CSO should be preserved, and that reform should be introduced in a way which is compatible with the preservation of the CSO so it does not undermine service standards or destabilise the uniform rate of postage.

## **7.1 The Nature of Australia Post’s CSO**

To assist Australia Post to fund the provision of its CSO, the Commonwealth Government has effectively forbidden parties from competing with it in some letter delivery services. As discussed in Chapter Four, these services are known as “reserved services”.

The reservation of letter delivery allows Australia Post to average costs of delivery across all delivery points. The profits generated from delivering letters on routes where the costs are lower than the uniform rate subsidise the losses sustained delivering letters on the routes where costs exceed the uniform rate. This method of using profits to fund CSOs is known as cross-subsidisation. Australia Post maintains that cross-subsidisation is the best method for funding CSOs. It is concerned about open competition in the letter delivery market because it argues that other corporations would only operate on the profitable routes, leaving Australia Post to deliver letters on the loss-making routes, and undermining the profits Australia Post uses to fund the CSO. The practice of only operating on the profitable routes of the postal network is known as cream-skimming, and is discussed further in Chapter Eight.

The question arises whether the cross-subsidisation funding arrangements are the only acceptable method of funding CSOs given that they involve substantial restrictions on competition. The cross-subsidisation arrangements prevent other organisations from competing in the market for the delivery of standard letters. This results in some postal users (those sending letters on the low-cost routes) being charged much

**Box 7.1** *Definition of a Community Service Obligation*

*A community service obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices (Steering Committee on National Performance Monitoring of Government Trading Enterprises 1994, p. xi).*

With only minor modifications, the above definition of a CSO has been accepted by the Commonwealth Government as an appropriate definition of a CSO (Industry Commission 1997).

The first element of the definition is that the GBE would not elect to perform the activity on a commercial basis or it would only perform it at a higher price than it is permitted to charge. This is because the activity is uncommercial or unprofitable at the current price. However, CSO activities do not include voluntary loss-making activities such as donations to charity, sponsorship, or other ‘good corporate citizenship’ activities.

Sometimes, corporations engage in loss-making activities because it is worthwhile to do so in order to expand the business (for example, offering loss-making products which entice consumers to buy other, more profitable products from the same business). Such activities are not CSOs.

The second element of the definition is that government directives are not CSOs if the directives also apply to private companies. For example, the costs incurred by Australia Post in complying with the Government’s requirements under the Corporations law are not CSOs because all corporations in Australia have to comply with it.

The requirement under section 27 to deliver letters almost anywhere in Australia for a uniform rate of 45 cents gives rise to a CSO in relation to some letter deliveries. As section 27 applies only to Australia Post, it meets the second element of the definition. However, letter delivery only meets the first element of the definition in relation to letters that Australia Post would not want to deliver for 45 cents. Therefore a CSO arises in relation to letters that: (1) cost more than 45 cents to deliver; and (2) that Australia Post would not be willing to make a loss on to encourage greater use of its postal system.

Source: Adapted from Bureau of Industry Economics 1995, p. 4

higher prices, prevents other providers from entering the market with innovative or different types of postal services, and decreases the pressure on Australia Post to seek greater efficiencies or pass on cost savings to postal users. These concerns are the basis for examining whether it is possible to open up the market for the delivery of letters while maintaining the CSO. If another method for funding the CSO could be found, then it might be possible to open up part or all of the letter delivery market to competition.

This chapter investigates the issue of whether further competition in the letter delivery market is possible by examining two questions.

- Can the letter delivery (and other) CSOs be funded in a way which protects the principle of universal delivery at a uniform price while enabling competition in the market for delivery of letters?; and
- What would be the effect of using other funding mechanisms?

This chapter considers these questions by:

- examining the cost of Australia Post's CSO to determine what implications this has for the appropriate funding mechanism for CSOs;
- examining the problems with cross-subsidisation and possible alternative funding arrangements; and
- discussing the most effective method for providing CSOs.

## 7.2 Cost of Providing the Letter Delivery CSO

In the 1996-97 financial year, Australia Post continued its trend of making significant profits out of its operations in the letter delivery market. It incurred CSO costs of \$67 million, and made a profit (after provision of CSOs) of \$120.2 million (Australia Post 1997a, p. 79 and p. 83).

There are a number of popular misconceptions about the nature and cost of the letter delivery CSO. These perceptions have the potential to influence beliefs about the appropriate funding arrangements. Some inaccurate perceptions are:

- *deliveries in rural and remote areas are the only loss-making element of the letter delivery service.* In 1996-97 the cost of providing letter delivery to, from, and within rural and remote areas contributed just over one third of total CSO costs (ie. \$25 million). The remainder related to delivery within Australia of incoming

international letters, and of mail delivered between metropolitan locations;

- *there are enormous costs involved in provision of letter delivery to rural and remote areas.* Twenty-nine percent of the population lives in rural and remote areas, about 5 220 000 people. If the letter service to these people makes an aggregate loss of \$25 million, then the loss per person is less than \$4.80 a year, the price of 11 letters. To put this cost in perspective, in 1996-97 over 4.2 billion letters and other articles were carried by Australia Post, an average of about 233 articles for each person in Australia. A significant part of the reason why rural and remote letter delivery only contributed to a third of the CSO cost is because delivery service standards are lower - there are less deliveries and delivery times are longer;
- *the beneficiary of the CSO is the recipient of the letter.* Both the recipient and the sender of the letter share the benefits of the CSO. This is because both parties benefit from being able to communicate by post;
- *CSOs are a large portion of Australia Post's total revenue and any expansion in CSOs would threaten Australia Post's viability/profitability.* In 1996-97, CSO costs amounted to only 4.2 percent of the revenue from letter delivery. Australia Post's profit in letter delivery services - after incurring CSO costs - was almost twice CSO costs; and
- *CSOs in a country with the population dispersal of Australia are very high.* Australia is one of the most urbanised countries in the world and most mail is intra-city. Therefore, most mail is carried on highly profitable city mail paths. Although the small population in rural and remote areas means that costs of delivery to rural and remote addresses can be high, it also means that relatively lower volumes of mail are carried. As a result, high costs are sustained on only a small percentage of mail.

As a starting point, the Council considers that it is important to recognise that the CSO represents a small part of the market. This does *not* mean that the CSO is unimportant; rather it means that the CSO is a sufficiently small part of Australia Post's letter delivery operations that it is feasible to examine other methods of funding besides cross-subsidisation.

The next section discusses how the CSO costs are arrived at, and the Council's views on the methodology used by Australia Post.

### 7.2.1 Australia Post's Costing Methodology

In accordance with government direction, Australia Post calculates the size of the letter delivery CSO using *the avoidable cost* methodology. The avoidable cost methodology counts costs as CSOs if Australia Post would not have incurred these costs if it did not have to provide the unprofitable components of the letter delivery service. The following description of the methodology is drawn from Australia Post documentation (Australia Post, submission 8, p. 92, and Australia Post 1992, p. 76).

Under the methodology, the cost of a CSO is the *net* cost that could be avoided *over the longer term* if the service was not supplied. The net cost is the cost avoided less the revenue earned on the service (the revenue should be less than the cost avoided if the service is to be a CSO). Box 7.2 provides a sample calculation.

#### Box 7.2 *Avoidable Cost - An Example*

Suppose:

- (a) Australia Post incurs costs of \$1 000 in providing a particular service;
- (b) the service is unprofitable because it only earns \$500 revenue;
- (c) if the service was discontinued, Australia Post would still incur an unavoidable cost of \$200 providing other services (which are profitable) and which require use of the same infrastructure (for example, the same mail van that provides the particular service would still be required to deliver mail in other areas);<sup>1</sup>

On the avoidable cost methodology, the CSO cost for this service is \$1 000 - \$200 - \$500, or \$300.

Australia Post argues that the avoidable cost methodology underestimates the true costs of providing the CSO. It argues that CSO costs should be measured using a methodology based on fully *distributed costs* or *stand alone* costs. Fully distributed costs measure the variable cost of an activity (in this case, delivery of unprofitable

<sup>1</sup> These 'unavoidable' costs must be deducted from CSO calculation because they will be incurred regardless of whether the CSO is supplied.

letters) plus a proportion of the fixed costs which are not directly attributable to any particular activity. Stand alone costs measure the costs as if the activity was provided in isolation from other activities.

The problem with using the fully distributed cost methodology or the stand alone cost methodology to calculate CSO costs in the postal industry is that they include a number of costs that Australia Post would have incurred even if it was not required to deliver the CSO. These costs relate to fixed infrastructure that is required in the delivery of both profitable and unprofitable letters, for example sorting machines, post offices, post boxes, and trucks involved in bulk transport of mail. Under the stand alone cost methodology, the profitable and unprofitable mail would be divided into two streams, and Australia Post would include in the CSO all the costs involved in delivering the unprofitable letters as though it had to set up separate, stand alone facilities to deliver those letters. Box 7.3 illustrates how these methodologies can overstate the costs of the CSO.

*Box 7.3 Treatment of CSO costs*

Suppose Australia Post sets up a sorting facility which sorts 1 million letters a day. Also assume that of these 1 million letters, 40 000 letters are unprofitable because after sorting they are delivered to remote destinations. Australia Post would need to make the same investment in the sorting facility even if it was not obliged to deliver the 40 000 unprofitable letters because a sorting facility capable of sorting the 960 000 profitable letters a day would cost the same amount to set up and operate. However, under the *fully distributed cost* methodology 4 percent of the costs of the sorting facility (40 000 over 1 million) would be included in the cost of the CSO. Under the *stand alone* methodology, the costs of constructing and operating a sorting facility capable of handling 40 000 letters a day would be included in the costs of the CSO.

The Council considers that the avoidable cost methodology is preferable to these other methodologies for calculating CSO costs. The Council notes that in network industries such as postal networks there is no method of calculating CSO costs that is totally unambiguous, and not therefore subject to some potential for discretion and arbitrary cost allocation. However, it considers that the avoidable cost methodology is a more accurate measure of costs because it does not include costs that Australia Post would still have to meet even if it was only interested in making a profit.

Australia Post's measurement of avoidable cost consists of three elements:

- mail path costs (the end-to-end costs arising from the following activities in relation to letters: acceptance; posted-processing; through-processing; transport; delivery processing; and delivery);
- local costs (including, for example, local overheads, accommodation costs and the cost of capital used in the provision of the service); and
- state and national overheads (including the cost of capital for owned assets).

First, Australia Post calculates the appropriate share of mail path costs that should be included in the CSO. A 'mail path' is the path followed by a letter from its point of origin from various Australia Post facilities such as sorting centres, post offices, and so on, to its destination. Australia Post collects data on the costs incurred and revenues earned by its 4 500 facilities. These figures are then allocated to mail paths using traffic indicators, which estimate how much mail flows through each facility. On this basis, the costs and revenues of facilities can be allocated to mail paths. For each mail path, costs are compared to revenue. If the cost exceeds the revenue, then the excess is included in CSO costs.

Second, the model examines the costs of facilities used to provide CSO services. If, in the absence of revenue from the CSO mail paths, a facility would not generate sufficient revenue to both cover its costs and make a specified return on its capital base, then it is counted in the CSO costs. For example, if a facility earns \$1 000, but mail on CSO mail paths accounts for \$40, the facility is treated as earning \$960. If the facility costs more than \$960 in operating and capital costs, then the excess of costs over earnings is counted toward the CSO.

Third, Australia Post calculates total state and national overhead costs (such as head office costs), and includes a share in CSO costs equal to the proportion of mail carried on CSO mail paths to total mail carried by Australia Post. For example, if 4 percent of Australia Post mail is carried on CSO mail paths, then 4 percent of state and national overhead costs are included in CSO costs.

The Council considers the appropriateness of this framework in the following section.



## 7.2.2 Analysis of Australia Post's CSO costs

It is helpful breaking down CSO costs into their component costs in order to gain a clearer picture of the sources of the CSO costs.<sup>2</sup> CSO costs can be broken down in two ways: on the basis of *direct and overhead costs*; and on the basis of *region*.

On the basis of *direct and overhead costs*, the 1996-97 figures for the CSO reveal that the CSO compromised \$40.6 million of path and local costs (61 percent), and \$26.4 million of state and national overheads (39 percent). Australia Post justifies the inclusion of this relatively high level of state and national overheads on the basis that:

*The cost of the CSO includes a share of State and National Overheads based on the proportion of CSO (loss making) letter volume to total letter volume. This is because in the event that letter volumes were to decrease significantly and CSO facilities were "closed", State and National Overheads would be reduced ... (Australia Post letter to Council, 16 January 1998).*

The Council considers that this basis for including overheads in CSO costs is likely to overstate the cost of CSOs. This is because many of these overheads may well have to be borne even if Australia Post did not deliver the CSO. Since the CSO represents only about 4 percent of total revenue from letter delivery, it is unlikely that Australia Post could avoid many of the State and National overhead costs in the event that it was not required to deliver the USO.

On the basis of *region*, the CSO can be analysed in terms of the proportion of the CSO which relates to:

- metropolitan delivery (where the letter is posted from a metropolitan area to a metropolitan address);
- rural and remote delivery (where the letter is posted from or delivered to a rural and remote address, including letters posted from metropolitan areas to rural and remote areas, and from rural and remote areas to metropolitan areas); and
- delivery of inwards international mail which Australia Post must deliver under an international treaty for mail delivery (This mail delivery makes

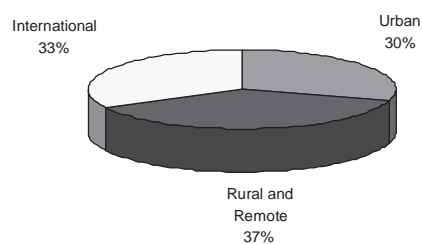
<sup>2</sup> The following CSO figures are taken from answers supplied to the Council by Australia Post by letter 16 January 1998 and in discussion. For a breakdown of CSO costs for 1993-94 see Castro and Maddock, 1996, pp. 264-265, and for the 1990-91 financial year, see Industry Commission 1992, p. 104.

a loss because Australia Post is inadequately compensated by other countries for the costs of delivering letters coming into Australia).

On 1996-97 figures, each of these categories contributed about one third of total CSO costs. Table 7.1 depicts the breakdown of CSO costs into each category.

Table 7.1 Australia Post's CSO Costs by Region

Region	Contribution
Metropolitan	\$20 m
Rural & Remote	\$25 m
International (inwards)	\$22 m
<b>Total</b>	<b>\$67 m</b>



Source: Supplied by Australia Post

Castro and Maddock, analysing CSO costs for the 1993-94 financial year, noted that calculation of CSO costs was sensitive to the rate of return required on capital - that is small differences in the required rate of return had a significant effect on CSO costs. The rate of return on capital relates to capital tied up in providing CSO services, such as the capital value of post offices and other facilities. In 1993-94, facilities were required to return 18 percent net on their capital cost; and the CSO would fall about \$1 million for each 1 percent reduction in the rate of return required on the capital investment (Castro and Maddock, 1996, p. 265).

The rate used for the 1996-97 calculation of the CSO was 18.75 percent. It is clear that this rate is significantly in excess of a normal rate of return on capital. Australia Post has announced that it will revise this rate for the 1997-98 financial year, and expects the revised rate to be about 12 percent (Australia Post letter to Council, 16 January 1998). Adopting a lower rate of return will result in a significant reduction in the costing of the CSO. If the reduction is comparable to that in the 1993-94 financial year, then the CSO cost would fall by about \$7 million or just over 10 percent, simply on the basis of using a 12 percent required rate of return rather than an 18.75 percent rate of return. If the required rate of return was reduced to nine percent, the cost of CSOs could fall a further \$3 million.

### **7.2.3 Criticisms of Australia Post's Methodology**

An issue which the Council must consider is whether Australia Post estimates CSO costs in a way which truly measures the costs associated with the universal delivery of letters. It is important that such costs are calculated accurately, both to determine the appropriate amount of funding, and the strategy for funding CSOs. Underestimation may lead to incorrect assessments of the cost of delivering USO services, while overestimation may give an unduly pessimistic view and will affect the basis of assessment of Australia Post's performance, as well as influencing strategies for funding CSOs.

The Council has some reservations about the methods used by Australia Post. It considers that there is a high likelihood that Australia Post overestimates the costs that it would not incur if it was freed of the obligation to deliver letters throughout Australia. The Council is particularly concerned about certain features of Australia Post's costing model:

- the large component related to delivery in metropolitan areas (about one third) where delivery could be expected to be profitable;
- the large component related to buildings (a significant proportion of both metropolitan and rural CSO costs are understood to relate to operating costs associated with buildings, including post offices, where mail is processed, and which do not return a net 18.75 percent); and
- the large component related to overheads (almost 40 percent).

These concerns arise because:

- overhead costs should not be expected to contribute 40 percent of CSO costs, since many overheads are not sensitive to mail volumes;
- a large number of the costs stated above could be expected to be reduced by internal management decisions, eg by better management of property in metropolitan and rural areas, and better management of overhead costs;
- CSO costs for the purposes of the avoidable cost methodology include all mail paths where letter delivery makes a loss. This ignores the point, made in Box 7.1, that a commercial letter delivery company could be expected to provide some loss-making services on the basis that they enable it to provide (almost) universal coverage and therefore encourage greater use of the postal network by companies seeking to mail to a broad cross-section of the community; and

- capital costs are very high at 18.75 percent. If the rate is reduced to a reasonable rate, then CSO costs could be expected to fall in the order of 10-15 percent.

The Council notes as a general point that the avoidable cost methodology may overstate CSO cost to the extent that in order to encourage greater use of its services, and to simplify its charging policy, Australia Post would only charge the uniform rate for CSO services. In the context of a service such as letter delivery, these factors could significantly increase the loss Australia Post would, in a competitive market, be willing to accept on certain services as part of a broader commercial strategy for maximising profitability.

The Council concludes that the current method used to calculate the cost of the CSO appears to be inconsistent with the principles of the avoidable cost methodology, and is likely to overstate the actual costs associated with the provision of universal service at a uniform price. The overstatement exaggerates the burden carried by Australia Post in fulfilling its CSO responsibilities. The Council notes, however, that in relation to the rate of return used in relation to capital, Australia Post is taking steps in conjunction with the Department of Finance to adopt a more realistic figure for future calculations of CSO costs. This will go some but not all of the way to producing a more accurate CSO cost.

The Council finds that the avoidable cost methodology is the appropriate methodology for calculating the cost of the CSO.

- The onus should be on Australia Post to justify to the Government that all costs included in the CSO meet the definition of a CSO in Box 7.1, in particular the inclusion of State and National overheads in CSO costs.
- The Government should independently assess CSO costs before implementing new funding arrangements for CSOs.

The Council has not audited Australia Post's reported CSO costs at this time. It considers that this task is better left until closer to the date on which the Government plans to implement the recommendations in relation to the changed basis for funding the CSOs, especially given Australia Post is currently refining its CSO costing model in consultation with the Department of Finance.

### 7.3 Other CSOs

Besides universal letter delivery, Australia Post performs other services which some might characterise as CSOs (see Box 7.4). Since there are no proposals to change existing arrangements in relation to these functions, and Australia Post is fully reimbursed for performing them, it is not necessary to consider their funding and delivery arrangements in this Chapter.

#### *Box 7.4 Other Governmental Obligations of Australia Post*

On behalf of a number of government departments, Australia Post provides services to specific groups within the community at below the cost of provision.

The services are:

- Australia Post provides a service called “Freepost”, which distributes braille literature free of charge to visually impaired and blind people. The Department of Social Security pays for this service; and
- Australia Post delivers mail at a concessional service to Australian Navy and Army forces stationed at sea or overseas. The Department of Defence pays for this service.

Additionally, since 1989, the government has directed Australia Post to provide, free of charge, pensioner mail redirection for the first month after a pensioner moves address. In 1996-97 Australia Post estimated that this Ministerial direction cost \$1.8 million (Australia Post 1997a, p.79).

#### 7.3.1 Preservation of Heritage Buildings

Chapter Six considered a range of possible USOs, based on perceived community expectations about the services that should be offered by Australia Post. Consideration of community expectations relating to the preservation of heritage buildings has been deferred to this Chapter because it is more in the nature of a CSO rather than a USO.

Australia Post has argued that the community expects the “preservation in postal use, and restoration, of General Post Offices; and other Post Offices which have local historic significance” (Australia Post, submission 8, p. 90).

Like all companies, Australia Post must comply with the *Australian Heritage Commission Act 1975* (the AHC Act) in relation to its holdings of heritage listed properties. Owners of heritage buildings cannot take any action which would adversely affect a listed building unless there is no ‘feasible and prudent’ alternative, and must minimise the impact of any unavoidable action that it does take. Owners must seek the advice of the Heritage Commission on any proposed action. Buildings that are not listed under the legislation are not covered by the requirements of the Act (Committee of Review - Commonwealth Owned Heritage Properties 1996, p. 26).

Australia Post states that the requirements of the Act impact particularly heavily upon it because it owns 155 heritage listed properties (Australia Post, submission 99, p. 58), and because of high public and political expectations that they should remain in use as post offices under Australia Post’s ownership (Australia Post, submission 99, p. 58). It estimates the annual cost of maintaining these buildings is \$29 million above normal maintenance costs for modern buildings (Vaile Report 1996, p. 91).<sup>3</sup> The Council understands that these costs do not include the costs associated with licensed post offices. Where a licensed post office is heritage-listed, the licensee rather than Australia Post bears the extra costs associated with maintenance of heritage values (POAAL, submission 12, p. 7).

Australia Post does not support the creation of an obligation relating to heritage buildings. It considers that this would implicitly bind it “to ongoing use and/or ownership of heritage buildings” (Australia Post, submission 99, p. 59), reducing its commercial flexibility.

Under the definition of CSOs, an obligation is not a CSO if the government requires other businesses in both the public or private sectors to undertake the activity (see Box 7.1). Under the AHC Act, Australia Post carries the same obligations as private sector organisations which own heritage listed building (for example, banks), and therefore could not be considered to currently be subject to a CSO in relation to heritage buildings.

A number of views have been put to the Council about whether Australia Post should bear a CSO in relation to heritage post offices. For example, the Australian Local Government Association supported a CSO:

*Local Government supports in general programs to conserve and manage features of social, cultural, architectural, historic,*

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3 Calculated on the 160 heritage listed buildings owned by Australia Post at that time.

*and Aboriginal significance. The network of heritage post offices under the control of Australia Post are an important cultural focus in towns and suburbs throughout Australia. Their refurbishment and high standards of maintenance in recent years has added significantly to the architectural landscape and arguably acted as an incentive to other building owners to follow suit (ALGA, submission 29, p. 3).*

The Australian Council of the National Trust also argued in support of a heritage CSO:

*Many of Australia Post's properties have become a very important part of the nation's cultural heritage. In many towns the post office building is a key component of the townscape. In addition to the heritage value there is a considerable degree of 'attachment' by local communities to such buildings (Australian Council of the National Trust, submission 21, p. 1).*

However, other submissions took a different view. The Eastern and Central Regional Development Organisation argued:

*Australia Post should not be commercially penalised or hindered in its ownership and occupancy of these buildings and that support should be available through Heritage grants etc. The issue of Australia Post disposing of these buildings and subsequent changes in the quality of maintenance and upkeep are also of concern because of the prominent positioning of these buildings and their relationship with the streetscape in their respective towns (Eastern and Central Regional Development Organisation, submission 28, p. 2).*

A number of submissions argued that ownership of heritage buildings was not necessarily a disadvantage, and to the extent that it was, Australia Post should make the appropriate management decisions to rationalise its ownership. The Local Government and Shires Association of NSW argued that "... heritage buildings are [not necessarily] a commercial liability ... many such buildings are well located and their historical value may be a marketing advantage" (Local Government and Shires Associations of NSW, submission 47, p. 2). Inverell Shire Council argued that:

*... the costs associated with a number of inferred CSOs appear to be ones that could be minimised through management*

*decisions. For example, Australia Post has already shown commercial acumen in management of its prime value heritage properties with the commercial redevelopment of the Sydney GPO (Inverell Shire Council, submission 71, p. 2).*

The submission from Treasury expressed concern that if heritage costs were included as an Australia Post obligation they would become part of the cost of postage. This might discourage use of the postage system and therefore, economic development (Commonwealth Department of Treasury, submission 52, p. 17). It follows that if heritage buildings were to be made an obligation on Australia Post, they should not be paid for through higher rates of postage.

The Council accepts that local communities value their heritage post offices. Such buildings beautify the streetscape and provide both a link with the past and a sense of continuity. However, this does not necessarily mean that the obligation of maintaining such buildings is a CSO which should be placed on Australia Post. The important question for this review is who should fund the costs involved in maintenance of heritage post offices, and whether Australia Post should be required to continue to own and maintain heritage post offices.

There are a number of arguments against placing special heritage obligations on Australia Post:

- other mechanisms exist for preservation of heritage buildings, such as State and Commonwealth heritage legislation;
- if Australia Post sold its heritage buildings, they would still be protected under current heritage legislation;
- it should not be assumed that the ownership of heritage buildings is a ‘burden’ for which Australia Post should be ‘compensated’;
- it is inappropriate to fund Australia Post for the cost of maintaining heritage buildings in cases where Australia Post might choose to operate out of such buildings anyway;
- it would be almost impossible to arrive at a proper estimate of the cost to Australia Post of a heritage CSO. The costs of operating out of a heritage building, such as additional maintenance, would need to be discounted for the intangible benefits conferred by operating out of heritage buildings;
- it is difficult to justify special funding for Australia Post’s heritage obligations when special funding is not available to other owners of heritage buildings; and



- many heritage post offices may not meet present day community needs to the same extent as more modern buildings, for example, easy access by physically disabled people.

For these reasons, the Council believes that it is more effective for heritage provisions to relate to *heritage buildings* rather than the *current owners* of those buildings. Imposing special obligations could increase Australia Post's incentives to dispose of its heritage post offices. The Council concludes it is appropriate that heritage obligations be dealt with under heritage legislation rather than under the *Australian Postal Corporation Act*. This position is in accordance with the recommendations of the Vaile report.

In meetings with members of the Secretariat of the Council, officers of the Australian Heritage Council pointed out that in some ways Australia Post was disadvantaged compared to private owners of heritage buildings. For example, the structure of States grants schemes for heritage buildings effectively denies government business enterprises that own heritage buildings any real chance of obtaining the tax incentives that are open to private owners of heritage buildings. This is illogical since it implies that heritage buildings owned by government business enterprises are somehow less worthy of financial support than privately owned heritage buildings. Such State based tax incentive schemes should not be structured to discriminate against government owned heritage buildings.

The Council considers that Australia Post should not be subject to a CSO to maintain and preserve in use heritage post offices. Governments may wish to consider ensuring that Australia Post is treated equally with private parties in terms of applications for State and Federal government grants and other incentives in relation to heritage buildings.

## 7.4 Options for Funding CSOS

There are a number of ways of funding CSOs. However, it is important to note that every method of funding imposes a tax on some people in order to benefit others. In the case of funding the letter delivery CSO, the choice is between taxing some postal users or taxing taxpayers generally. Cross-subsidisation involves taxing some postal users.

The ideal funding mechanism for CSOs would have the following characteristics:

- it would be equitable between different groups in the community;
- the appropriate target groups would receive the benefit of the CSO;
- it would encourage the service provider to offer a high level of performance while looking for the most efficient and cost-effective way to provide the service;
- it would be forward-looking; that is, attuned to market developments and changes in the needs of postal users;
- it would be administratively simple;
- it would encourage the maximum level of competition in the marketplace that is compatible with providing the CSO;
- the cost of providing the CSO would be transparent (open to public scrutiny), thus allowing the community to assess whether it was receiving value for money; and
- it would only fund CSOs that governments and the community considered worthy of funding, and it would fund these to the appropriate level (that is, it would not provide CSOs where the cost of provision is hugely in excess of the benefits provided by the CSOs, especially where other mechanisms exist to meet the need designed to be met by the CSO).

While all of these criteria are important, it is unlikely that any method of funding CSOs will meet all of these characteristics. The method for funding CSOs is likely to represent the best compromise between these objectives rather than an ideal solution.

The Government's general policy on funding social obligations is that it prefers to fund most CSOs by direct payment. In relation to CSOs which arise out of a requirement to provide a universal service (as is the case with Australia Post's letter delivery CSO) the Government has not committed itself to a specific policy position. The government's general policy with regard to delivery of CSOs is outlined in Box 7.5.

#### **7.4.1 The Case for Change from the Current Cross-Subsidy Funding Arrangements**

Australia Post contends that cross-subsidy arrangements are:

- easy to administer; and

*Box 7.5 Commonwealth Government Policy in relation to CSOs*

Commonwealth Government directives require the responsible Minister to ensure that CSOs are specified and that the costs of the CSOs are transparent. Moreover, the directive to undertake a CSO activity should be in the form of a Cabinet Decision, Ministerial direction or a provision in legislation (Department of Finance 1996, p. 103). The Department of Finance has a record of all identified CSOs performed by Commonwealth GBEs.

Source: Industry Commission 1997, p. 14

- facilitate a uniform rate of postage across Australia, which fulfils equity considerations and simplifies assessment of postal charges for letters.

Additionally, it has been argued that cross-subsidies represent the best way to guarantee the delivery of CSOs. However, this may not be the case because:

- cross-subsidisation provides incentives for Australia Post to reduce or discontinue CSOs because these costs reduce its profitability. In 1996 the Vaile Committee reported that Australia Post failed to provide letter delivery to 80 000 households (Vaile 1996, p. 41);
- as competition from other forms of communication grows, and puts greater pressure on Australia Post's profitability, it may become more difficult to maintain CSOs at current service standards; and
- other methods can be just as secure if funding is protected by legislation or some other means.

Furthermore, cross-subsidy funding arrangements have a number of disadvantages:

- they require extensive restrictions on competition;
- they are not transparent;
- they require some users to pay significantly more than the cost of delivering their mail; and
- they create tensions between commercial objectives and CSOs.

Each of these disadvantages is considered below.

### *Restricts Competition*

In order to maintain cross-subsidies to pay for CSOs, it is necessary to restrict competition. This is because if a competitor was allowed to enter the market, it would undercut Australia Post on the more profitable mail paths, thus taking away its ability to earn the profits needed to cross-subsidise. As discussed in Chapters Eight it is possible to still maintain a uniform price but inject considerably more competition if CSOs are not funded by an internal cross-subsidy.

### *Not Transparent*

The cross-subsidy method of funding CSOs is not transparent because it does not enable the public to ascertain the amount and effect of the funding arrangement.

Australia Post has argued that the cross-subsidy funding method is transparent because it is required to cost the CSO using the avoidable cost methodology (Australia Post, submission 8, p. 93). The Vaile Committee seemed to accept this argument (Vaile Report 1996, pp. 81 - 85).

The Council disagrees with this view. It considers that while Australia Post is required to estimate its annual costs of providing the CSO there is considerable uncertainty about its methodology, how it allocates costs, what mail paths or services are considered to be CSOs and so on (discussed above). More importantly, cross-subsidy funding clouds the information needed by Government to make decisions about the postal industry. It prevents the Government from being able to make clear decisions that an owner/shareholder would normally be able to make, such as: is the price of postage too high or low; is Australia Post sufficiently innovative in the products and services it offers; and is Australia Post performing well?

### *Inefficient Pricing*

Cross subsidy funding requires some users to be overcharged in order to fund other users. The present system requires that users pay too much on high volume, high profit mail paths. If prices were lower, then more mail would be sent on these paths, further increasing economies of scale, and reducing prices still further. Under-utilisation of these paths due to higher prices can thus be seen as a cost, particularly to businesses which are heavily reliant on postal services.

Some people might take the view that 45 cents is a relatively cheap price to pay to send a letter, and that there would be very little effect on customers if postage prices

fell. While this may be true when only one or two letters are sent, it is not true in relation to large mail-outs. The price charged for postage can discourage people and businesses from engaging in large mail-outs.

*Creates tensions between commercial objectives and CSOs*

Australia Post is subject to a requirement to operate commercially. It makes good sense for Australia Post to operate in this way, as has been evidenced by the rise in its level of services, efficiency, and profitability since corporatisation.

Australia Post also has an obligation to deliver CSOs, despite the fact that this obligation clearly conflicts with its commercial objectives. Under cross-subsidisation funding arrangements, Australia Post faces the temptation of cutting back on CSO service standards in order to boost profitability. Further, even if it fully meets some defined CSO service standard, Australia Post may operate less efficiently because of the confusion between its two objectives and because of reduced incentives to seek greater efficiencies. For example, the current funding arrangements may not provide Australia Post with strong incentives to improve the provision of CSOs above the minimum levels required by legislation, even when the extra costs of doing so are very low. Other methods of funding can build in incentives to lift standards where the extra costs are justifiable on some basis, for example by linking the amount of compensation received by Australia Post to the service standard that it provides.

Given the problems outlined above, the Council has looked at other methods of funding CSOs. These include:

- accepting a lower rate of return;
- direct budgetary payments by the Commonwealth Government; and
- levies on other service providers.

These methods overcome, to a greater or lesser extent, the problems associated with cross-subsidisation. They permit greater competition in the market for letter delivery services; they increase the level of transparency of CSOs; and they have the potential to reduce the tensions between Australia Post's commercial objectives and CSOs. To some extent, they reduce the level of inefficient pricing, although this depends on the extent to which postal users can obtain a rate below the uniform rate.

### 7.4.2 Accepting a Lower Rate Of Return

Australia Post, like all government business enterprises, is required to achieve a commercial rate of return on its assets. Under this method of funding, the Government could accept a lower than commercial rate of return from Australia Post, in exchange for which it would provide CSOs. Another way of funding CSOs might be to allow Australia Post to claim tax concessions in relation to CSO costs. In practice, this is the same as accepting a lower rate of return.

It should be recognised that accepting a lower rate of return does have costs. The revenue foregone from reduced dividends to the Government would have to be found elsewhere. Further, Australia Post is like any business in that it needs to reinvest some of its profits in new assets in order to continue to provide the same level of service in the longer term. If Australia Post's profitability fell, it might need to seek capital from Government to maintain the assets it uses to provide letter delivery services. If Australia Post's profitability fell still further, it might not be able to afford to fund the CSO. However, Australia Post's profitability is unlikely to fall this far.

A major problem with accepting a lower rate of return is that it is not very transparent. Unless the Government knows what rate of return Australia Post could have earned except for the provision of the CSO, and what the CSO should cost to provide, it is difficult for the Government to assess what rate of return Australia Post should earn.

Several submissions pointed to this and related problems:

*[a lower rate of return] doesn't encourage Australia Post to seek a commercial rate of return on its assets (POAAL, submission 84, p. 21).*

*a lower rate of return on assets ... distorts management information and decision-making, and clouds external evaluation of Australia Post's performance (ACCI, submission 85, p. 9).*

*[a lower rate of return] distorts essential financial information required by management and is inconsistent with GBEs, such as Australia Post, operating on a commercial basis (ACCI, submission 45, p. 38).*

The Council considers that requiring a lower rate of return would confuse the signals for good management of Australia Post's business, perhaps leading to inefficiency and under-performance.

The Council accepts that, due to these concerns, accepting a lower rate of return from Australia Post is not a sound method for funding the CSO.

### 7.4.3 Direct Budgetary Payments

This requires the government to make budget payments to Australia Post to meet the cost of providing CSOs. These payments should be based on an independent assessment of the costs of providing the CSO services.

Direct funding has most of the desirable characteristics outlined at the head of this section and has the following advantages over cross-subsidisation:

- it allows for greater competition while still ensuring that funding is available to cover the costs of CSOs; and
- it is transparent.

Both the Industry Commission report (IC 1992, p. 128) and the Humphry report (Humphry 1997, pp. 23-24) recommended direct budgetary funding as the best method for funding CSOs.

Some submissions raised concerns about the prospect of direct funding. These concerns are discussed below.

#### *Reduced incentives to provide CSOs efficiently*

The view was put to the Industry Commission in 1992 and the Vaile Committee in 1996 (Vaile Report, 1996, p. 82) that if Australia Post's CSOs were funded by direct budgetary payments then this would reduce its incentives to provide CSOs efficiently since Australia Post would be fully compensated for all its CSO costs no matter how high.

However, the Government would have more information to base an assessment of the costs of providing the CSO. If the market was opened to competition, it would be easier to identify CSO activities and to calculate the efficient cost of delivery by reference to industry benchmarks. Further, as many aspects of Australia Post's CSO services are already contracted out (eg some rural and remote area delivery

services) clear costs of some CSO services are already available. Also, the Government could independently audit Australia Post's CSO costs when setting the appropriate level of funding. Finally, by setting funding in advance, the Government would remove Australia Post's incentives to overspend in the provision of the CSO.

#### *Costs associated with direct budgetary funding*

Direct budget funding comes out of tax revenue, and therefore incurs the administrative costs associated with collecting tax. The Australia Post submission argues that funding CSOs out of tax also "incurs an efficiency cost". The efficiency cost arises from the fact that tax collection discourages economic activity.

The Council considers that all forms of funding result in money being collected from one group in order to provide the CSOs. Therefore, funding CSOs will always impose a tax on those who pay more in order to finance the provision of the high cost services. It is likely that the impact of tax measures on economic activity is less when the tax is collected from the whole community (that is, through general revenue) than when it is collected only from postal users.

#### *Vulnerability of funding*

A number of submissions expressed the fear that if CSOs were funded from budget, they could be arbitrarily cut by Parliament. A number of the submissions put this position:

*The obvious problem with budgetary funding is the continuous scrutiny of such expenditure and the inclination to consider cuts in the subsidy to extract windfall dividends, or impose other abnormal expenditures, particularly when Governments are in deficit reduction mode (Communications Electrical Plumbing Union, submission 16, p. 8).*

*... there is little evidence to suggest that where public sector organisations have been relieved of CSOs that these same CSOs have been directly replaced by transfers. It appears that the nexus becomes lost and funding for the CSO enters competition with the whole range of competing demands on government finances (Local Government and Shires Associations of NSW, submission 47, p. 3).*

The Vaile Committee agreed with this position. In its view:



*the budgetary process, with its tight deadlines and short time frames, is not suitable for the in-depth study that is required to examine the efficient delivery of CSOs (Vaile Report 1996, p. 86).*

In the case of postal services there are already some CSOs (see Box 7.4) which have been funded by direct budgetary payments for some time. Given the cost of the letter delivery CSO is small compared with the strength of community support for its retention there is automatically strong political pressure against CSO funding being reduced during the budget process.

In addition, there are ways of safe-guarding or locking-in the direct funding of CSOs. The funding of CSOs could be linked to the service standards in the section 28C regulations, such that the level of funding could not be cut in circumstances where this might threaten Australia Post's ability to meet the required service standard. In addition, CSO funding could be negotiated upfront for a period of, say, five years, to guarantee stability of funding for an extended period of time. Through the use of this method, the Council considers that it would be possible to overcome community concerns about arbitrary cuts to CSO funding.

At present, some of the concern about cuts to direct funding comes from the fact that the letter delivery USO is ill-defined. If the USO is more clearly defined in line with the Council's recommendations, then the link between cuts and falling service standards will be more clear-cut, and therefore easier to safeguard against.

The Council considers that direct budgetary funding of the CSO represents a feasible option.

#### **7.4.4 Levies on other Service Providers**

This model for funding CSOs requires service providers competing against Australia Post to contribute to the cost of providing the CSO. The contribution would be calculated according to the service provider's market share.

A model similar to this has been used to fund CSOs in the telecommunications industry. The telecommunications model is explained in Box 7.6.

This model has the advantage that it allows for competition, provides a level playing field for competitors (since one participant, Australia Post, is not left to shoulder the full burden of providing CSOs), and provides a secure source of funding for CSOs which is not vulnerable to budget cuts.

*Box 7.6 Telecommunications model for the funding of CSOs*

The basic principle of the telecommunications model for funding CSOs is that all telecommunications carriers offering telecommunications services should contribute to the costs of delivering CSOs.

When the Government decided to permit greater competition in the telecommunications industry it passed legislation requiring Telstra, the leading corporation in the market, to provide a USO. Telstra was required to connect all households to the telephone network that requested connection, even if connection was unprofitable.

Each telecommunications carrier competing in the telecommunications market was required to cover the loss made on the CSO in proportion to its share of usage of the network. For the 1997-98 financial year, the levy will be based on the carrier's share of the total revenue earned in the market.

It should be recognised that the industry levy would affect the prices charged by competitors. All competitors, including Australia Post, would need to put up their prices in order to recoup the levy. The amount that Australia Post earned by putting up its prices would cover its contribution to the industry levy.

The Council recognises that the industry levy maintains some degree of cross-subsidy funding, since postal users will still pay for the levy as part of their postal charges. However, the cross-subsidy will be external to Australia Post, and therefore more transparent. Further, it will permit greater competition in the letter delivery market, which is likely to result in a fall in the postage rate paid by a significant number of customers.

*The framework for implementing an Industry Levy*

Challenges posed by the introduction of an industry levy are:

- it is difficult in postal services to isolate an objective measure of activity (eg market share or volume) on which to calculate a company's contribution to the CSO. The measure should ideally be both practical to measure and reflect the competitor's share of the postal market; and

- Australia Post may not have strong incentives to seek to provide CSO services at the most efficient cost if it knew that it would, in any event, be compensated for the full cost of provision.

Australia Post has argued that it may be difficult to collect an industry levy because:

*... in a competitive postal market, with low barriers to entry and low capital intensity, competition is likely to involve many small size operators. With larger number of competitors, many of small size, entry into and exit from the industry would be easy and frequent. In those circumstances it would be difficult to measure turnover or profit at the individual operator level (Australia Post, submission 99, p. 64).*

However, Australia Post considers that some form of industry levy is desirable if the Government permits greater competition:

*Despite the inherent difficulties, ... should deregulation of the postal market occur at a later stage, measures would need to be introduced to ensure - on competitive neutrality grounds - that postal industry participants contributed to CSO costs (Australia Post, submission 99, p. 64).*

In designing an industry levy it would be necessary to collect sufficient money to meet the costs of the CSO while not discouraging new companies from entering the market. One option would be to set a low initial licence fee for all companies who wish to provide letter services, and then use a system of fee bands, so that as companies increase their share of the market they would also increase their contribution to the CSO. The bands would need to be sufficiently narrow so that moving between them would not result in large jumps in licence fees, but sufficiently broad as to reduce the cost of administering the system.

The Council considers that the following principles could guide the implementation of an industry levy:

- service providers (that is, competitors in the market) could be required to be licensed to deliver letters. The licence should only apply to the carriage of standard sized letters;
- service providers could be required to pay a licence fee as a contribution to the funding of the CSO;

- the licence fee could be based on the volume of letter business undertaken by the service provider. As outlined above, for simplicity the licence fee could be set as a number of increments according to broad measures of the size of the business, so that as the volumes carried by the service provider grew, a new increment could apply at particular points;
- the fee could be paid in advance and then adjusted periodically. For example, the fee could be set every five years in advance, and paid in annual instalments;
- the fee could be set low during the first five years of operation so as not to discourage competitors from entering the letter delivery market, and then increased. In order not to catch service providers by surprise, they should be informed in advance of the level of both the initial and increased fee;
- the fee could be audited at random to prevent understatement of volumes with penalties including fines and the revocation of the licence for any party that was caught understating volumes. One option could be for service providers to be able to choose to install secure metering devices to reduce their audit obligations;
- the fee could be paid into a common pool from which Australia Post, as the party required to provide the USO, could be entitled to draw. Australia Post's entitlement could be assessed from the audited cost of the CSOs; and
- the system of licensing, assessment, and enforcement could be managed by an independent body. Chapter Nine discusses the appropriateness of different institutional arrangements.

Such an arrangement would mean that the total fees paid by all Australia Post's competitors would equate with their share of the market. For example, if competitors captured 20 percent of the market, they would pay 20 percent of the total CSO costs. The technical details of collection of the levy could be determined by the postal regulator after further consultation with interested parties.

The Council considers that an industry levy represents a feasible method for funding the letter delivery CSO.

In conclusion, the Council considers that direct funding is the preferable method for funding the CSO, because it removes the constraints on growth and price distortions in the letter delivery market. However, if direct funding is not adopted, the Council

considers that an industry levy represents the best alternative method for funding the CSO.

***Key Recommendation***

**The Council recommends funding of the CSO by direct budgetary payments.**

#### **7.4.5 Level of Funding under Alternative Funding Arrangements**

A critical question is the appropriate level of funding if the CSO is funded by either direct budgetary payments or by an industry levy. Australia Post should be provided with sufficient compensation to ensure that it maintains and improves service standards throughout Australia. However, it should not be overcompensated or compensated in a way that weakens its incentives to find ways to provide the same level of service at a lower cost.

Under direct budget funding, the Council considers that the Government should set CSO funding in advance for five year periods. During each period, Australia Post should be free to retain any extra profits earned by making savings in the provision of CSOs, on the understanding that the postal regulator will monitor service standards to ensure that Australia Post is maintaining acceptable standards of delivery. This method of funding would provide Australia Post with a stable and secure level of funding, ensure that service standards are maintained, and provide it with incentives to provide the service at reasonable cost. This payment method would accord with the recommendation above to protect the funding of CSOs through legislation.

In keeping with the Council's recommendation above that the Government should independently assess CSO costs before changing the method of funding CSOs, the Council considers that the Government should independently audit Australia Post's CSO costs prior to setting CSO funding.

***Key Recommendation***

**The Council recommends that the Government negotiate CSO funding in advance for five year periods.**

As a further point, the Council notes that the appropriate level of funding for Australia Post is complicated by the fact that in Chapter Six the Council recommends retention of the uniform rate of postage for all letter delivery services, and in Chapter Eight the Council recommends that Australia Post retain its monopoly over delivery of household mail. By charging a uniform rate Australia Post will be able to cross-subsidise loss-making services out of any monopoly profits earned on remaining reserved services. While these profits would not cover CSO costs, it is appropriate to take them into account when assessing the appropriate funding to provide to Australia Post.

Therefore, to assess the amount of the CSO fund, it would be appropriate to:

- calculate the avoidable cost of the CSO services; and
- discount this avoidable cost by the amount of profits above a normal rate of return that Australia Post earns on the remaining reserved services.

## 7.5 Methods for Providing CSOs

One issue facing the Council is the most efficient method for providing CSOs. To date, the Commonwealth Government has required Australia Post to provide them.

A number of submissions argued that CSOs could be provided more cheaply and at the same service level if Australia Post was required to contract them out to private postal deliverers. Alternatively, the Government could require Australia Post to compete against other companies to provide CSOs. (It should be noted that contracting out is not a method of *funding* CSOs.)

This section examines the feasibility of contracting out in the context of CSO provision. Chapter Eleven discusses contracting out more generally.

Increasingly, governments at the local, state and federal level are contracting out the delivery of a range of public services. For example, the Commonwealth Government has contracted out the national telephone teletypewriter service (which enables people with hearing or speech impairment to use the telephone) to a private company, the Australian Communications Exchange.

Contracting out of service delivery can be beneficial to the community when it is implemented in a way which makes both the service standards and cost of delivery more transparent. If correctly handled, contracting out can create the right incentives

to seek efficiencies, because the contractor can be permitted to retain a share of the savings generated by providing a more efficient service.

At present, Australia Post has contracted out a number of letter delivery services, such as mail delivery in rural and remote locations, and licensed post office services.

Notwithstanding the benefits of contracting out, a number of submissions have raised concerns about the standards of service delivered by postal contractors. For example, the Town of Albany has argued that contractors carrying both Australia Post and non-postal articles give priority to the delivery of non-postal articles. The NSW Farmers' Federation stated in its submission that:

*A persistent comment is that the incidence of misdirected mail has increased where an agent has taken over postal service responsibility. Inaccuracy... particularly impacts on rural people given that some areas of NSW only receive one mail delivery per week (NSW Farmers' Federation, submission 31, p. 3).*

The submission from the Australian Council of Trade Unions argued that the benefits of contracting out remained to be proved, and that contracting out led to less accountability, lower quality, and could boost costs if transaction costs (the costs of establishing and managing the contract) were taken into account (ACTU, submission 130, attachment 1, pp. 1-10).

However, an alternative view was put forward by the Eastern and Central Regional Development Organisation:

*There was general regional satisfaction over the contracting out of services and the operation of licensed retail outlets. The quality and level of customer service provided by Licensed Post Offices in rural towns was favourably commented on by their representative communities (Eastern and Central Regional Development Organisation, submission 28, p. 1).*

The consensus in the submissions seemed to be that while initially there were some teething problems with Australia Post contracting out services, these had been addressed as the contractor acquired more experience. The Council considers that with adequate monitoring of contract arrangements, Australia Post should be able to ensure contractors meet their contractual responsibilities.

There may be some scope to contract out more services. However, the Council does not consider that it is necessary to make any recommendations in this regard because Australia Post already has incentives to pursue opportunities to contract out where it makes commercial sense.

This conclusion, however, leaves open the broader question of whether the Commonwealth Government should contract out the provision of CSOs, and require Australia Post to compete with other companies to provide CSOs. The Council has concluded that at present this approach is not feasible.

First, it is difficult to draw a line around all CSO activities and separate them from non-CSO or profit-making activities. For example, delivery of a letter posted in a post box in suburban Brisbane to a farm outside the town of Thargomindah might be a CSO because this delivery costs more than 45 cents. However, the initial collection and sorting of this letter might be performed in conjunction with other profitable activities, eg the collection and sorting of letters from the same post box bound for inner-city Brisbane. On this basis, it would only be feasible to contract out specific CSO activities, such as delivery from Thargomindah to the farm. As stated above, Australia Post already has sufficient commercial incentives to contract out such activities.

Second, contracting out only produces cheaper prices where there is genuine competition. Since Australia Post is currently the only provider with a universal network and possesses economies of scope and scale, it would most likely face very little real competition when bidding for provision of CSO services. Other tenderers, unless they could combine provision of the CSO with other activities, would need to bid on the basis of stand alone costs (where all the costs of performing activity are included in the tender price). Australia Post, on the other hand, could offset some of the bid costs against existing operations (especially in areas such as collection and sorting). Thus it could bid a price just lower than stand alone cost and still win the contract. As noted earlier, at present Australia Post provides CSOs at avoidable cost, which according to Australia Post is less than half the stand alone cost (Australia Post, submission 8, p. 93). This means that if Australia Post were awarded the contract at just less than stand alone cost, the cost of provision might actually double.<sup>4</sup>

The Council considers that if competitors are able to enter the market and grow to a reasonable size, they may be able to provide significant competition because they,

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See Stumpf 1996, p. 298.



like Australia Post, would be able to offset the costs of CSO provision against other activities. However, at present, contracting out of CSO activities is not likely to produce cost savings because of the lack of competition.

***Recommendation***

**The Council recommends that the Government should not seek to contract out CSO activities at this stage, but this policy should be reviewed in 2005.**

In conclusion, the Council reaffirms the value of the letter delivery service. It agrees with the comments of the NSW Farmers' Federation that:

*Mail delivery provides a vital service in terms of the social and commercial requirements of rural people. ... People in rural and remote areas tend to rely more heavily upon the mail service to conduct social and business activities since the cost of other forms of communication are relatively higher than in metropolitan areas (NSW Farmers' Federation, submission 31, p. 1).*

*Access to a cost-effective, timely and efficient postal service is a basic necessity for country people and is a responsibility to which the Government should remain committed (NSW Farmers' Federation, submission 124, p. 5).*

However, preservation and enhancement of the letter delivery service is not necessarily a bar to greater competition. As the Isolated Children's Parents' Association has stated:

*ICPA (Aust) has no problem with increased competition to Australia Post even if it means a further curtailment of Australia Post's formally reserved services, provided that there be no down grading of services to rural and remote areas and regulations be put in place defining clearly its Community Service Obligations and responsibilities (Isolated Children's Parents' Association, submission 93, p. 4)*

In fact, greater competition is often a spur to better service.

The Council considers, by replacing cross-subsidisation with some other method for funding the CSO, and better definition of the USO, there is scope for greater competition in letter delivery services while maintaining universal delivery at a uniform rate.

The following chapter examines in detail the scope for greater competition in letter delivery services and the benefits that more competition can bring for postal users.

# Chapter Eight: Competition in Letter Services

*While the letter monopoly confers a number of advantages on Australia Post, it also offers advantages for some of its customers, particularly those who benefit from the community service obligations (CSOs). However, there are costs, borne by large volume customers, competitors and the wider community because of the market restrictions. Is it possible to open up the monopoly to competition without putting the postal CSO in jeopardy?*

The postal service embodies not just commercially viable mail services, but it also fulfils a range of social obligations. Foremost among these obligations is the requirement to provide a universal service at a uniform postage rate. These social obligations have been discussed in Chapters Six and Seven. These chapters also described how Australia Post's social obligations are currently funded using a cross-subsidy. The revenue base for the cross-subsidy is protected through the reservation, by legislation, of some mail services to Australia Post. This also facilitates the uniform postage rate.

This chapter begins with a discussion of the services which are reserved to Australia Post. Its main focus is on how to improve competitive pressures in the postal services market. In forming a view on how to achieve this, the Council has noted the effects of past reforms, international experience in postal reform, as well as taking account of the industry's assessment. In addition, the Council engaged a consultant to model the effects of increased competition on Australia Post. The likely effects on customers, competitors and Australia Post of the removal of restrictions in the postal services markets are also canvassed. This analysis leads to the Council's recommendations on the most appropriate reform package.

## 8.1 What are Reserved Services?

The provisions in the *Australian Postal Corporation Act 1989* define the reserved services according to the characteristics of the services and products, rather than as

a list of specific products and services. Subject to the exemptions in section 30 (see Section 4.3.4), the extent of Australia Post's monopoly is described in Box 8.1. The standard letter service<sup>1</sup> (letters for which the current charge is 45 cents), accounts for most of the reserved services, by value and volume; however, the reserved services extend further than this.

*Box 8.1 Products Covered By The Reserved Services Provisions*

*Domestic mail (posted in Australia for delivery within Australia)*

Standard and large letters - weighing up to 250 grams or for which the fee is up to four times the standard letter rate (\$1.80). At present, Australia Post's charges for large letters weighing up to 250 grams are all less than \$1.80. Special products in these categories include the following.

Discounted products linked to the prices of standard and large letters (up to 250 grams) such as:

- seasonal greeting cards;
- pre-sort discounts (including interconnection);
- advertising mail discounts; and
- local delivery discounts.

Mail with special services attached such as:

- postage pre-paid envelops;
- certified mail;
- acknowledgment of delivery; and
- reply paid.

*International mail*

Inwards bound letters

*Postage Stamps*

Australia Post also has the exclusive right to issue postage stamps within Australia.

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<sup>1</sup> The standard letter service and the standard postal article are discussed in greater detail in Chapter Four.

## 8.2 Benefits of Competition

Australia Post's monopoly involves some significant constraints on competition. This review is to inquire into the justification for these constraints. Under the Competition Principles Agreements legislative barriers to competition should remain only if there is a net public benefit resulting from their retention and if the objective of the legislation can only be achieved by restricting competition.

There are various reasons why increasing competition can advantage users of postal services and the community generally.

Effective communications are very important to commercial dealings by both individuals and businesses. Traditional postal services should be produced as efficiently as possible, sold at the lowest possible prices and provide a flexible range of services which meet customer needs. It is also important that services are developed which take advantage of new opportunities. This means capitalising on new techniques and technologies by exploiting advances in information technology and telecommunications to enhance postal services. It also means pricing these new services as competitively as possible. A postal service industry which is operating in a competitive environment will be in a good position to tackle broader competitive challenges, such as those arising from electronic services.

There are four main reasons why these outcomes are less likely without competition.

*1. Competition provides clear incentives for efficiency and lower costs.*

An enterprise with a protected monopoly usually faces inadequate incentives to take advantage of cost savings, resulting in higher prices to consumers. Several submissions argued that Australia Post had proceeded slowly in implementing efficiency improvements in the monopoly services:

*...there has been no benchmark for the quality and price of the service provided by Australia Post. Australia Post has been afforded the luxury of improving efficiency at its own pace and at the expense of the consumer (Streetfile, submission 10, p. 31).*

TNT commented that:

*...in the uncontestable areas of its monopoly, Australia Post has no incentive to innovate, improve its cost effectiveness or price more efficiently (TNT, submission 43, p. 2).*

2. *Competition ensures that cost savings mean lower prices.*

An enterprise which has some of its market protected from competition does not always need to pass cost savings on to consumers, even if its prices are regulated in the protected market. Australia Post's rates of return on both assets and shareholder's funds are well above those reported by publicly listed companies. Several submissions noted concerns that Australia Post's strong financial performance had not been shared with customers through lower prices, as would be expected in a competitive market. Streetfile noted that:

*Australia Post has returned record profits while not increasing prices, therefore Australians must have paid too much (Streetfile, submission 10, p. 31).*

Treasury also had concerns:

*While at face value AP's customers appear to have benefited from the nominal price freeze (ie as a result of the real price fall), they may not have shared fully in AP's achieved productivity gains to the extent that might have been possible...(Treasury, submission 52, p.20).*

During the period of the price freeze (from 1992 to the present) Australia Post's financial performance has been extremely strong:

*AP's return on assets has increased each year since 1992-93, reaching 17.6 percent during 1995-96, reflecting strong increases in its earnings. Between 1991-92 and 1995-96, AP's earnings before interest and tax increased by 62 per cent compared with average growth in total assets of 7 per cent (Treasury, submission 52, p.19).*

Since 1992 Australia Post has paid dividends of \$546.7 million and made capital repayments of \$450 million (most of which was paid during the three years to 1997). The dividend payment rates are set by the Government, as are the capital repayments. In addition to the normal dividend payments, Australia Post made a special dividend payment in 1996/97 (See Chapter Five).

3. *Competition creates pressure for innovation.*

The opportunity to provide new types of postal services may be lost if they are not taken up by Australia Post because the restrictions on competition imposed by the reserved services mean other providers are prohibited from supplying some services.

The Major Mail Users Association (MMUA) stated:

*... that true growth of that [the hard-copy mail] market is stifled, albeit without ill-will or intention, in reaching its true potential because of the Act's restrictions and definitions (MMUA, submission 33, p. 13).*

Even if Australia Post is a least cost provider of postal services, its monopoly status may mean that it does not need to be as innovative as it would in a competitive market. Thus, its products and services may be different if it faced a competitive environment:

*A Post Office protected against the rigours of competition from new entrants has limited incentives to introduce new products or keep down the costs of existing services (Esrin and de Meza 1990, p. 2).*

Indirect competition from electronic communications will place some pressure on Australia Post to improve its services. However, as noted earlier in this report, telecommunications can never substitute for all postal services. Therefore, the competitive pressure from electronic communications will vary between the different products and customers Australia Post serves. Only

some customers will benefit as many will still be buying services where Australia Post has very little competition.

4. *Multiple suppliers means a greater range of services which would meet the needs of all customers.*

It is unlikely to be commercially sensible for one company to provide the full range of services that might be expected in a competitive market.

If companies diversify too broadly it can lead to problems. In recent years there has been a trend for companies to focus more on core activities and divest themselves of non-core business. This allows them to focus on the efficiencies of the core markets and products. This is not to suggest that Australia Post has diversified too far, but that it needs to be recognised that a company which tries to be all things to all people can become unmanageable. For example, in the Netherlands, the private company owner of PTT, the postal and telecommunications company, has decided to split the two arms of the company into two separate businesses.

Thus, restricting market participation is likely to restrict the range of services offered.

Further, restricting the range of services available and the participation of other firms is also likely to restrict growth and employment in the industry overall, and thereby growth and employment in the Australian economy.

The question then for this review is can the restrictions on competition be removed and the social obligations still be fulfilled?

As noted in Chapter Six and Chapter Seven, it is both possible and desirable to fund the community service obligation (CSO) other than by cross-subsidy. On the other hand, the maintenance of the uniform rate of postage will still require some market restrictions.

### **8.3 Likely Impact of Introducing Competition**

There are several sources of information which can be used to assess the likely effect and effectiveness of any changes to the reserved services protection.



For instance, the Council has looked at what happened after the 1994 legislative changes, when, amongst other things, the protection of the reserved services was reduced. In addition, some other countries have either deregulated their postal services sectors or significantly reduced the scope of the postal monopoly. Study of what occurred in these countries gives some indication of the possible effects of such actions for Australia. NERA has completed a study of developments in selected countries for the Council. As well, many of those who participate in the market have provided advice on the likely impact of reform. The Council has also commissioned a consultancy which models the effects of reduced monopoly on Australia Post. Summaries of these consultancies are in Appendices 3 and 4.

### 8.3.1 Previous Postal Reforms

The 1994 amendments to section 30 of the *Australian Postal Corporation Act 1989* allowed competition in a number of services which had previously been reserved to Australia Post. In summary, these products fall into six categories:

- domestic letters weighing between 250 and 500 grams;
- domestic letters carried for between \$1.80 and \$4.50, including products linked to domestic letter prices, such as bulk discounts;
- newspapers, magazines, books, catalogues and leaflets directed to a particular person or address and enclosed in a cover;
- letters moved within document exchange networks;
- Express Post (DL, C5 and B4 sizes); and
- international outward bound mail.

In 1994, these services generated around ten percent of Australia Post's annual revenues.

Australia Post told the Vaile inquiry that it had lost approximately \$18 million in potential growth as a result of the reduction in reserved services (Vaile Report 1996, p. 142). This is considerably less than the \$250 million which Australia Post originally claimed had been 'put at risk' by the changed legislation (Australia Post 1993a). The \$18 million was a loss of growth: in fact, the actual revenue from these services increased.

There are several reasons for the small impact on Australia Post of these legislative changes.

First, the changes were, in some cases, ratification of what had been occurring in the market place for quite some time: for example, document exchanges had been operating in the major cities for several years.

Second, the changes in the weight and price limits were in a range where potential competition was (and still is) weak. For example, a service markedly better than the standard letter service (such as a guaranteed overnight service), would cost considerably more than four times the standard letter rate and often more than ten times the standard letter rate (the pre-1994 limit on reserved services).

Speaking in the House of Representatives debate on the amendments to the Act in November 1994 Mr Wakelin MP (Member for the seat of Grey) said:

*Overseas experience has shown that the gap between the standard letter price and the reserved service threshold must be quite narrow before any effective competition eventuates (Hansard 1994, p. 2973).*

Potential competitors believe that the area of greatest possible competition is for services which could be priced at or below that of the standard letter rate. There are a number of reasons for this, including the bulk discounts that Australia Post offers to large customers and the need for new players to market themselves as effective alternatives to Australia Post by offering a lower price.

Third, for international outward bound mail, the competition has emerged mainly for those users who do not need counter service. Australia Post has tackled this competition by negotiating rates for large international mailings (the Business Post International promotion).

### 8.3.2 International Reforms

There have been several levels of reform in other countries.

Some, such as Sweden and Finland, have completely deregulated the postal monopoly (in Sweden the CSO has been maintained but not fully funded by Government).

In Sweden, the post office's exclusive right to letter mail has been removed. However, Sweden Post is required to provide a universal service at a uniform price. It is not reimbursed for the costs of the universal service, but it is reimbursed for its social obligations associated with the letter service, including literature for the blind and

deliveries for the disabled. Since deregulation, competition has emerged on local routes. However, not all these competitors have been successful. In addition, there have been a number of court actions alleging that Sweden Post has been using its market power unfairly.

On the other hand, Sweden Post's financial position has been deteriorating since deregulation, to the point where the Government has commissioned a study into the long term financial position of Sweden Post. Sweden Post maintains that it is hindered in its ability to compete as it cannot offer discounted "local prices" to counter competition on the intra-city routes.

This problem demonstrates the importance of making sure the market rules applying after deregulation do not unnecessarily restrict the government postal authority and allow for effective competition.

There has also been a suggestion that Sweden Post's current financial difficulties are in part caused by problems with its banking business. Despite these financial difficulties, Sweden Post claims that its costs have fallen since deregulation and that volumes have risen.

In Finland, the market for postal services has been deregulated since 1991. So far only Finland Post has been granted a licence to service all of Finland. However, other enterprises have applied for restricted area licenses. It is, however, worth noting that a licence is not required for the provision of some postal services, so long as they:

*...do not cause excessive difficulty to the maintenance of nation-wide operation of postal services (Statutory Order on Postal Services quoted in NERA 1997a p. 41).*

Finland Post has noted that it considers that its biggest competitive challenges will come from electronic communications, not other traditional postal service providers.

At the moment, the Finnish USO is funded from the postal administration's profits. Finland Post has performed well since liberalisation. Finland Post estimates that it has about 85 percent of the postal services market. Even so, the Finnish Government is examining ways of ensuring continued funding of the USO, including an industry levy.

In the Netherlands, the Post Office (PTT) has been privatised. PTT (which provides both postal and telecommunications services) is part of larger company - KPN. The

parent company has announced that it intends to split the PTT into two groups. There is still a legislated letter monopoly in the Netherlands, supplied by PTT Post.

In the broader European Union (EU) market, there are moves to bring postal administrations into harmony. A part of the EU policy on postal services is to encourage use of common terminology and standards. These include a common definition of CSO (which the EU does not see as necessarily being accompanied by a uniform price requirement), common definition of reserved services and access arrangements. In addition, the EU proposals would have postal administrations keeping separate accounting records for reserved and non-reserved services.

In 1997, Canada Post's postal monopoly was reviewed. The Canadian government has avoided radical reform of the post office but has put in place reforms it believes will enable Canada Post to earn an acceptable rate of return. Canada Post earned a profit of \$CAN 70 million on revenue of \$CAN 4.9 billion in 1996.

In New Zealand the monopoly has been reduced to twice the letter rate. There is a Bill before the New Zealand Parliament to deregulate postal services which is expected to be passed in 1998. There are a number of interesting aspects to the proposals. While mail services will be completely deregulated, New Zealand Post will remain responsible for the delivery of the CSO, which it is expected will be funded from the continued profitability of the New Zealand post office and through financial benefits associated with its official designation for UPU purposes (essentially earnings from sales of stamps). Broader access is also a feature of the Bill, with fair and reasonable terms and conditions to be negotiated between New Zealand Post and the enterprise seeking access.

Several conclusions can be drawn from the overseas experiences. Reform of postal services has generally lagged other economic reforms. The most dramatic results have occurred when both the postal authority and the government are moving together on reform. In addition, each country has its own special needs and expectations of its postal service. These needs and expectations are driven by geographic, cultural and historical factors. As a result, the reform packages need to be tailored to each country's special requirements.

### **8.3.3 Industry Assessment**

Many submissions and discussions focussed on the need for reform and its likely outcomes. A number of submissions called for no change in the reserved services

and uniform price legislation. In general, these submissions stressed that the system was working and need not be changed.

For example, the Country Women's Association (CWA) wrote:

*In conclusion we feel that Australia Post at the present is servicing its customers well, and is completely adequate as it stands. "If it ain't broke don't mend it" (CWA, submission 20, p. 3).*

The Post Office Agents Association Limited (POAAL) noted:

*We believe that the statutory reservation to Australia Post of the exclusive right to carry letters is both necessary and vital for the well-being of the country as a whole ... The reservation of certain services to Australia Post enables a standard service to remain in place with the security and reliability customers have come to expect from Australia Post and its contractors (POAAL, submission 12, p. 8).*

The MMUA has noted that Australia Post could benefit from competition, however, it stressed the need to maintain the network:

*We are very conscious, however, of the need for great care to be taken to get the balance right, not from the perspective of protecting Australia Post from competition but rather that the vast network it runs (which is invaluable to Australian commerce) should not be damaged, nor delivery performances suffer (Major Mail Users of Australia Ltd, submission 121, p. 5).*

On the other hand, Treasury has noted that it is possible to exaggerate the likely effects on Australia Post of increased competition. It argues that in a deregulated environment, Australia Post can compete for bulk mail through the continuing use of discounts, and that this will remain an important component of its revenue. Additionally, while the uniform price would restrict Australia Post's ability to compete on price for single letters or low volume mailings, its current operations have a number of non-price advantages. These advantages include Australia Post's anywhere-to-anywhere network and its strong customer loyalty.

TNT are keen to expose the postal services market to competition, arguing that the current restrictions impose significant inefficiencies and costs on Australian business:

*Current restrictions on competition in Australia's postal services and cross funding the universal service obligation fosters inefficiency and imposes unnecessarily high costs on all users and an effective tax on business.*

*..The progressive removal of all restrictions on competition with Australia Post will deliver service innovation, lower prices and international competitiveness (TNT, submission 87, p. i).*

From a different perspective, Ansett noted that there were problems with the lack of competitive pressures:

*...the current restrictions with regard to reserved services, combined with constraints with regard to access to Australia Post's network are inhibiting the use of written material delivered to homes, offices and post office boxes to the detriment not only of the consumer interest but also businesses and their employment and economic development potential (Ansett Australia, submission 83, p. 2).*

Few submissions commented on past reforms. However, those comments which were received, both in the submissions and in meetings, suggested that the 1994 reforms have had little impact on competition in postal services.

The Communications, Electrical, Plumbing Union (CEPU) argued that Australia Post was now subject to considerable competitive pressures, particularly in mail processing and delivery. The CEPU went on to say that Australia Post operates one of the best postal services in the world. The Union quoted a World Bank report (Ranganathan, K. and R. Dey 1996) which concluded:

*It [Australia Post] is now ranked as one of the better performing postal enterprises....The lessons of the Australian experience in postal reform indicate that measured, carefully designed reform provides a good path toward optimal consumer and social benefit (quoted in CEPU, submission 16, p. 4).*

### 8.3.4 National Competition Council Consultancy

The Council commissioned Arthur Andersen to undertake a study of the effects on Australia Post's financial position of reductions in the amount a competitor can charge to carry letters. Arthur Andersen was asked to report on the effects on Australia Post of reducing the threshold to three, two and one times the standard letter rate, as well as the effect of removing the reserved services protection. In developing its model, Arthur Andersen assessed the level of competition likely at each reduction in the price threshold, as well as its effects on Australia Post's position in that market. The results of the modelling reported in this review are Arthur Andersen's, not Australia Post's.

The Arthur Andersen base case is explained in Chapter Five.

The scenarios are modelled as changes to the base case and have the joint assumptions that:

- any change to the regulation of the market occurs in 2000; and
- it takes three years for the impact of the change to completely filter through the market.

The following is a summary of the scenarios developed by Arthur Andersen.

#### *Scenario One: Threshold reduced to Three Times Standard Letter Rate*

Arthur Andersen reports that the model predicts no material change from the base case.

#### *Scenario Two: Threshold reduced to Two Times Standard Letter Rate*

The results of this scenario suggest a limited impact compared to the base case. By 2005 there is an annual revenue loss of \$30 million, an annual EBIT (earnings before interest and taxes) loss of \$13 million and a minimal impact on cashflow. These losses resulted from increased competition in the delivery of large letters. Overall, there was little impact on Australia Post's rate of return; by 2005 this is predicted to be 15.11 percent, compared to 15.48 percent in the base case.

### *Scenario Three: Threshold reduced to One Times Standard Letter Rate*

There are two effects on performance in this scenario: aggregation strategies<sup>2</sup> and increased competition, with the bulk of the effects arising from aggregation. At present, aggregation is not an option as Australia Post does not permit bulk mail lodgements to comprise other than one discrete mailing from one organisation. It is therefore not possible to access the maximum Australia Post bulk mail discounts by consolidating mail from various sources.

Under Scenario Three, there is a \$174 million decline in Australia Post's total revenues compared to the 2005 base case outcome. Arthur Andersen suggests that while the results for this scenario will certainly have a measurable impact on Australia Post's financial performance, its operations are still viable. Arthur Andersen predicts a rate of return of 11.5 percent in 2005, three percentage points less than in the base case.

Of considerable interest is the significance of the aggregation effect compared to the competitive effects. Arthur Andersen has done some sensitivity analysis on its model, including the effect of aggregation alone. It appears from this work, that in the One Times scenario, aggregation accounts for around two thirds of the forecast fall in both profits and revenue. From this analysis, it is likely that Australia Post's proposal for a graduated phase-down to 'One Times' protection will have a very limited impact on Australia Post and the market.

### *Scenario Four: Open Competition*

This scenario removes the restrictions on the prices competitors can charge, and on the carriage and delivery of the currently reserved services. This means that postage prices will be based on costs and that competing services will emerge. In the previous scenarios, which contained market protection based on price restrictions, Arthur Andersen concluded that only niche market opportunities would emerge as competitors could not undercut Australia Post's prevailing price structure. However, the removal of the price restrictions in the open competition scenario would make it much more likely that more broadly based competition would emerge.

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2 In the One Times and Open Competition scenarios, Arthur Andersen has relaxed the aggregation restrictions currently placed on bulk mail by Australia Post. The Australia Post reform option (See Appendix Six) does not contemplate relaxation of these restrictions.



With open competition, compared to the base case, Australia Post's revenues decrease by \$347 million. As well, projected EBIT virtually halves from \$504 million (base case in 2005) to \$260 million. As a consequence, projected net profits are also around half the base case at \$150 million compared to \$307 million. The rate of return on assets would fall to 8.1 percent while the rate of return on capital falls to 18.9 percent.

It is important to note that in comparison to the \$233 million net profit Australia Post achieved in 1996-97, the change in net profits is not substantial. Further, the Arthur Andersen assumption is that there is no change to the funding of the CSO. The Council has recommended that Australia Post be directly funded for the CSO. This would add to the projected profits and reduce the impact of erosion of market share due to increased competition.

Thus, even faced with open competition, under the Arthur Andersen model, Australia Post remains a viable business: the Council considers that a commercial rate of return for the Australia Post business is 8-9 percent.<sup>3</sup> The greatest downside effect is to reduce the government's dividends. On the other hand, there are considerable consumer benefits, including a significant drop in prices, and no increase in the uniform rate. All this is achieved with no closure of postal outlets and the retention of the letter service USO at current standards.

## **8.4 The Council's Reform Package**

### **8.4.1 Level of Deregulation**

The work done by the Council and by its consultants indicates that there is potential to increase competition for the reserved services without putting at risk the national network or the uniform price. The current postal arrangements create a strong link between the protection and level of the reserved services and the ability of Australia Post to provide and fund the CSOs. The results of the Arthur Andersen modelling indicate it would be possible to further increase competition in the supply of postal services, while still allowing enough cross-subsidy to fund the CSO.

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3 This is discussed in detail in Section 5.4.

If alternative means of funding the CSOs are used in combination with effective safeguards on the type and quality of services provided, then greater levels of competition would be possible, with less impact on Australia Post.

The discussion in Chapters Six and Seven and earlier in this chapter has presented a number of points which favour increasing competition.

- Increased competition need not necessarily lead to a loss of the CSO services. It is desirable to fund the CSOs externally so that the objective of providing a universal service does not impede the introduction of competition.
- Business customers, including small business customers, can benefit from competition.
- Competition can be introduced in a way which does not undermine the uniform rate of postage, or disadvantage small volume customers, who have most frequently suggested that the monopoly should be retained.
- Competition will put pressure on Australia Post's businesses but Australia Post will remain viable, particularly with a business focus and attention to reducing costs.
- There are several companies which could provide low cost innovative postal services if they were allowed to compete with Australia Post.

The Council's reform package has five key components:

1. a uniform rate of postage should be retained for individuals and households posting standard letters;
2. Australia Post should be allowed to offer discounts to business customers but no business should pay more than the uniform rate to post a standard letter;
3. the USO should be retained, with the CSOs fully funded;
4. the monopoly over household mail should be retained by requiring competitors to charge two times the standard letter rate for this mail; and
5. business and inwards international mail should be opened to competition.

The first three components are discussed in Chapters Six and Seven. The last two are the subject of this chapter.

All elements of this package are interrelated and therefore the Council's approach to the uniform rate of postage and the CSOs has influenced its approach to reform.

*Retention of the monopoly over household mail by requiring competitors to charge two times the standard letter rate*

The reasons for maintaining the uniform rate of postage for household and individual mail is discussed in Chapter Six. To give effect to the uniform rate of postage, it is necessary to retain part of the monopoly.

If Australia Post has a uniform rate of postage for mail sent by households and individuals, there is a risk that other providers would target the most profitable routes, that is metropolitan mail, and undercut Australia Post. Thus city residents would have the choice of a greater range of services and lower prices than available in rural areas. To satisfy the equity considerations and ensure this cannot happen, it will be necessary to prevent other operators providing those services covered by the uniform rate of postage. Therefore, those services covered by the uniform rate of postage should be reserved to Australia Post.

To offer some degree of protection to this market, the Council considers that the threshold for competition should be two times the uniform postage rate. The service that is covered by the uniform rate of postage will continue to be the ordinary letter service. It will not cover any other services provided by Australia Post, such as those offering faster delivery.

*Business and inwards international mail should be opened to competition*

The Council's analysis has shown that the greatest gains from competition will flow to business customers. It is possible to realise these gains by:

- at least partially funding the CSOs other than by a cross-subsidy;
- introducing a maximum charge for business mail; and
- removing business mail from the reserved services.

This package will give business the choice of using the 45 cent letter service, an alternative postal service provider or a discounted service through Australia Post. In addition, the Universal Service Obligation will still apply to letters sent by businesses.

***Key Recommendation***

**The Council recommends that business mail should be opened to competition. The minimum competitors can charge for those letters which remain in the monopoly (household mail) should be two times the standard letter rate.**

### 8.4.2 Letter and Reserved Services Definition

To give effect to the Council's recommendation to increase competition it is necessary to look at both the definition of a letter and the definition of reserved services. Chapter Two discussed the criticisms of the current letter definition. The Council's approach is to make the letter definition as simple as possible and then to also simplify sections 29 and 30 to reduce the confusion caused by the range of exceptions from the reserved services.

The Council's view is that only standard postal articles that cost less than two times the uniform rate, and do not originate from business, should be reserved to Australia Post. The Council has considered various suggestions for how this result can be achieved simply.

By way of illustration, the changes to the Act could be along the following lines:

**“letter”**

means a **standard postal article** that contains an addressed written communication.

The reserved services could then read in section 29:

**Services reserved to Australia Post**

- (1) Australia Post has the exclusive right to carry letters for a fee or charge, other than **exempt letters**, within Australia.
- (2) For the purposes of this section, a letter is an **exempt letter** if the letter is:

- (a) one that costs at least two times the fee or charge that Australia Post imposes for the carriage of a standard postal article; or
  - (b) originates from a business.
- (3) In this section, **business** includes a business not carried on for a profit.

It is important for the definition of business in the legislation to fully capture the Council's meaning. The above definition is from the TPA. The benefit of the TPA definition of business is that it is an inclusive one, it is likely to be interpreted broadly, and therefore result in less confusion. An alternative is to be more descriptive. For example;

- (3) In this section, **business** includes any entity whose primary function is to provide goods and services and includes: charitable organisations, non-profit organisations, corporate bodies, partnerships, associations, agencies, public institutions (including government departments and elected officials), or any other thing that is involved in commerce or industry.

The Council considers that 'business' should include more than just entities engaged in trade or commerce, so that for example, governments and charities are also included. It should also cover enterprises such as small businesses and farms.

In deciding if a customer is a business customer or not, a carrier should not be required to undertake exhaustive investigations. This would be time consuming, costly and would have the effect of stifling competition. Rather, it should be sufficient for the carrier to make sufficient inquiries to reasonably assume the customer is posting business mail.

There will need to be changes to section 27 to make it clear that Australia Post's universal service obligation includes the requirement to supply a standard letter service for all standard postal articles, including those letters exempt under the reserved service. One way of achieving this would be to amend section 27 (2)(a) to refer to letters instead of the reference to 'letters that Australia Post has the exclusive right to carry.' Section 27 (2)(a) would then read:

- (a) to carry, within Australia, **letters**; and

Under the approach outlined above, all the exclusions to the reserved services are covered in section 29. Under the Council's recommendation, all of the exemptions currently in section 30 remain outside the reserved services, and so section 30 would be repealed. Overall, to ensure there is less doubt about what is covered by the reserved services, the explanatory memorandum to the amending bill should discuss the changes in suitable detail.

### 8.4.3 Postage Stamps

Under section 29(3), Australia Post has the exclusive right to issue postage stamps within Australia. Australia Post's Sprintpak division produces stamps for Australia Post as well as other postal authorities. This right to *issue* stamps is not the same as Australia Post's control over the *sale* of stamps. This second issue is discussed in Chapter Ten.

The monopoly on the issuing of postage stamps has two aspects. First, postage stamps are proof of prepayment for postal services. Second, stamps are collectors' items.

#### *Stamps for pre-payment*

The monopoly on issuing stamps means that competitors cannot issue their own postage stamps. However, if prepayment is required by competitors, other means are available. For example, courier companies can supply prepaid envelopes, sticky labels or other means of payments. In New Zealand, the proposals to deregulate the postal services include:

*...the retention of the exclusive right of New Zealand Post to issue official New Zealand postage stamps for UPU [Universal Postal Union] purposes for a period of at least five years. Other operators may issue coupons or labels, but these will not be recognised as 'official' New Zealand stamps (New Zealand Government 1997, p. 6).*

The monopoly on issuing postage stamps does not appear to have a significant impact on the ability of others to compete with Australia Post's services. The Council received several comments in submissions on this issue, all of which agreed with the above conclusion. For example, Reader's Digest noted:

*The issuing of stamps does not have any impact on others to compete with Australia Post. As pointed out they are proof of payment. Any competitor could develop their own proof of payment system as it is relevant to them (Reader's Digest, submission 116, p.3).*

The Council considers that the rights of Australia Post to issue of postage stamps as proof of payment does not restrict competition.

### *Stamps as collectibles*

As collectibles, postage stamps may offer Australia Post the opportunity to exploit its monopoly position. To the extent that its philatelic products are different to philatelic products from other countries, Australia Post has some market power: only Australia Post can produce Australia Post stamps. This level of market power may approximate levels available to holders of trade mark brands or copyrights. Australia Post has been working to expand this market.

While it is not possible to compete head on with Australia Post in the philatelic market (except in the resale of Australia Post stamps) Australia Post faces competition from stamp producers outside Australia and from vendors of collectibles in general. It therefore faces competition from a number of sources.

It appears likely that the legislation provides no real competitive advantages for Australia Post. There do not appear to be any substantial competition or competitive neutrality issues in the postage stamp monopoly.

### *Resale Price Maintenance*

Section 48 of the TPA bans resale price maintenance (RPM). Essentially, resale price maintenance is defined as conduct which is:

- *attempting to induce a person not to sell the supplier's products or services at less than a price specified by the supplier;*
- *making it known to a person that the supplier will not supply her or him unless that person agrees not to sell below the supplier's specified price; or*

- *entering an agreement for the supply of goods or services containing a provision that the purchaser will not sell below the supplier's specified price (Miller 1996, p. 199).*

At the same time, section 33A of the Australia Post Act prohibits the sale or supply of stamps for less than their face value. In these circumstances, the Australia Post Act takes precedence. Section 33A was inserted as part of the 1994 Australia Post Act amendments to clarify the Australia Post Board's power to:

*...set terms and conditions covering the retail sale of postage stamps by post office agents and licensees. The ... amendment is needed to support the uniform pricing policy for standard letters (House of Representatives 1994, p. 2971).*

This clause restricts the development of competitive markets between Australia Post and agents for the supply of stamps.

Treasury has argued that:

*For each stamp sold outside the retail chain, AP only receives the 'wholesale price' and, by losing the difference between the retail and 'wholesale' price, it arguably diminishes its ability to fund the USO. It has been further argued that if retailers were allowed to undercut the retail price this would exacerbate the loss of revenue (Treasury, submission 52, p. 18).*

The Australian Competition and Consumer Commission (ACCC) has the power to grant exceptions to the RPM provisions of the TPA, if it is convinced there is a public benefit which outweighs the anti-competitive costs. Treasury has suggested that Australia Post's argument for the retention of section 33A of the Australia Post Act:

*...should be tested by the ACCC and that authorisation under the Trade Practices Act would be preferable to an industry specific exemption (Treasury, submission 52, p. 18).*

The Council believes that to maintain the Government's uniform price objective the general discounting of stamps would not be appropriate. However, the market for postal services should change following the recommended deregulation. It may therefore be appropriate to review the benefits and costs of RPM at the same time as the uniform rate (see Chapter Six).



***Recommendation***

**The Council recommends that the exception to the resale price maintenance provisions be reviewed in conjunction with the review of the uniform rate of postage in 2005.**

#### **8.4.4 Street Posting Boxes**

Several of the submissions to the review have suggested that Australia Post gains an advantage from its right to erect street posting boxes. While the ability to erect such boxes is not reserved to Australia Post, section 95 of the Australia Post Act confers on Australia Post the right to erect, maintain and use street boxes.

While other operators may be able to reach agreement with local authorities on the erection of similar boxes, it is claimed Australia Post's statutory right confers considerable advantages on it:

*...only Australia Post has the statutory right to erect and service kerbside posting boxes at whatever commercially attractive location it chooses without the need to submit to environmental, town planning or traffic regulation (TNT, submission 43, p. 11).*

Several groups involved in this review have maintained that this gives Australia Post a unique advantage in being able to reduce the costs of one of the vital parts of the service chain - namely collection of articles.

With the introduction of the Express Post service, Australia Post used the legislation to erect gold boxes specifically for collecting Express Post items. At the time of its introduction, the Express Post service fell mainly within the definition of the reserved services. Following the 1994 legislative amendments to the Australia Post Act, it now operates completely in the competitive market. Competitors have consistently argued that the continuing use of the gold boxes confers a large benefit on Australia Post's ability to compete in this market, and that this was arguably not the intention of the legislation.

The Council notes that the right to erect collection boxes for the reserved services is an important aspect of Australia Post's ability to provide access as required by the

universal service obligation. However, there is some evidence to suggest that extending this right to the collection of products clearly in the competitive market segment confers an unintended advantage on Australia Post.

In its Options Paper, the Council flagged three options:

- allowing others to have similar rights to erect boxes;
- requiring Australia Post to allow access to the Australia Post boxes; or
- restricting the application of section 95 to reserved services.

The Council is of the opinion that extending the rights to erect collection boxes or requiring Australia Post to allow access to its boxes are unnecessarily complex ways of dealing with this issue. The Council appreciates that the ability of the community to access postal services is an important aspect of the Universal Service Obligation. While it is not possible to guarantee that street posting boxes are used only for reserved services, it is feasible to remove Australia Post's advantage for new boxes targeted specifically at non-reserved services. The Council therefore recommends that the right to erect posting boxes should be maintained but it should be restricted to the ordinary red posting boxes suitable for posting standard letters.

#### ***Recommendation***

**The Council recommends that the right of Australia Post to erect posting boxes should be maintained for the ordinary red posting boxes suitable for posting standard letters. Otherwise, Australia Post should be subject to the same requirements as other postal services providers.**

This should in no way impede the ability of any operator, including Australia Post, to negotiate with the relevant authorities to erect street posting boxes or other collection facilities. The effect should be to put Australia Post on the same footing as other operators in respect to street collection of items not covered by the reserved services.

#### **8.4.5 International Mail**

International mail, while constituting a small fraction of Australia Post's mail is responsible for a significant proportion of the CSO. This is a consequence of the payments system for dealing with international mail known as terminal dues.

*Box 8.2 Terminal Dues*

The system of terminal dues is administered by the Universal Postal Union (UPU), a specialised United Nations' institution which regulates international postal services. In 1996, there were 189 member countries of the UPU.

Terminal dues operate as a system of clearances for the settlement of accounts between postal administrations for the carriage of international mail.

Article 73 of the UPU Convention applies when a country has an excess of inwards mail over outwards mail. In this case the country has the right to collect a payment for the costs of delivering the excess international mail. Conversely, administrations with an excess of outward mail make a payment for its delivery.

The level of payment is set at the average cost of delivery across all countries. While the level of payment was increased in 1996, following the last UPU Convention in Seoul, the rates are still well below Australia Post's cost of delivery.

Until the 1994 legislative amendments, all international mail was reserved to Australia Post. Since then, outward bound international mail has been open to competition.

Australia Post appears to be facing some vigorous competition for the business (large volume) segment of the outward bound international mail market. However, for other smaller volume customers who require a counter service (such as people from overseas who want to exchange letters with family members) competition has been slow to emerge. Overall, Australia Post reports that its volume of international mail has increased, particularly outward mail, which has grown from around 147 million articles in 1993-94 to over 160 million articles in 1996-97.

Delivery of inwards international mail is reserved to Australia Post. Inwards mail is either paid for at the appropriate UPU rates (for other UPU members) or at the domestic letter rate for non-UPU members. However, Australia Post still has a sizeable CSO to fund, mainly because the UPU rates provide inadequate compensation to Australia Post for the delivery of incoming international mail (see Box 8.2). The broader issue of Australia's involvement in international postal treaties and obligations is canvassed in Chapter Nine.

If inwards international mail was deregulated, to the extent that inwards mail would need to interconnect with Australia Post's domestic letter stream and pay Australian rates, Australia Post should gain. To the extent that inwards international mail is delivered by other parties and this mail was previously delivered by Australia Post at a loss, then Australia Post should also gain.

Australia Post (Australia Post, submission 99, p. 16) has argued that if international inwards mail was deregulated, there would be an incentive for other service providers to consolidate domestic mail offshore, bring it back into Australia as international mail and so bypass Australia Post. However, the Council's recommendation for more competition in letter delivery in Australia means this is no longer a problem, as other postal service providers will be able to deliver in Australia.

The Council considers that the international inwards mail market should be opened to competition. An illustration of how this could be achieved is in the example of changes to section 29 of the Act in section 8.4.2.

***Key Recommendation***

**The Council recommends that inward international mail be opened to competition.**

The UPU does not appear to be structured in such a way as to allow for more than one postal authority from each member country; that is, it does not contemplate competition in postal services in its member countries. The treaty also requires each member country to identify its designated UPU carrier. If the inwards international mail was opened to competition, other carriers of this mail would be expected to emerge. The question then arises as to who should be the designated UPU carrier.

In the longer term, Australia may wish to initiate some changes to the UPU constitution to allow for the situation where there is more than one carrier. In the meantime, following the New Zealand model, Australia Post could remain the designated UPU member, which would give it, amongst other things, the right to issue official stamps.

The other issues of UPU membership, including the delegation to the UPU, are discussed in the broader context of Australia's obligations to the UPU in Chapter Nine.

## 8.5 Effect of Competition

This section considers the impact on various groups of exposing mail services provided to business to competition while retaining Australia Post's monopoly over household mail.

Postal services are used by every business in Australia. Few other essential services affect the costs of so many businesses. Therefore, the cost of postal services is not only important from the perspective of the postal industry, but also in terms of its impact on other industries in Australia.

### 8.5.1 Customers

The effects of increased competition on customers will be various.

#### *Individual customers and households*

For some categories of customers, particularly small volume mailers, including individuals, households and businesses with low mail volumes, the effects may be barely noticeable. Australia Post will still charge a uniform rate of postage and the universal service will still be available. In submissions, it was usually these groups which suggested that the current policies should not change. By retaining the monopoly for these customers, the Council's recommendations will ensure their interests are protected.

These customers will also still have access to a complaints mechanism, through the office of the Ombudsman. In addition, the industry code of conduct will ensure that practical issues of postal delivery are addressed so that services, such as mail holding and mail redirection, are still available, no matter who delivers the mail (see Chapter Nine).

#### *Large volume customers*

Large volume users and mailing houses have argued that there would be significant gains from competition. The Council's recommendation to increase competition in these areas will have a number of effects. These customers should encounter greater choice of both product and supplier, increased flexibility, lower prices and the ability

to negotiate terms and conditions and even special products and services. As TNT has noted, opening these markets to competition:

*...would result in an immediate expansion in the range of service offerings, allowing customers a choice of collection options including on site pick up, a range of delivery times and service frequencies, and various priority, tracking and security options at differentiated competitive prices. (TNT, submission 87, p. 7).*

Streetfile has noted that the restrictions on competition have amongst other things:

*...imposed indirect taxes on business and urban consumers;...prevented mail from taking its rightful place as the low cost alternative for direct consumer marketing, thereby adding to consumer costs;...prevented the transfer to Australia of expertise, skill and technology needed to resolve distance communications problems for Australia's rural and remote communities... (Streetfile, submission 10, p. 31).*

For example, Streetfile claims that the price of letters for large volume mailers could fall by as much as 20 percent if the postal services market was opened up. Streetfile suggested that this could translate into annual savings of at least \$144 million for large volume mailers.

#### *Small business customers*

Small business will have a choice of using the 45 cent letter service, an alternative postal provider, or a discounted service through Australia Post.

Several submissions noted that there are a number of organisations, including small businesses, which do not generate sufficient mail to take advantage of Australia Post's current bulk mail discounts and which could benefit from a more competitive regime:

*Small business in particular would benefit from the opportunity to have service and price packages tailored to their individual requirements (TNT, submission 87, p. 7).*

However, with competition there are strong incentives for Australia Post to attract the maximum business it can. Therefore, it is likely that greater discounts will be available to small business.

Some submissions have suggested that there may be advantages to be gained for small businesses if mail consolidation is permitted. At present, a minimum mailing of 1000 letters is required to qualify for a bulk discount.<sup>4</sup> Maximum discounts are available if sorting is to postcode level. To gain the largest discounts, the volume of mail generally needs to be quite high. Because of the volumes required, most small businesses would not qualify for bulk mail discounts. More mail could be sorted to the postcode level if mail from more than one mailing was combined by the mailing house processing the mail. Such consolidation of mail from multiple jobs is currently prohibited in the terms and conditions of the bulk mail service. Australia Post's proposal does not envisage this changing.

One mail house noted:

*...we need to be able to aggregate mail of similar classification across multiple clients. This provides the advantage to smaller bulk mail customers to gain access to higher levels of presort discount (Salmat, submission 118, p.13).*

The Council's proposal does not require Australia Post to accept aggregated mail. It does, however, mean that there would be strong incentives for Australia Post to maximise its volume and minimise its costs. To the extent that aggregation reduces Australia Post's costs of sorting and barcoding small business mail and provides savings for customers (thus encouraging them to use Australia Post's services) then allowing aggregation will be attractive to Australia Post.

#### *Remote Area Customers*

The services provided to rural and remote area customers will be largely unchanged.

- Customers in rural and remote areas will still have access to the uniform rate of postage.
- The industry codes of practice will ensure that there will still be mechanisms for dealing with mail redirection and return mail.
- Australia Post will still be required to provide a universal service.

In addition, the recommendations offer benefits to rural and remote customers.

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<sup>4</sup> The minimum lodgement is 1000 letters if delivery is to a single postcode and 2500 if delivery is to more than one post code.

- There will be greater certainty in their CSOs. Not only will the CSO be better defined, but customers will know what to expect from the CSO. The delivery of CSOs will be monitored and the results made public.
- If Australia Post wishes to make changes in the way mail is delivered in rural and remote communities and therefore needs to conduct a poll of the community, there are recommendations in this report which will ensure that there is better information available about the polling and its effects. This will make the polling fairer and more open so that the results accurately reflect the wishes of the community.
- Those customers who receive less than three mail deliveries a week will have fees for locked and private bags abolished.

### **8.5.2 Competitors**

Competitors to Australia Post are likely to fall into two categories: those supplying a full letter service (although not necessarily with universal coverage) and those supplying part of the letter service, such as mail houses. The targets for both groups, at least in the short to medium term, will be high volume mail users and business mail generators.

It is not possible to predict precisely the type or number of competitors which will arise, or the range of services they will provide.

Any competitor will need to offer an attractive package in order to overcome the reputation and customer loyalty Australia Post will retain. In particular, Australia Post has strong customer loyalty and a very positive customer image. For a large number of postal service users, the cost of the postage is only a small part of their budget, so incentives to switch suppliers may need to be very strong.

The types of alternative delivery networks most likely to emerge with competition would be within and between major metropolitan and regional centres. For example:

- a national network linking metropolitan and major regional cities, but with no rural or remote coverage; and
- a number of local networks, serving metropolitan or regional centres.

Several organisations have indicated they may consider setting up a national network. Indeed, Streetfile has noted that its coverage is already very wide:



*Streetfile is already an alternative postal network. We operate the largest private sector addressed delivery network in Australia, delivering to 96 per cent of Australian households (5.85 million) through a network of 24,168 contractors offering seven days a week, 365 days a year deliveries (Streetfile, submission 10, p. 38).*

Where the postal service has been opened to competition in other countries, new service providers have targeted local area delivery. This has occurred in both Sweden and Finland. In Australia, if companies wish to provide this kind of service at present, they must do so as couriers:

*The first [matter] is Australia Post's monopoly over intra-town mail. It is our understanding that alternative deliverers of mail within the town of Narrogin must assume courier status if they are to undertake the work. Further, that courier status brings with it a high degree of regulation and control that simply make it uneconomic to compete with Australia Post (Town of Narrogin, submission 48, p.1).*

Reform will also allow competitors to offer a wider range of services than at present. While some of these services and products may bear a strong resemblance to Australia Post products, there will be scope for niche products, particularly at the local level, and products tailored to customers' needs. It is likely that competitors will face considerable competition from Australia Post as it seeks to protect its market while at the same time expanding its product lines to counter the emerging competitive pressures.

As Australia Post provides only one type and level of service for its reserved services, consumers have no choice in the level of service.<sup>5</sup> TNT has argued that it is not possible to know exactly what consumers would demand, and what suppliers could provide in a deregulated market:

*The experience with telecommunications and other utilities demonstrates that competition will lead to an improved array of services, a choice of packages tailored to customers service requirements and usage patterns, and a greater customer focus. Only a competitive environment allows a meaningful answer to*

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5 Mailers who are able to post in sufficient bulk to take advantage of the bulk pre-sort discounts are able to choose a lower level of service and pay less by choosing the 'Off Peak' option.

*whether the current postal arrangements are satisfactorily meeting the community's needs. Certainly we know that where other utility services have been opened to competition, the consumer has responded positively to the increased choice and the market has grown. There is little doubt that consumers would like to see more flexibility in opening hours, have access to weekend deliveries and be able to choose between a greater variety of appropriately priced services. (TNT, submission 43, p. 10)*

Several other submissions have also noted the effects of freer competition following the reform of the telecommunications market:

*Increased competition (eg telecommunications) in other markets has seen dramatic improvements in the quality, price and range of services available. A relaxation of the competitive restrictions that saw similar developments in the postal sector would be desirable (Insurance Council of Australia Ltd, submission 134, p.5).*

The Council's reform package will also allow for competitors to access the private post boxes supplied by Australia Post as well as the CSO services. This will have particular relevance for competitors for whom breadth of coverage is important.

### **8.5.3 Australia Post**

In assessing the impact on Australia Post of removing business mail from the reserved services, the Council has considered a number of issues, including:

- the potential impact of cream skimming;
- the effect of Australia Post's proposal for increasing competition; and
- the results of the Council's consultancy.

#### *Cream Skimming*

Australia Post and others have argued that reducing the monopoly will reduce Australia Post's ability to fund the CSO because of 'cream skimming' by other service providers (see Box 8.3).

Australia Post notes that:

*If however, several producers were to offer the service, it is unlikely that price uniformity can be assured.*

*The most serious breaches would occur from “cream skimmers” who would concentrate their efforts on the easier-to-service routes, leaving it to Australia Post to service high cost routes. Clearly this would be both inefficient and inequitable (Australia Post, submission 8, p. 84).*

The National Farmers’ Federation also raised concerns about the possibility of cream skimming:

*... further removal of statutory reservations could reduce Australia Post’s ability to meet its community service obligations. The current reserved standard letter service allows the fixed costs associated with providing the service to be spread across the entire community (National Farmers’ Federation, submission 39, p. 8).*

#### *Box 8.3 Cream Skimming*

The standard (45 cent) letter service does not make a loss on all routes. On most routes, in particular intra-city mail paths, it makes a profit. However, on some routes, such as between remote locations in different states, 45 cents does not cover the costs of delivery. Australia Post uses the revenue from its profitable routes to cover its costs on the loss-making routes.

If Australia Post did not have the protection of legislation, other operators might seek to service the very profitable mail paths by undercutting Australia Post. They might be able to do so because Australia Post has a higher average cost over its entire network because of its need to service the loss-making mail paths.

The strategy of servicing only the highly profitable mail paths while ignoring loss-making mail paths is sometimes called ‘cream-skimming’ or ‘cherry picking’.

In contemplating the question of market entry, it is important to note that competitors will be able to make a profit in three circumstances:

- cream skimming;
- providing new types of services; and
- offering existing services at lower prices.

The last two are highly desirable, as the result is services which better meet the needs of customers at a lower cost.

The potential for cream skimming arises when there are restrictions on Australia Post's ability to price services down to cost. There are currently two types of restrictions which affect Australia Post's ability to compete on price. First, the funding of the CSOs through a cross-subsidy. Second, the uniform rate of postage.

Under the Council's recommendations Australia Post is protected from both of these potential sources of cream skimming. On the first, the Council has recommended alternative ways of funding the CSOs. On the second, the Council is recommending retaining a monopoly over the services covered by the uniform rate of postage and therefore competitors are prohibited from competing in these services unless they charge at least double the uniform rate.

#### *Australia Post's Option*

Australia Post's preferred reform option is reproduced at Appendix 6. It argues for a phased reduction in the reserved services protection from four times the standard letter rate to one times the standard letter rate, but maintains the prohibition on aggregation of mail from different sources.

Several submissions have commented on the Australia Post proposal. Mayne Nickless noted:

*Adoption of Australia Post's proposal would see its position strengthened further. Its intention to invest major funds (understood to be \$495 million), continuation of, albeit reduced, reserved services protection until 2002, retention of the local delivery natural monopoly and publicly stated growth predictions in non core activities ... allows Australia Post unfair advantage to build its strength in the contestable areas. At the same time it*

*offers no specific objectives as to how it will improve its customer performance from a satisfaction level of about 93%, which is unacceptable in a transactions based business (Mayne Nickless, submission 120, p.1).*

In a similar vein, TNT commented:

*...we do not consider that a phased reduction in the degree of protection offered to the standard letter would result in any significant increase in competition. While ever the incumbent service provider enjoys protection through a price multiple ...[it] makes very little difference to the fact that there is a negative incentive for customers to choose an alternative supplier (TNT, submission 87, p. 8).*

Australia Post argued that around 70 percent of its letter volume would be vulnerable to competition under its proposal. While this may be true in principle, it is difficult to contemplate the emergence of significant competition. All evidence suggests that at one times protection, there is little incentive for an expansion of alternative networks. In particular, there is no evidence of any expansion which would target only the small business and residential markets, which make up the bulk of the mail identified by Australia Post as 'at risk'. The very strong loyalty of most Australia Post customers and the fact that postal services account for only a very small proportion of budgets for non-bulk mailers means that alternate network suppliers are unlikely to expand at one times protection.

Arthur Andersen suggested that niche markets, typically focussing on areas of high population density and on products which readily give rise to opportunities for service differentiation, will be where most competition arises from a one times reserved service. Arthur Andersen suggested that this competition is most likely to arise in the bulk pre-sort mail market, if competitors can bundle together some of their value adding services with the postage. There is greatest scope for this with large (non-standard) letters. While the exact nature of this competition is difficult to quantify, the Council estimates that, based on the Arthur Andersen model, actual competition would affect less than five percent of all letter mail. This is well below the ten to twenty percent of the total letter market implied by Australia Post's proposal.

It is important to note that Australia Post's preferred option is not the same as the one times scenario built by Arthur Andersen and reported above and in Appendix

Three. The latter includes aggregation and it is this factor, rather than the reduction in the monopoly protection per se, which drives most of the change reported by Arthur Andersen in this scenario. Arthur Andersen undertook further work modelling the effects of aggregation alone. If these effects are removed from its one times scenario, Arthur Andersen predicts a loss of after-tax profits of around five percent by 2003, rather than a loss in the order of 30 to 47 percent as estimated by Australia Post (submission 8, p. 102).

Accordingly, the negative effects of the one times scenario suggested by Australia Post are overly pessimistic. In addition, it is not clear that the Australia Post model allows for any action on the part of Australia Post in countering competition, such as lowering costs or growing the market by offering new products.

Australia Post has said that its preferred option:

*...has many benefits which should not be overlooked: exposure of an additional one billion dollars of revenue to competition (reducing the reserved service to only 16 percent of total revenue) (Australia Post, submission 97, p. 4).*

While the reform package proposed by the Council looks very different to Australia Post's package, in gross terms they will liberalise a similar proportion of current services. The 1994 amendments deregulated letter services which, at the time, accounted for around ten per cent of Australia Post's annual revenues. Currently, about fifty percent of Australia Post's revenue is earned from services in competitive markets. Under Australia Post's proposal, this would increase to 84 percent. This compares with the Council's package where the revenue exposed to competition is 93 percent, albeit introduced over a shorter time-frame.<sup>6</sup> The main difference lies in the deliberate targeting by the Council of deregulation of services where competition would provide the greatest benefits to the community and the least threat to the universal service obligation.

#### *Arthur Andersen Consultancy*

The open competition scenario, considered by Arthur Andersen, predicts very little interest from competitors in supplying services to household customers. Therefore, the results of the open competition scenario would be similar to the Council's proposal

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<sup>6</sup> In addition, the Australia Post estimate is at the high end of the range and assumes that nearly all non-bulk letters will be vulnerable to competitors. On the other hand, the Council's estimates are based on an estimate of the amount of business mail which could realistically be expected to be vulnerable to competitors.

of removing business mail from the reserved services. The model predicts that even under the open competition scenario, Australia Post would remain viable, albeit earning a rate of return less than at present but still in an acceptable range given the nature of its business. Return on assets at 8.1 percent is within the average for publicly listed companies (see Chapter Five).

One of the reasons for funding the CSOs externally is so that Australia Post can be compensated for the supply of the CSO services after the reduction in monopoly protection. Arthur Andersen models Australia Post's financial health without this compensation. As the costs of the CSOs are already factored into the model, any CSO funding received by Australia Post would improve Australia Post's profit levels. Arthur Andersen notes that its model results are sensitive to the assumptions used. For example, if competitors were more aggressive in seeking market share, if growth in mail volumes is significantly less than projected and so on, Australia Post's financial position could be worse than predicted.

On the other hand, the model does not take into account any possible reactions by Australia Post to improve its financial performance in the face of greater competitive pressures. In particular, Arthur Andersen has noted that like any business facing competitive pressures, to withstand future competition, Australia Post will need to continue to address its strategic directions and search for ways to reduce costs, increase efficiencies and find new markets and products.

The Arthur Andersen model is based on very conservative assumptions. In other words, the likelihood is that the model understates Australia Post's robustness in the face of increasing competition, while the potential for Australia Post to exceed the results is high. For instance, Australia Post could improve its profitability beyond the results predicted by Arthur Andersen if:

- it reduced operating costs or improved efficiency;
- it deferred investment or identified investment savings;
- there was external funding of the CSOs;
- there was increased growth in mail volumes resulting from lower prices or new services offered in a more competitive environment; and
- Australia Post reassessed its way of doing business in order to counter the impact of competition and reverse the erosion of its margins.

### *Licensed Post Offices*

The Council's recommendations will have most impact on the bulk and business mail sections of the market. There should be very little effect on the retail market. The effect of the recommendations on LPOs therefore should be small.

However, the Council does recognise that some LPOs rely heavily on mail sorting and delivery functions. To the extent that these volumes are eroded through competition to Australia Post, the income of these LPOs may be affected. In addition, some LPOs which rely heavily on small business custom may find that some of their custom is lost if new competitors target the very small business sector. However, it may be in Australia Post's interests in a more competitive market to allow its outlets, including LPOs, to provide distribution services to other service providers.

Some of these potential adverse effects will be mitigated to the extent that the increase in competition encourages growth in the market and some of this is captured by Australia Post.

Further, many LPOs are in rural and remote areas. The Council's recommendations to maintain the USO and CSO will mean that for most LPOs mail volumes will not be affected.

#### **8.5.4 The Government**

Another outcome from the Arthur Andersen modelling is that as increased competition will impact on Australia Post's profitability, so too will it impact on the size of the dividend paid by Australia Post to the Government. Arthur Andersen predicts that by 2005, the dividend to Government would be around \$150 million in the open competition case, or about half what it would be under the base case model. While this would cause the Government's revenues to be smaller than they would otherwise be, any reduction would be offset by the increase in tax revenue associated with any increased activity in the postal services market arising from increased competition.

The Government is also a large customer of Australia Post and any increased efficiencies in the provision of postal services will lower costs of postal services for government departments, agencies and businesses.



### 8.5.5 Employment

In a more competitive market, one of Australia Post's main aims will be to maintain its market share. To the extent that Australia Post is successful in achieving this, the impact on employment at Australia Post should be mitigated:

*If Australia Post was successful in expanding the appeal of its core services, the resulting increase in mail volumes will continue to provide employment opportunities for staff (Mayne Nickless, submission 120, p.21).*

Based on recent history and the evidence provided to the Council, postal industry activity is likely to increase with less regulation and more competition. As prices fall, volumes can be expected to rise and this creates opportunities for new entrants as well as incumbents. Further, increased market freedom should provide new incentives for innovation and hence further market growth.

Increased growth in the postal services market will lead to growth in investment and, due to the labour intensive nature of the business, it will also lead to increased employment:

*Streetfile expects to approach a deregulated market with substantial capital investment. Others might be expected to do the same (Streetfile, submission 10, p. 32).*

While some of this employment may be in delivery, other related areas of employment are also likely to increase, such as sales and marketing. For example, direct marketing would be expected to expand in a more competitive environment, with consequent employment effects. Reader's Digest has stated:

*Direct marketing has created new supporting industries.....The ripple effect on employment is incalculable, but substantial since it spreads into organisations which use and rely on direct marketing such as banks, insurance firms, airlines, publishers, etc (Reader's Digest, submission 56, p. 3).*

Since 1994 there has been limited deregulation of postal services. While Australia Post's workforce has been static over that period, total employment in the industry has increased. Over the past two years there has been a 15 percent increase in employment in the postal and courier services sector (Australian Bureau of Statistics,

Labour Force Estimates). Even in a totally deregulated market, postal services will remain relatively labour intensive, and total employment is likely to be strongly influenced by the level of services provided and overall industry activity.

Because the Universal Service Obligation and the resulting CSOs are retained this will also ensure that reductions in regional employment levels will be minimised.

The CEPU has suggested that:

*Many competitors do not provide comparable employment to Australia Post, its workforce being essentially casual, untrained, under-paid and with little incentive for commitment to standards. Employment growth in such areas cannot compensate the Australian community on a one-for-one basis for the loss of full-time, award covered and skilled employment at Australia Post (CEPU, submission 127, p.49).*

Australia Post has suggested that growth is likely to be mostly in areas with low paid and casual or temporary employment (Australia Post, submission 99, p. 31).

However, in order to compete with Australia Post, the level of delivery guarantee and service that competitors offer may need to match or exceed that of Australia Post. Those wishing to compete against Australia Post will need employment and industrial relations strategies which will ensure that their employees can provide this level of service. It is likely that Australia Post and the CEPU are overly pessimistic.

In any case, the Council is wary of arguments about what may, or may not, be high quality jobs - particularly when the argument supports fewer jobs overall at a time of high unemployment. The Council considers that a company's costs are not automatically lowered by employing casual, untrained people on low pay. What is important is the skills employees have and the quality of their work, that is their productivity. In a competitive market, the more productive jobs will expand, while the less productive ones will contract. If the CEPU argument is that Australia Post jobs will be more productive than jobs in competing companies then the number of people employed by Australia Post will not fall.

### **8.5.6 Price of a letter**

Australia Post currently charges 45 cents for delivery of a standard sized letter to almost anywhere in Australia. It has stated that it will continue with the standard

letter price freeze until 2002 if its preferred option for reform is accepted (see Appendix Six).

As noted in Chapter Five, Australia Post has earned record profits while holding the price of the standard letter constant. At the same time, its productivity growth has been well in excess of the increase in CPI. The very high level of Australia Post's profitability has raised the question of the sharing of its efficiency gains. In particular, it has been suggested that Australia Post has failed to pass on to its customers the full benefit of its efficiency gains.

For example, Treasury has noted that prices would have fallen in nominal terms in the period of the price freeze of 45 cents if:

*...a CPI-X price capping arrangement with  $X > CPI$  had been in place over the period... a reduction in prices for Australia Post's reserved services could be investigated (Treasury, submission 52, p. 20).*

The stated justification for the cross-subsidy arrangements is funding of the CSO. However, the Industry Commission argued that, after deduction of its CSO costs, Australia Post was over-funded by the cross-subsidy arrangements by as much as \$238 million a year (Industry Commission, submission 58, p. 52). Streetfile put the figure at a more conservative \$135 million (Streetfile, submission 10, p. 31).

The Council is unsure of the extent to which the letter price could be lowered in the face of competition. The Council has recommended opening the business letter segment of the letter delivery market to competition. As a result, Australia Post will have less ability to cut the standard letter rate. If the remaining reserved market only makes a reasonable return at the current uniform rate (taking account of the available economies of scale and scope in Australia Post's business), then it would be inappropriate to recommend reduction in the uniform rate. Accordingly, the Council does not consider it is appropriate at this stage to recommend reduction in the present rate of 45 cents until the full effects of competition become clear. On the other hand, the Council considers that Australia Post should be free to lower the standard letter rate if it wishes to do so in response to competition. Any application for an increase in price will be subject to ACCC scrutiny (see Chapter Nine).

***Recommendation***

**The current rate of postage of 45 cents should remain if the Council's recommendation to deregulate business mail is adopted. Australia Post should be free to lower the rate of postage below the current rate if it wishes.**

## **8.6 Making Competition Work**

The recommendations set out in this chapter will significantly increase the level of competition in postal services. However, they obviously do not equate to full deregulation. Australia Post still has a monopoly over household mail, the uniform rate of postage is retained and there is a requirement for Australia Post to meet Universal Service Obligations covering letter delivery.

As a result, it is necessary to look carefully at what regulation should cover the postal services industry. This regulation will need to support competition, service quality and the achievement of consumer objectives. These issues are discussed in the following chapter.

# Chapter Nine: Structural Issues and Access

*The introduction of competition to a monopoly market requires consideration of the structural arrangements which would provide the best opportunity for effective competition to evolve. This requires an examination of the regulatory and institutional arrangements in place and whether these arrangements are appropriate in a deregulated market. Other structural issues, such as an incumbent's level of monopoly power, may also need to be addressed to ensure that consumers gain the benefit of competition and the threat of competition.*

The Terms of Reference for the review require the Council to have regard to the Government's obligations under the Competition Principles Agreement of April 1995, which embodied a commitment in relation to the structural reform of public monopolies.

This commitment requires that the Commonwealth, before introducing competition to a public monopoly, separate out any regulatory role from the operation of the business and consider, among other things, the merits of changing the structure of the business by separating out those parts which have monopoly characteristics.

The Terms of Reference also require the Council to look at the operation of the current mail interconnection arrangements and the possible application of the general interconnection arrangements under the *Trade Practices Act 1974*.

The Council is therefore required as part of the review to examine the merits of separating the competitive elements of Australia Post's business from the monopoly elements, the most appropriate arrangements for access to the postal network by third parties and future arrangements for the regulation of postal services.

This chapter discusses these issues.

As the Terms of Reference also require the Council to have regard to the Commonwealth Government's commitment to maintaining Australia Post in full public ownership, the Council is also outlining issues concerning public ownership of Australia Post.

## **9.1 Addressing Monopoly Behaviour**

The principles underlying the National Competition Policy suggest that where competition is to be introduced to a sector traditionally supplied by a public monopoly, which has natural monopoly elements integrated with potentially competitive activities, there should be a presumption in favour of structural separation of the natural monopoly from competitive elements.

The rationale for this principle is that structural separation will act as a safeguard against anti-competitive behaviour by the former monopoly in a more liberalised market environment. The removal of regulatory barriers from a legislated monopoly market may not always of itself deliver a competitive market. Although removal of legislative impediments to competition is an essential step towards the introduction of competition, significant structural impediments to competition may remain and serve to delay or obstruct the benefits of competition.

Where an incumbent provides a number of integrated activities comprising elements that are open to competition and elements that have strong monopoly characteristics, there are risks which need to be considered when deciding the best approach to reform. For Australia Post, the potential risks are that it could:

- misuse its legislated monopoly over letter services to subsidise services in competitive markets;
- misuse the incumbent advantages of economies of scale or scope in some segments to damage competitors in other segments of the market;
- exploit the network externalities in the national post network to monopolise what would otherwise be competitive markets; or misuse other sources of market power.

These risks are discussed below.

### 9.1.1 Cross Subsidisation

Where a natural monopoly exists, or where an incumbent has strong monopoly characteristics, the potential exists for a business to use profits earned by the monopoly activity in a predatory manner. Specifically, without appropriate safeguards, monopoly returns could be used to subsidise services sold in competitive markets. In the case of reserved and non-reserved postal services, such a cross-subsidy would apply if prices charged for a non-reserved service were below the cost of providing that service.

Anti-competitive cross-subsidisation can deter potential competitors from entering the market and force out or severely disadvantage existing competitors. The likely outcome of such behaviour is that an incumbent's former monopoly status will be maintained and the full benefits of competition will not be delivered to consumers.

While Australia Post currently has a clear mandate to use cross-subsidies to fund its CSOs (see Chapter Seven), questions have been raised about Australia Post's ability to use cross-subsidies outside the reserved services. In particular, whether Australia Post's prices in competitive markets are being cross-subsidised from reserved services revenues.

According to Streetfile:

*...Australia Post is reluctant to reveal the detail of its letter service because there is substantial cross subsidy from the reserved services to commercial operations giving it a substantial competitive advantage in its other markets. For instance, in Australia Post annual reports, there is no mention of any vehicles used for the parcel service. This suggest that parcels are carried by the letter mail fleet. Carefully worded statements about no movement of profit between reserved and non-reserved services do not remove suspicion that the Australia Post infrastructure is so tightly intertwined that the Corporation has an enormous market advantage as a result of delivering the CSO (Streetfile, submission 10, p. 24, emphasis in original).*

Australia Post stated that:

*Cross subsidisation of competitive, non reserved services from the reserved services would infringe the principles of competitive*

*neutrality, and may breach the Trade Practices Act, to which Post is subject. **The enterprise is careful not to cross subsidise any of its competitive services as indicated.** A well developed product costing system based on regularly updated empirical information and supplemented by activity based costing ensures that postal prices are based on actual cost (Australia Post, submission 8, p. 111, emphasis in original).*

The Australian Newsagents' Federation has commented that:

*... it is difficult because of the financial information available to us to give hard supporting evidence for our claims that the retail activities of Australia Post are being cross subsidised by their reserve activities. However, our collective experience as efficient retailers coupled with our observations of various activities of Australia Post, leave us with no doubt that this is so.*

*In general the selling price of many Australia Post retail items, in particular stationery, is lower than what any competitive retailer would consider sustainable if he is to remain in business.*

*We therefore need to ask how this is being achieved and a response that it is through the bulk buying capacity of Australia Post, simply doesn't hold true as newsagents have access to similar buying capacity through their own buying group (Australian Newsagents' Federation, submission 109, p. 3).*

The difficulty with claims of cross-subsidy is verifying that Australia Post has priced services below cost in an anti-competitive manner. Many of the services provided by Australia Post involve joint costs. The nature of Australia Post's business also allows for some economies of scope<sup>1</sup>, in part because of the existence of the joint costs. It may well be that the extra cost of supporting some services is low. In particular, if the services in question are 'one off' contracts, arguably it is Australia Post's short term costs which are pertinent and these are likely to be very low (assuming that such 'one off' contracts do not impose any additional capital costs).

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That is, the ability of a business to share the costs of its facilities across a number of products.



A number of options are available to safeguard against anti-competitive cross-subsidisation. These include:

- structural separation of Australia Post;
- third party access to Australia Post's network;
- anti-competitive conduct provisions in the TPA; and
- detailed accounting separation of Australia Post's activities.

Each is discussed in the following sections.

## **9.2 Structural Separation**

The extent of Australia Post's market power has implications for the merits of changing its structure and whether there is a need to separate out those parts which have monopoly characteristics, or whether other competitive safeguards such as anti-competitive conduct provisions in the TPA, accounting separation or third party access are more appropriate.

The strongest form of monopoly power is natural monopoly. Therefore, if there are natural monopoly elements in Australia Post's business, there is a stronger case for changing the structure of Australia Post. The services which Australia Post supplies competitively, such as financial, retail, electronic communications and parcel delivery services, clearly do not fall into this category given that there are other suppliers of these products and services. However, the provision of traditional letter services, over which Australia Post has had a longstanding exclusive right, may have some natural monopoly characteristics.

The Industry Commission identifies an industry as a natural monopoly if the total costs of production are lower when a single firm produces the entire industry's output than when the same output is produced by two or more firms (IC 1992, p. 169). The existence of strong economies of scale, economies of scope and other attributes such as network advantages are factors which make it possible for a single firm to produce the same output more efficiently than two firms.

It is also possible for an organisation to have a substantial level of monopoly power without it technically being a natural monopoly. For example, while Australia Post could not be considered dominant in the broad 'messaging' market, which incorporates electronic substitutes to traditional postal services

(see Chapter One and Appendix Five), it is likely to have considerable monopoly power in the business to household messaging market, given that there are currently few electronic substitutes to postal services in this market segment.

### 9.2.1 Economies of Scale

Australia Post sees economies of scale as critical to its ability to provide a universal service and a uniform price.

*In Post's business, economies of scale are a key enabler. It facilitates price restraint, which promotes volume growth, which contributes to productivity gains that drive profit and produce scope for re-investment in infrastructure to further enhance economies (Australia Post, submission 8, p. 14).*

Economies of scale often result from high fixed costs and low operating costs. In this case, if a company increases its output it can spread the fixed costs over a greater number of products, reducing the cost per item. When the industry has continuing economies of scale it is more efficient for the community to have a single producer.

Identifying the existence of economies of scale is not a simple task, particularly in a complex organisation such as a postal service provider undertaking a range of activities. Therefore, it is useful to look at each of the individual activities undertaken by a postal service provider separately. A postal network can be broken into three basic activities: mail collection and delivery, sorting, and the transportation of bulk mail. These activities are discussed in the following sections.

#### *Mail Collection and Delivery*

Mail collection involves receiving mail at the post office as well as collecting prepaid mail from post boxes. Mail delivery is essentially the reverse process: mail is taken from a central point and delivered to customers within the area. While Australia Post does not specify the source of its economies of scale, it implies that they are derived from mail *delivery*:

*Delivering a national, scheduled, high quality letter service requires fixed facilities which impose a degree of fixed costs. If*

*... mail volumes and market share fall significantly, then average letter costs will rise... (Australia Post, submission 8, p. 14).*

The cost of the collection and delivery of mail is based on the number of collection or delivery points within an area. The pick-up and delivery points can be close together (concentrated), for example city mail, or they can be far apart (dispersed), such as in remote areas. The average cost of postal services will fall with greater volumes of mail and more dense collection and delivery points.

Sidak argued that for mail *collection*:

*Local service has three components: inward sortation by postal carriers, door-to-door delivery by postal carriers in trucks and on foot, and collection of mail at mailboxes and post offices. Those three elements involve well-understood, traditional technology. Economies of scale in those activities are minimal. The productive inputs involved, primarily labor services and vehicles, can be “smoothly” adjusted to reflect the volume of mail (Sidak 1996, p. 32).*

and that:

*... collection of mail at retail access points cannot be considered to have natural monopoly characteristics. ... there is nothing inherent in government ownership and control over retail locations and the equipment used to provide local distribution service that would suggest the presence of cost savings from unified ownership and control (Sidak 1996, p. 36).*

There do not appear to be any characteristics of mail collection which would give it strong economies of scale. For example, as argued by the IC in its 1992 Report on postal services, there are already a range of businesses, like newsagents, convenience stores and petrol stations where individuals could deposit mail for posting, just as they do at the post office.

There is some debate however about whether or not there are economies of scale in letter delivery. In considering this issue, it is useful to first have regard to whether there are large fixed costs associated with letter delivery. For example, there is a trend towards the clustering of letterboxes in highly urbanised

areas, and clustering of road side letter boxes in rural and remote areas. This allows some reduction in travel time between letter boxes (thereby allowing more letter boxes to be serviced and higher letter volumes to be achieved), forcing the consumer to undertake part of the letter's journey (that is from the letterbox to the door). Changing the position of letter boxes, however, only changes marginally the cost of providing a delivery service. Therefore, there are potentially some fixed costs associated with letter delivery. The question which then arises is whether the fixed costs are large enough to result in substantial economies of scale.

Panzar stated that:

*I think it is safe to assume that there are significant economies of scale in delivery services. It would surely be wasteful to have two or more carriers making daily visits to all the mail boxes in a given neighbourhood (Panzar 1991, p. 223).*

Alternatively Sidak argued:

*We do not observe, for example, "natural monopoly" delivery services in each metropolitan or rural area that act as common carriers for delivering pizza, appliances, furniture, or nursery products. Why not? Because any gains from exploiting economies of scale are more than offset by other aspects of service quality that derive from controlling one's own delivery network (Sidak 1996, p. 35).*

The IC suggested that the situation in Australia is somewhere in between:

*In areas of high volume and high density there is already more than one organisation delivering material to letter boxes. Progress Press and Salmat provide regular letterbox delivery for advertising material in cities and major regional centres. In contrast, in rural areas where volumes are smaller, it is likely to be more efficient for only one delivery firm to provide the regular service because economies of scale are still available (IC 1992, p. 171).*

Since the IC report, other postal service providers, such as Salmat and Streetfile, have continued to provide delivery services. These businesses are growing

and the number of delivery points they serve is increasing. Streetfile has noted that it:

*... began addressed home delivery services in 1991, specialising in the delivery of magazines, advertising, promotional and direct marketing material. Its business has doubled since then into a national network involving 24,168 contractors in deliveries to 96 per cent of Australian households (Streetfile, submission 10, p. 8).*

TNT has also commented that:

*Numerous private courier companies and alternative service providers have already invested very significant sums in facilities and delivery networks to compete in the limited postal market. The fact that their extensive networks are artificially prevented from achieving the optimum economies of scale and scope is to the detriment of business efficiency (TNT, submission 87, p. 7).*

It is, however, still evident that in rural and remote areas mail contractors are providing a combination of services, including mail delivery.

The Post Office Agents Association has commented that:

*Many Mail Contractors at present “subsidise” their mail runs by delivering other services at the time of delivering mail, eg groceries, milk, papers, thus making it cost-effective and efficient (POAAL, submission 84, p. 22).*

It would therefore appear that delivery of mail may exhibit some monopoly characteristics, however the extent of these characteristics will vary between geographic areas. This variance is largely dependent on the demographic features associated with the region. These features will influence the volume of mail delivered and the distance mail is carried. The frequency of mail delivery also has implications for the extent to which an area exhibits natural monopoly characteristics.

Australia Post’s delivery activities in areas where volumes are low and populations dispersed appear to exhibit the strongest monopoly characteristics.

### *Mail Sorting*

Mail sorting occurs each time mail is to be directed to different destinations along the path from mail sender to receiver. For example, it can occur at the post office at which the mail is lodged, at dedicated mail sorting centers and prior to final delivery. Australia Post uses a range of technologies to sort letters and parcels. They span from sorting letters by hand (for example where ‘posties’ sort the mail for their rounds) to optical character recognition equipment which sorts more than 30 000 letters per hour and 13 000 packets per hour. Some mail sorting equipment, such as that facilitated by the use of letter barcoding, requires centralised mail sorting centres to provide sufficient volume to maximise the use of the equipment.

Currently there are several factors which indicate that although there are some economies of scale in sorting, they are not strong enough to warrant all sorting being carried out by Australia Post.

For example, Australia Post has commented that a reduction in performance for letter delivery has been due partly to saturation of processing capacity in NSW and Victoria (Australia Post 1996, p. 11). Australia Post has announced plans for the expansion of its sorting facilities, including the development of new sorting centres in Sydney and Melbourne, and the restructuring of its network. The expansion includes new equipment for the faster sorting of mail at greater capacities. This indicates that economies of scale exist only at the level of the individual sorting facility.

Further, it is apparent that private mail houses can sort some types of mail more efficiently than Australia Post. Specifically, Australia Post provides discounts for sorted mail lodged under bulk mail delivery arrangements. For this activity to be viable to mail houses, the total combined cost of the use of Australia Post’s network plus the costs incurred by the mail house would generally need to be less than 45 cents. The IC has noted that several hundred mailing houses, which sort mail, exist in Australia. The IC commented:

*If there were large economies of scale still to be gained in mail sorting, mailing houses would not be viable because the costs to Australia Post of sorting all of the mail in its own mail centres would be lower. In short, the economies of scale in sorting are*

*likely to have been exhausted already, particularly in the cities (IC 1992, p. 171).*

Sidak has provided the following comments on the monopoly characteristics of local inward sorting:

*The inward sortation function can be split among multiple firms without a loss in efficiency. Just as inward sortation is split across postal employees, it can be split across companies. Indeed, larger mailers perform a degree of inward sortation to qualify for presort discounts. ... There are no apparent economies of scale of any significance for inward sortation (Sidak 1996, p. 33).*

Although scale economies exist at the level of the individual sorting facility, and have the potential to be increased through the introduction of more advanced sorting equipment, evidence suggests that it is economically feasible for more than one organisation to operate a sorting facility. Therefore, mail sorting exhibits only limited natural monopoly characteristics.

#### *Transportation of Bulk Mail*

The transportation of bulk mail exhibits only limited monopoly characteristics. This is demonstrated by Australia Post's use of both its own vehicles and the competitive transport services of private freight operators for the carriage of bulk mail.

The market for these services is characterised by low barriers to entry and exit as the assets required, such as warehouse facilities, trucks and planes, can be disposed of relatively easily if a firm chooses to close its business. Further, these assets can be readily diverted to other uses when not carrying mail.

Notwithstanding the economies which can be achieved through coordination of transportation systems, transportation services for bulk mail can clearly be provided by multiple carriers, be they postal service providers themselves or freight service providers contracted to a postal service provider. Organisations wishing to provide postal services are clearly capable of acquiring or providing such transport services.

### 9.2.2 Economies of Scope

Economies of scope refers to the ability of a business to undertake several functions using the same facilities, and thereby share the costs of the facilities across a number of products.

The World Bank has commented on economies of scope associated with the mail collection and delivery function:

*... it is generally believed that there are substantial economies of scope between delivery and collection. The physical network associated with delivery could be utilized for the collection function as well, which would do away with the need to duplicate the fixed costs of delivery to carry out collection. However, the peak load nature of the postal service may give rise to a stronger form of economies of scope. The distribution of the arrival of mail for inward delivery (final delivery to destined addresses) has a peak pattern: mail arrives at set times, within a narrow window of time, in bulk, throughout the day. The distribution of the arrival of mail for collection, on the other hand, is even throughout the day. The staffing level and operations are usually planned to absorb the peaks of the inward delivery work load. This gives the post office extra capacity to process outward activities during periods of little or no delivery activities. This shared, synergistic capacity relationship between inward and outward mail flows has a significant impact on the incremental costs of both. The economies of scope found in collection and delivery are stronger than those resulting from the mere sharing of resources and overhead (Ranganathan and Dey 1996, p. 45).*

Australia Post is a multi-product enterprise and is able to spread its fixed costs across a wide range of activities and services. This reduces the extent to which its success or failure is dependent on one particular product. A reduction in volume in one activity or service will not result in more than a slight increase in the average cost over all activities. Australia Post provides a number of traditional postal services, such as delivery of letters, parcels, unaddressed mail, publications, promotional material, magazines and newspapers. It also has a number of ancillary businesses, providing financial, retail and electronic communications services, which also supply products and services through postal outlets. This includes provision of financial and communications services



such as bill payment and electronic mail, respectively, and retail products such as packaging, toys and greeting cards. There are clear benefits to Australia Post of using its retail and distribution network to provide a range of services and therefore there are likely to be significant economies of scope.

It appears highly likely that there are economies of scope between the services provided by Australia Post. The impact of these economies will depend on the type of activities provided by the particular facilities in question. For example, the use of Australia Post offices to collect both parcels and letters and to supply other postal services is likely to result in strong economies of scope.

Overall, the benefits derived from these economies of scope would, over time, be available to new entrants to the postal services market.

### 9.2.3 Network Externalities

A key feature of Australia Post is its legislated requirement to provide all Australians with reasonable access to a letter service. Australia Post is also obliged to provide a standard letter service at a single rate. Consequently, only Australia Post has established an Australia wide network of post offices and delivery agents, which guarantees that it will deliver a letter anywhere in Australia.

TNT identified Australia Post's comprehensive delivery network as a significant competitive advantage and as a source of economies of scale and scope:

*Experience with the deregulation of other public sector monopoly utilities has amply demonstrated that customer inertia against a background of lifelong experience with a single service provider with a highly recognised brand name cannot be over estimated. Moreover, the comprehensive delivery network operated by every postal service incumbent represents a significant competitive advantage and a source of economies of scale and scope (TNT, submission 43, p. 1).*

Sidak suggested that the benefits of postal network externalities can be shared between multiple operators:

*Network externalities are said to exist if adding more customers or points of access to a network increases benefits or lowers*

*costs to the existing customers of the network. Thus, telephone subscribers benefit from companies' hooking up additional customers because they can reach or be reached by more people. Even if network economies are present, that need not imply that there should be only one network operator and owner. Networking benefits can be achieved by interconnecting multiple networks. Moreover, portions of any given network can be owned and operated independently, with interconnections achieved through contracts. The analogy between postal networks and telecommunications, rail, and electric power networks is a tenuous one in any case. The local postal network bears little resemblance to those networks, because there are no location-specific transmission or rail lines that require substantial capital investment. The postal routes covered by persons can be duplicated with relatively low capital expenditures.*

*The postal network may exhibit coordination economies in a particular form, as evidenced by the use of hub-and-spoke systems by competing carriers. Such a pattern does not imply that only one network should operate, nor does it suggest that the government must own and operate such a network. Moreover, the coordination problems differ little from those of any transportation or wholesale company that must sort and route packages from one address to another (Sidak 1996, p. 32).*

In recent years, Australia Post has not had a complete monopoly over the letter service, as the current Act specifies some exemptions to Australia Post's reserved services. These exemptions have allowed other companies to provide mail services. For example, Streetfile and Salmat distribute material such as magazines, and courier companies can carry letters for more than four times the standard postage fee of \$1.80. The services covered by the current exemptions are very similar to letter services. In a deregulated market, most of these companies are likely to be able to provide the services now reserved to Australia Post.

Given that competitors to Australia Post currently exist, there is little evidence to suggest that opening the reserved letter services to competition would not result in competition over time merely as a consequence of network externalities in postal services. While this does not mean that other providers will try to

duplicate Australia Post's network in full, they may replicate parts of the network where this is commercially feasible.

#### 9.2.4 Is Structural Separation of Australia Post's Network Necessary?

Some of the concerns of submitters to this review have arisen because it is hard to demonstrate that the sharing of facilities by Australia Post does not give rise to competitive neutrality issues, particularly without a transparent approach to separating out the costs of different parts of Australia Post's business. Consequently, several submissions have recommended structural separation of Australia Post's activities to address these concerns.

Mayne Nickless suggested that:

*Transparency is critical, particularly from an access price, CSO and performance management perspective (Mayne Nickless, submission 120, p. 17).*

and that:

*Structural separation of Australia Post's reserved services (especially local delivery) from its non reserved services will assist in these areas in terms of determining access pricing (Mayne Nickless, submission 120, p. 17).*

Similarly, the Major Mail Users of Australia Ltd proposed:

*having the ownership of the network changed from Australia Post to the Commonwealth;*

*... Australia Post becoming the custodian-operator of the (then) **National Postal Network**;*

*appointing a regulating postal authority ... to which all providers of mail delivery services making use of the Commonwealth's network would be answerable; (MMUA, submission 121, p. 13, emphasis in original)*

Some submissions queried Australia Post's role in providing many, if not all, non-reserved services. Mayne Nickless argued that:

*The participation of Australia Post in non-reserved services provides opportunities for the cross-subsidisation of its competitive businesses from its reserved services. The perception of unfair practices by Australia Post has a negative impact on the contestability of the non-reserved services market segments (Mayne Nickless, submission 14, p. 2).*

However, according to the Australian Chamber of Commerce and Industry:

*Commerce and industry has no objection to Australia Post, as a commercially-oriented, diversified postal services enterprise, developing and offering these products and services, provided: this is done on a commercial and competitive basis, without cross-subsidies; and, they are not considered reserved activities, or sustained in a monopoly situation (ACCI, submission 45, p. 17).*

Australia Post advised that:

*the "one stop shop" concept, introduced over the past 6 years, has been overwhelmingly popular with small business and general consumers;*

*to attempt to wind back those levels of service, value and convenience would bring about a consumer backlash ... (Australia Post, submission 99, p. 92).*

The Council has considered the MMUA's and Mayne Nickless' proposal of separating Australia Post's 'delivery network' from other elements of its business. The Council believes that for structural separation of this kind to be necessary for the development of competition, Australia Post's delivery network would need to exhibit strong and ubiquitous natural monopoly characteristics.

The Council does not consider that Australia Post's network, and the facilities associated with this network, exhibit such a strong degree of 'bottleneck' power across all regions serviced by Australia Post. The provision of postal delivery

services does not generally involve the use of essential facilities<sup>2</sup> as the capital required to provide a postal service, such as land, buildings and vehicles, is generally not sunk and can be disposed of relatively easily in the event of market exit. As noted by Sidak:

*The postal system is often referred to as a network industry because any transportation and delivery system has many of the features of a network, particularly in terms of dispersed collection and delivery and centralized sorting. That analogy does not, however, imply that the capital equipment of a postal delivery system is in any way comparable to that of a transmission network composed of pipelines or electric lines. To the contrary, equipment for the postal system is far from being an irreversible investment and is certainly not transaction specific (Sidak 1996, p. 42).*

Having regard to these matters, the Council does not consider that structural separation of different elements of Australia Post's activities would be essential for the delivery of effective competition. The revenue derived from Australia Post's activities which could be considered a natural monopoly, specifically services to rural and remote areas, is minimal relative to that derived from potentially non-monopoly activities. Further, the limited range of reserved services recommended by the Council in its reform package reduces the potential for Australia Post to engage in rent seeking activities and cross-subsidisation.

The Council considers that there are advantages in providing a range of products through Australia Post's network. However, it is acknowledged that there are risks for the development of competition when a company is operating in both monopoly and competitive markets. Nevertheless, the Council believes that these risks are reduced when a former legislated monopoly, with relatively low barriers to entry, is opened to new market participants or to the threat of entry by new participants. Such a policy serves to neutralise over time the advantages or disadvantages of the former monopolist. A limited range of reserved services, as recommended by the Council in its reform package, is important for reducing these risks.

Further, the Council's consultation process suggested strong support for the Australia Post view, indicating that users of many services like the convenience

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2 That is, access to these facilities by third parties is not generally essential for the development of competition.

of a one-stop-shop. For example, Australia Post's retail outlets and the services available within those outlets are generally well received both in the metropolitan and regional centres. Stakeholders have indicated that being able to pay bills, purchase stationery, envelopes and stamps and mail letters and parcels at one location is clearly in the interests of customers.

**The Council considers that structurally separating Australia Post's natural monopoly activities from its contestable activities is not necessary given the pro-competitive elements of the Council's reform package.**

### **9.3 Third Party Access To Australia Post's Network**

Information provided to the Council over the course of the review has identified that Australia Post is likely to have:

- some economies of scale in local mail delivery;
- limited economies of scale in mail sorting;
- economies of scope because of the ability to share facilities amongst different services;
- some benefits from an established national network; and
- some initial advantages because of its established market position.

None of these factors are likely to be pervasive enough to result in Australia Post having a natural monopoly in postal services. However, these factors are likely to be strong enough to make it difficult for new entrants to compete with Australia Post at a national level.

Streetfile, TNT and Mayne Nickless have all suggested that they would increase their involvement in the postal market if the letter service reservation was removed or reduced. They are, however, likely to focus on high volume customers in order to get the volumes necessary to compete with Australia Post. It is unlikely that these or any other companies would themselves deliver to all points in Australia.

Arthur Andersen has noted that from its consultation with various mailing houses, currently only Streetfile or Salmat would appear to have the network capability to develop full national coverage (Arthur Andersen 1997, p. 37).

Arthur Andersen also commented that:

*Several potential competitors claim to have fairly substantial delivery networks, covering more than 90% of all households in Australia. It is conceivable that one or more of these companies will undertake to provide a full mail service, although some interconnection with Australia Post would appear inevitable in remote areas (Arthur Andersen 1997, p. 5).*

and that:

*While it is unlikely that any competitor will fully replicate Australia Post's network, it is feasible for existing market players to integrate their networks with each other and bypass most of Australia Post's network - especially on the termination end of a service. However to provide a comparable full "end to end" service a competitor will require more direct network duplication or regulated equal access provisions governing the collection/delivery of post direct to residential households, business street addresses and post boxes as well as greater access to existing postal retail outlets. Return and unanswered mail would need to be considered in such a scenario (Arthur Andersen 1997, p. 23).*

Given that it is unlikely that new postal service providers will themselves offer 100 percent delivery coverage in a deregulated market, and Australia Post will retain some monopoly power in the early stages of deregulation, the Council has considered safeguards for competition in the absence of structural separation. For example, if there were substantial benefits from competition in bulk letter delivery but Australia Post had monopoly power in mail delivery to post office boxes, it is unlikely that effective competition in this market would eventuate. Without adequate competitive safeguards, new competitors would be unable to overcome Australia Post's advantage in 'final' mail delivery to post office boxes.

As noted by Arthur Andersen:

*... Australia Post also currently controls important aspects of the access regime to all or part of its network. For example, we understand that competitors cannot obtain access to post office box deliveries unless the full Australia Post charge has been paid. This clearly represents an exclusion of potential competitors from this part of the market (Arthur Andersen 1997, p. 12).*

In this case safeguards would be necessary to protect the benefits of competition. Such safeguards would need to address access to the elements of Australia Post's network which have the strongest monopoly characteristics.

### 9.3.1 Current Access Arrangements

The *Australian Postal Corporation Act 1989* currently provides for users to gain access to Australia Post's network by the delivery of pre-sorted bulk mail to designated mail centres. Australia Post provides discounts for bulk mail users wishing to interconnect with its network in this manner.

Currently, section 32B of the Act provides that the ACCC may inquire into a dispute between Australia Post and an access seeker over the terms and conditions or price of access. The ACCC does not itself have power to resolve such a dispute. It may, however, make a recommendation to the Minister for Communications and the Arts, who has power to direct Australia Post to act in accordance with the recommendation of the ACCC.

Australia Post offers two types of access provisions and associated discounts: bulk discounts and interconnect discounts. These access provisions entitle users to discounts on their postage in exchange for performing some elements of the postal delivery work normally performed by Australia Post. The access provisions apply in respect of the letter service, but have different discounts for small, medium, large, and extra large letters.

Typical access arrangements are described in Box 9.1.



### Box 9.1 Typical Access Arrangements

A large user of mail (for example, an energy, water or telecommunications service provider) will generally post well in excess of one million letters annually (in some cases, tens of millions). It may be responsible for its own mail, or it may contract out its mail requirements to a mailing house.

The user will generate mail from its computer database and will then deliver it in pre-sorted bags of 1000 letters to Australia Post for final delivery. The process of delivering bags of mail to Australia Post in minimum lots of 1000 entitles the user to a *bulk* discount. If the mail is also pre-sorted by state or postcode, greater discounts apply. The customer obtains the *bulk* discount because it has performed the collection and sorting elements of the letter delivery chain.

The user may elect to deliver the mail to a mail centre designated by Australia Post in the State in which it will be delivered. A further discount applies in this case called a *bulk interconnect* discount. Only bulk mail may be interconnected.

The *bulk interconnect* discount reflects the fact that the user has performed the collection, sorting, and transport elements of the mail delivery chain, leaving Australia Post to perform only final delivery to the customers.

Under section 32A of the Act, the discounts for bulk interconnect are intended to reflect the costs avoided by Australia Post because the task was performed by the user.

Some users, including the MMUA, have criticised the structure of current access arrangements, arguing that it offers them insufficient discounts to make access worthwhile. These complaints asserted that Australia Post:

- insists on unreasonable terms and conditions in relation to payment of access charges (for example, seven days terms, bank guarantees of payment);
- does not compensate users for some of their value-adding services that reduced the overall costs to Australia Post;
- is not prepared to offer volume discounts for the largest users, and that the discounts it offers are less than the savings it could

make by allowing users to perform more of the steps in the postal delivery chain;

- is likely to insist that, in the future, users introduce bar-coding technology even though it is obsolete compared to database sorting techniques;
- will not give mail houses competitive prices for international mail routed through Australia for distribution in South East Asia. It cross-subsidises in order to undercut mail houses in this market; and
- offers different rates when quoting a price to subcontract on behalf of a mail house than those quoted to a customer of a mail house.

Major users have argued that Australia Post is only able to extract these terms and conditions because of its current statutory monopoly. With the removal of most of this statutory monopoly, as recommended in the Council's reform package, the Council believes that Australia Post will be subject to greater competitive discipline in the postal services market. Specifically, the Council considers that as a consequence of increased competition, Australia Post will need to be more responsive to the requirements of its customers.

However, as discussed below, monopoly power in local mail delivery to particular regions and to post office boxes may preclude new entrants to the postal services market from offering a full service and serve to diminish the benefits achievable through a more liberalised postal services market.

#### **9.4 Issues For Future Access Arrangements**

As discussed in Chapter Eight, it appears likely that future competition in the delivery of postal services for business customers will be focussed in urban areas and provincial cities. Competitors are likely to target high volume customers in order to get the volumes necessary to compete with Australia Post. It is unlikely that competitors would establish a universal postal network, with coverage in remote areas akin to that provided by Australia Post as part of its CSO, nor will competitors have physical access for delivery to Australia Post post office box numbers. The Council observes that areas funded as CSOs, primarily rural and remote areas, are uneconomic for any provider to service. Further, the Council notes that as a result of Australia Post's longstanding

position as a monopoly postal service provider, it has established post office boxes which are physically inaccessible for delivery access by alternative postal service providers. TNT:

*...advocates the creation of an industry specific access regime ... (which) would need to specifically address delivery access to GPO Box facilities, access to Post Office counter and mail holding facilities, bulk lodgement and access to delivery services (TNT, submission 87, p. 10).*

Ansett Australia also commented on delivery access to post office boxes, arguing that this matter:

*...is becoming an increasingly important issue as, increasingly, catalogue and magazine as well as direct mail address lists, include a substantial number of addressees using a Post Office box. It is by no means clear whether Australian Air Express' exclusive access to Post Office boxes is on the basis of payment of a price reflecting the actual costs of that access (Ansett Australia, submission 83, p. 4).*

Streefile also suggested that:

***...Australia Post should be required to provide network interconnection for competitors on reasonable and negotiated terms. These arrangements, including access to post office boxes, delivery contractors and processing centres, should be monitored by an industry regulator who could adjudicate in the event of a dispute (Streetfile, submission 10, p. 5, emphasis in original).***

The Council believes that business customers with mailings which include post office box numbers and rural/remote addresses would be unable to receive a full service from competitors in a liberalised postal services market, as mail would need to be split between Australia Post and competing providers. In the initial years of competition, these factors would serve to reinforce Australia Post's incumbent power. Specifically, competitors would be disadvantaged relative to Australia Post by not being able to provide a full service for customers, in addition to having to establish their own postal services networks and market profiles. The Council believes that this could impede market entry, damage

the competition that has already developed in the postal services market and consequently limit the benefits available to consumers through competition.

Arthur Andersen noted that:

*Clearly the importance of an interconnection regime should lie in its ability to give customer's the choice of a broad suite of postal services from a variety of industry players. In this way, efficiency gains accrue to competitors from better cost management and the avoidance of a wasteful duplication of networks (Arthur Andersen 1997, p. 20).*

Having regard to these issues, the Council has considered what access arrangements should apply to a more liberalised postal services market.

#### **9.4.1 Future Access Arrangements**

Australia Post is not subject to Part IIIA of the TPA<sup>3</sup>, which deals with access to services provided through nationally significant infrastructure. Under Part IIIA, a business that wants access to a particular infrastructure service may apply to the National Competition Council to have the service 'declared'. If it is, the business and the infrastructure operator are then required to try to negotiate terms and conditions of access. If they fail to reach agreement, the terms and conditions are determined by the ACCC through legally binding arbitration. Part IIIA also allows owners of infrastructure to make access undertakings to the ACCC which set out the terms and conditions under which they will provide access to their facilities.

The nature of infrastructure used to provide postal services is such that, even without Australia Post's legislative exemption from Part IIIA, it is unlikely that postal services would intrinsically meet the tests for declaration required under Part IIIA. Notwithstanding this, the Council notes that it has not considered an application for access to postal services under Part IIIA and therefore has not reached a decision on whether there are any services provided by Australia Post which could be subject to declaration. Further, the Council sees no practical reason why postal services not subject to a specific access regime under the TPA should have a legislative exemption from Part IIIA.

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Section 32D of the Australian Postal Corporation Act 1989.

In considering what access arrangements are appropriate as a competitive safeguard, the Council has been mindful of the need to ensure that access arrangements for postal services provide a competitive discipline to Australia Post's network, promote efficiency in infrastructure investment and facilitate competition and innovation in the provision of postal services. Further, the Council has balanced the objective of attaining greater competition in postal services with the costs of implementing and administering any new access regime and the impact it may have on the incentives for Australia Post to invest in its network.

Having considered these issues, the Council believes that regulated access arrangements should apply to areas serviced by Australia Post as part of its CSOs given that such areas are, by virtue of their CSO status, uneconomic to service. Under the Council's reform package, funding of services to CSO areas will be provided through the Federal budget or an industry levy. It is appropriate that new postal service providers gain access to delivery services provided by this element of Australia Post's network given that it would be manifestly inefficient for more than one postal provider to deliver letters in these areas.

The Council also considers that mandated access arrangements should apply to delivery services provided by Australia Post where physical access for letter delivery is unavailable. This would encompass delivery to Australia Post post office box numbers, as this particular element of Australia Post's business will have strong monopoly characteristics in the initial years of market liberalisation, by virtue of:

- Australia Post's longstanding position as a monopoly provider of postal services, which is complementary to the provision of post office box numbers;
- inability of some customers to receive mail other than through a post office box;
- past Australia Post policy on location of, and physical accessibility for delivery to, post office boxes; and
- reluctance by businesses to change to post office box numbers provided by competing postal service providers, because of general customer inertia given Australia Post's former monopoly status and the costs to businesses associated with changes to stationary and other address information.

The Council notes that competing postal service providers who provide post office boxes for their customers should enter into reciprocal postal office box access arrangements with Australia Post and other providers, where physical access for letter delivery is unavailable.

It is therefore the Council's view that mandated access arrangements should be restricted to:

- areas where Australia Post provides a service only because of its Community Service Obligation (CSO); and
- services for which physical access is unavailable (that is, primarily post office box numbers).

The Council considers that access to other elements of Australia Post's network by competing postal service providers should be on the basis of commercial negotiation, but that postal services not subject to mandated access arrangements should not be exempt from Part IIIA.

The Council is of the view that deregulation of the postal services market will render current legislated access arrangements for bulk mail interconnection unnecessary. Liberalising the business mail market, as provided for in the Council's reform package, along with the introduction of access arrangements, will enable competitors to enter this market and provide the pressure needed for Australia Post to offer appropriate bulk mail discounts.

#### *Regulatory provisions for access*

As discussed above, while it is unlikely that postal services would meet the tests for declaration required under Part IIIA, this does not negate the monopoly power inherent in CSOs and post office box services and the need for third party access arrangements for these services. The Council believes that access arrangements are needed to address the monopoly power inherent in these aspects of Australia Post's network, which has been established as an outcome of past government policy.

In considering appropriate regulatory arrangements to support access to CSOs and post office box services, the Council has had regard to mechanisms currently in place in Australia which assist businesses to obtain access to infrastructure services. The Competition Principles Agreement indicates a preference for

commercial negotiation (that is, without regulatory intervention), to provide the basis for parties to arrive at access arrangements. However, the Council recognises that in some circumstances, providing a regulatory framework for commercial negotiation can promote better policy outcomes by constraining market power, reducing uncertainty and producing more ‘workable’ outcomes. The Council considers that these principles apply to mandated access arrangements for CSO and post office box services, given the matters discussed previously.

Having regard to the limited scope of mandated access arrangements proposed by the Council, and the other safeguards to competition discussed in the following section<sup>4</sup>, it is considered that a ‘light handed’ approach to the regulatory provisions to support access to CSO and post office box services is appropriate. Accordingly, the Council favours a compulsory access “undertaking” to support access to these services. Such a regime would limit regulatory cost on industry and regulators alike, given that once an undertaking is settled, both industry and regulators will have certainty as to the parameters of the mandated access arrangements.

Currently under Part IIIA of the TPA, any infrastructure owner or operator may voluntarily give a written undertaking to the ACCC which sets out the terms and conditions on which businesses will be provided with access to a service. By making an undertaking, an infrastructure owner or operator can remove uncertainty about what access conditions will apply to a service. If accepted, undertakings are legally binding, so other businesses can use them to gain access. Before accepting an undertaking, the ACCC is obliged to conduct a public consultation process.

The Council believes that the general structure for access undertakings under Part IIIA of the TPA should be adopted for an access undertaking regime for postal services. A key difference to the general provisions would be a compulsory requirement for Australia Post to have in place an access undertaking for CSO and post office box services at the time of market liberalisation. As currently provided for in the TPA, the ACCC would be required to conduct a public consultation process. The Council considers that this should occur in the lead up to market liberalisation.

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<sup>4</sup> That is, a new section in the TPA dealing specifically with anti-competitive conduct in the market for postal services and a requirement for detailed accounting information on Australia Post’s activities.

The coverage and terms and conditions for access to CSO services and post office boxes should be reviewed five years after the introduction of competition - that is, in 2005.

Key issues for the ACCC in assessing the undertaking will be the terms and conditions for access<sup>5</sup>, including the pricing methodology used by Australia Post to determine the cost of providing access. While the Council is of the view that these issues should be largely resolved by the ACCC in consultation with the postal services industry, the following pricing matters have been identified as issues which should be addressed by an access undertaking accepted by the ACCC.

### *Access Pricing*

As noted previously, major mail users have expressed concern about the level of discount available for delivery of bulk pre-sorted letters and in respect of interconnection. Currently, the discounts available for delivery of bulk pre-sorted small letters are seven cents and nine cents (off the standard letter rate of 45 cents), depending on the speed of delivery. For interconnection, discounts of one cent and 0.5 a cent are available, again depending on the speed of delivery. The cheapest postage rate, for small letters that have been pre-sorted and delivered to a designated mail centre near the point of final delivery for off-peak delivery, is 35.5 cents. In order to earn this discount, users must transport the mail to the state in which it will be delivered. Major mail users have indicated that this can cost more than the discount offered by Australia Post.

Australia Post has justified this discount on the basis that it is consistent with an *avoidable cost* methodology as required by Section 32A of the TPA. Australia Post maintains that it would still need to operate transport services between states even if it did not have additional bulk mail from major mail users. Therefore, Australia Post contends that as its avoided costs if it did not carry additional mail would be small, the level of discount available for this mail should also be small.

A key deficiency of the current interconnect pricing arrangements is that the discounts offered do not closely reflect the transport costs that Australia Post has saved on a particular route because it did not have to perform a line haul

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5 For example, the point(s) in Australia Post's network at which access should be made available and the arrangements for material handling (that is, the types of containers used to lodge 'interconnect' mail) where access is provided.



task. This is because the discount is not route specific and represents only an average of savings on line haul costs. That is, as the discount is constant regardless of the origin of mail, the technology employed to carry it<sup>6</sup> and, generally, the volume of mail carried, the pricing arrangements do not reflect the actual cost of providing the interconnect service.

A more efficient pricing methodology would take into account only the *direct* costs of providing an access service. This rebalancing of interconnect access prices would be consistent with a reduction in averaging of prices for business mail which Australia Post would be likely to undertake in a deregulated market. The IC has commented on access pricing for postal services, concluding that:

*Compared to the current pricing system, adopting a cost-based approach to access pricing could improve efficiency by ensuring that access prices more closely reflect the true resource cost to Australia Post of providing bulk mail sorting and delivery services.*

*Applying cost-based access pricing to postal services will require addressing several practical implementation issues. In practice, some broad banding of access charges would be required to cope with the many different journeys that mail can take. Implementing this approach may also necessitate greater accounting separation of Australia Post's activities than currently occurs (for the purposes of price determination and verification). If the reserved service were to be retained, the access charge may also need to include a fixed component reflecting Australia Post's universal service costs (IC, submission 58, p. 39).*

Arthur Andersen stated that:

*...the present access regime is cost based in so far as the standard mail rate effectively represents an "end to end" service cost. This is uncertain given that the uniform letter rate attempts to satisfy several policy objectives and may not be a true measure of the underlying cost of mail delivery. This is further*

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6 For example, it is now possible for bulk mailings to be transmitted interstate and from overseas electronically, converted into hard copy and then delivered as conventional mail items.

*complicated by Universal Service Obligations being factored into the reserved services pricing regime.*

*While the extent and nature of competition in postal markets will depend on access being reasonably cost based (a directly attributable incremental cost basis should be considered here), the retention of the present discount system will not necessarily best service this purpose.*

*In brief, the present discount structure:*

- does not factor any additional processing a mailing house undertakes which would save Australia Post duplicating the process nor resulting flow through efficiency gains to a network.*
- The rationale for bulk pre-sort discounts is based on the required speed of delivery, number and size of the letters lodged (implicitly costs avoided by Post) not the full costs of work and processes undertaken by a mailing house to conform to bulk pre-sort delivery requirements.*
- does not allow for an unbundling of services based on actual functional requirements of an interconnecting party (end to end service vs individual service components).*
- does not provide clear price signals to the market on the actual cost of access and variables which may reduce the cost of access further.*

*If greater competition is to be fostered in postal markets a more transparent access price will be a key requirement. The present derivation of a wholesale price from a retail charging structure does not properly reflect the structural separation of Australia Post's role as both a direct competitor and access provider (Arthur Andersen 1997, p. 21).*

Panzar's comments on a pricing framework for access to postal services are also instructive:

*Under a regime of nondiscriminatory access pricing, the postal service would pay the same rate for access to the local delivery network as any of its competitors. This rate is the average cost bundled rate less the incremental unit cost of all nondelivery functions. This rate should be available to any competitor willing to deliver presorted, route sequenced mail to the loading dock of a local post office. Put in discount terms, the discount paid to mailers that perform all postal functions except local delivery should be exactly equal to the costs the postal service would have incurred had it moved the mail through the nondelivery portion of its system (Panzar 1993, p. 97).*

***Recommendation***

**The Council recommends that only the direct costs of providing access to CSO and post office box services should be taken into account in determining access prices. These costs would include consideration of Australia Post's return on assets.**

The Council believes that the cost of providing access should not include the loss of profits in upstream or downstream markets which Australia Post may incur as a result of providing access. At the same time, access prices under an access undertaking should not exceed prices charged by Australia Post for retail or bulk postal services which are akin to services supplied under access undertakings.

The Council notes that the approach to access pricing discussed above is suggested principally for the mandated access arrangements for CSO and post office box services. However, this approach would also be an appropriate reference point for commercial negotiations, given that competition has to date been limited in the postal services market, and current operators and new entrants may be uncertain about what to expect in regard to access pricing in a more competitive market. Correspondingly, as an infrastructure owner/operator

requires a reasonable idea about future cash flows to facilitate new investment projects, some certainty in relation to its pricing is desirable.

#### **9.4.2 Recommended Arrangements for Granting Access to Postal Services**

The Council's preferred approach to providing access to regulated elements of the postal network is a composite of existing postal access arrangements and arrangements supported by the National Competition Policy. In recommending a framework for these arrangements, the Council's approach has been, as far as practicable, to minimise the costs associated with regulation while providing a safeguard for the development of effective competition within the postal services industry.

The Council considers that the arrangements for providing regulated third party access to postal services should:

- comprise mandated access arrangements under the TPA, supporting third party access to the postal network through a compulsory access undertaking. The scope of this undertaking will be limited to areas where Australia Post provides a service only because of its CSO and services for which physical delivery access is unavailable, that is, primarily post office box numbers. Only these services will be required to be approved by the ACCC for mandated access through an undertaking; and
- be administered by the ACCC, which would have the power to accept, or if necessary determine, an access undertaking applicable to CSO and post office box services at the time of market liberalisation. Before accepting this undertaking, the ACCC would be required to conduct a public consultation process in the lead up to market liberalisation, canvassing issues including, but not limited to, the conditions of access and pricing. Should it be necessary for the ACCC to determine an access undertaking, this should occur within three months of market liberalisation.

The Council considers that access to other elements of Australia Post's network by competing postal service providers should be on the basis of commercial negotiation. However, the Council believes that postal services not subject to mandated access arrangements should also be subject to Part IIIA of the TPA.

Therefore, the Council is of the view that the exemption from Part IIIA and current access regulation applicable to postal services should be removed from the *Australian Postal Corporation Act*.

***Recommendation***

**The Council recommends that:**

- **a compulsory access undertaking, to be approved by the ACCC, be developed by Australia Post for CSO and post office box services; and**
- **if Australia Post does not submit an acceptable undertaking the ACCC should determine the terms and conditions for access.**

**The Council also recommends that Australia Post's exemption from Part IIIA of the *Trade Practices Act* should be repealed.**

## **9.5 Anti-Competitive Conduct Provisions and Accounting Separation**

As discussed elsewhere in this Report, Australia Post is currently subject to all provisions of the TPA, other than Part IIIA. The ability of the general provisions of the TPA alone to safeguard competition in a more liberalised postal services market has been considered by the Council in light of issues concerning Australia Post's level of market power.

The Industry Commission noted that:

*Australia Post is the dominant provider of postal services in Australia. This is largely because its privileges and responsibilities under the Act both encourage and require it to maintain a broad network. In 1995-96 it handled over 4 billion mail items including letters and parcels but excluding unaddressed advertising (IC, submission 58, p. 6).*

TNT has characterised Australia Post's market position as:

*...entrenched ... as a monopoly service provider with universal brand recognition and network coverage ... (TNT, submission 87, p. i)*

Further, Streetfile has argued that:

*Australia Post fiercely defends its monopoly including with prosecution. Predominantly, these actions have been taken against companies that compete with Australia Post in de regulated sections of the postal market. It appears that this behaviour is intended, at best, to “warn off” competitors testing the Reserved Services or, at worst, to improve Australia Post’s competitive edge in markets bordering letter mail. The conduct was documented in the 1992 Industry Commission report (Streetfile, submission 10, p. 15).*

Streetfile also claimed that:

*Armed with a monopoly and market dominance, Australia Post has prevented other providers from making good their potential contribution to the community. The corporation has been accused of intimidation and anti-competitive practices (Streetfile, submission 10, p. 32).*

The Council agrees that Australia Post’s status as the official provider of postal services gives it considerable strength in the postal services market. However, the Council believes that the dominance of an incumbent can be broken down through deregulation and, if appropriate, supporting regulatory arrangements. For example, Telstra’s dominance in the market for mobile telephone services has been reduced through the licensing of competing mobile telephone service carriers and the establishment of access and other regulatory arrangements.

While Australia Post’s established network and brand name would provide it with a clear initial advantage in a more liberalised postal services market, this advantage would not be insurmountable. With the establishment of appropriate access arrangements for competing postal service providers, and other competitive safeguards to ensure the efficacy of these arrangements, effective competition in postal services could be achieved over time.

The Council acknowledges, as discussed in Chapter Two and Appendix Five, that Australia Post’s traditional letter services also face increasing competition from a variety of electronic communications services, particularly in the ‘business to business mail’ market segment. Notwithstanding this, in one key market segment to be opened to further competition under the Council’s reform

package (that is, ‘business to household mail’), electronic substitutes are limited and will continue to be for the next five to ten years (NERA 1997b, p. 41). As noted by the Industry Commission:

*... Australia Post’s share of the messages market is well below the two-thirds threshold. But in the key market segment of business to household mail (where competition from electronic substitutes is weakest), Australia Post is currently the dominant provider (IC, submission 58, p. 32).*

The Council considers that Part IV of the TPA would constitute an appropriate and adequate safeguard against anti-competitive conduct in a mature competitive postal services market. The TPA seeks to prevent anti competitive practices by companies with market power. However, the Council believes that during the initial years of deregulation, additional competitive safeguards will be necessary to ensure that Australia Post’s inherent market power is not used inappropriately to stymie competition. This power is derived from Australia Post’s incumbent advantages, which include an established universal network, specific structural arrangements involving joint ventures, customer inertia and a recognised brand name. In a more competitive environment, there is a threat that the power derived from these advantages could be used to inappropriately drive existing operators from the market, and preclude other companies from entering the postal services market and operating on an equal basis.

### **9.5.1 Additional Anti-Competitive Conduct Provisions**

The Council believes that a new sub-section should be inserted under section 46 of the TPA to deal specifically with anti-competitive conduct in the market for postal services. This new sub-section would, in contrast to section 46(1) of the TPA, place the onus on a postal service provider to establish that it has not engaged in anti-competitive conduct, rather than the onus being placed on the ACCC or an affected party.

Once evidence is established that:

1. a postal service provider has a substantial degree of power in a postal services market; and
2. the effect of taking advantage of that power is a substantial reduction in competition;

the anti-competitive purpose of that conduct will be *presumed* under this new sub-section.

The question of whether a postal service provider has engaged in anti-competitive conduct would ultimately be determined by a court using the same tests as are currently applied under section 46(1). The primary difference is that the new sub-section would oblige a service provider to supply evidence that it has not engaged in anti-competitive conduct. As currently provided for under the TPA, the ACCC would, where appropriate, be able to issue an exemption order for such conduct.

This new competitive safeguard would be established principally to address anti-competitive conduct by any postal service provider which has a substantial degree of power in a ‘postal services market’, which would be defined as the market segment for postal services which has been opened to competition (that is, ‘business’ mail). While it would introduce industry specific provisions into the TPA, this new provision would not be as intrusive as Part XIB of the TPA, which deals specifically with anti-competitive conduct in telecommunications markets. For example, under the new sub-section, the ACCC would not have the power that it has under Part XIB to issue a ‘competition notice’ to a person engaging in anti-competitive conduct. This is to reflect the lesser degree of incumbent market power associated with the postal services market compared to the market for telecommunications services.

The Council believes that the introduction of this new provision for postal services has merit because it will remove total reliance on section 46(1) of the TPA when dealing with unilateral anti-competitive conduct in the postal services market. By removing the need to prove ‘purpose’ and placing the onus of proof on a postal service provider to establish that it has not engaged in anti-competitive conduct, this new provision will provide a stronger prohibition against unilateral anti-competitive conduct in the postal services market than currently exists under section 46(1) of the TPA.

Further, the Council considers that this new provision will be beneficial in the initial years of deregulation because it will:

- require the ACCC to focus its regulatory oversight on the segment of the postal services market undergoing reform, that is, the business letter market formerly reserved to Australia Post;



- provide a stronger regulatory safeguard against anti-competitive behaviour than would otherwise exist were the current provisions in Part IV of the TPA to be the only principal safeguards during the initial years of deregulation; and
- allow, where appropriate, swift and vigorous action under the TPA:
  - while the postal industry is undergoing substantial change; and
  - when anti-competitive behaviour could prevent the potential benefits of competition from being realised.

Further, while competition in the postal services market is at an immature stage, this provision will be a necessary competitive safeguard to support the ‘light handed’ postal access regime proposed by the Council in its reform package.

The Council envisages that pecuniary penalties on a person in breach of this new provision would be imposed by a court. As currently provided for in the TPA, a third party would also be able to take court action if affected.

### **9.5.2 Accounting Separation**

The Council believes that detailed accounting information may be necessary to provide evidence of predatory behaviour and would therefore assist the ACCC in applying the general provisions of the TPA and those specific to a deregulated postal services market. This would act as a safeguard against anti-competitive cross-subsidisation and inappropriate internal cost allocation between Australia Post’s activities.

Information derived from detailed accounts is also important for determining the cost of providing access to Australia Post’s network. Specifically, financial information should be disaggregated for the elements of the network which are the subject of an access undertaking. While the Council has recommended a ‘light handed’ access regime for postal services in its reform package, it considers that accounting information on the services subject to access is equally important to the commercial negotiation of access. It would also assist the ACCC in investigating alleged breaches of the TPA in respect of postal services.

The issue of accounting separation has been raised by a number of submitters. Ansett Australia has commented that Australia Post's joint ownership of Australian Air Express with Qantas has had a number of effects which should be considered by the Council, which included:

*lack of clarity as to the basis upon which costs are allocated between Australia Post and Australian Air Express in the case of joint products, whether within or outside the "reserved" categories (Ansett Australia, submission 83, p. 2).*

As noted previously, the Australian Newsagents Federation has also commented on cost allocation and cross-subsidisation issues concerning Australia Post. It argued that it is:

*... essential that there ... be clear separation and reporting on the various elements which comprise the activities of Australia Post ensuring that cross subsidisation of activities cannot be hidden.*

*At present no public reporting takes place which allows proper analysis of the various activities to be undertaken (Australian Newsagents' Federation, submission 109, p. 4).*

Correspondingly, Mayne Nickless proposed that:

*There should be a review by an independent body on transfer pricing principles applied by Australia Post and on other cost allocation methodologies used, ensuring that they are in accordance with the competitive neutrality principle. This should be confirmed in a statement to be included in Australia post's financial statements.*

*Such accounting separation is an essential precursor to establishing appropriate interconnection rates for all of its services (Mayne Nickless, submission 120, p. 4).*

and that:

*Auditors are generally not in a position to report on these matters, and hence, would require the assistance of specialists (Mayne Nickless, submission 120, p. 18).*

Further, TNT also commented that:

*... regulatory reform must include a requirement for Australia Post to implement full accounting separation of its postal service activities with independent audit, oversight and access regulation by an independent regulatory body (TNT, submission 87, p. i).*

To provide the safeguards necessary in the early years of deregulation, the Council considers that Australia Post needs to be in a position to provide, on request from the ACCC, clear details which account separately for reserved and non-reserved postal services, including separate costing of the retail functions. The Council also believes that Australia Post should be able to furnish information which substantiates the direct cost of providing access to its network, in particular the cost of providing CSO services.

It is therefore the Council's view that an onus should be placed on Australia Post to, on a regular basis, justify its accounting arrangements to an independent auditor charged with responsibility for assuring that Australia Post is able to account separately, and at a sufficient level of detail, for these activities. The auditor should:

- be independent of Australia Post;
- not be Australia Post's regular auditor; and
- have sufficient expertise in best practice accounting for businesses which are vertically and horizontally integrated.

***Recommendation***

**The Council recommends that two additional competitive safeguards should be put in place during the initial years of deregulation:**

- 1. A new section in the TPA dealing specifically with anti-competitive conduct in the market for postal services. The need for this provision should be reviewed in 2005.**
- 2. A requirement for detailed auditing and accounting information on Australia Post's activities, to provide for transparency of the financial relationships between different elements of its business.**

## 9.6 Price Regulation

In a monopoly or when it is difficult for companies to set up competing businesses, the opportunity exists for an incumbent to charge higher prices than would be possible if competition was strong. Price regulation is one means of addressing the problems raised by a lack of competition.

Australia Post's reserved services are subject to prices surveillance under the *Prices Surveillance Act 1983*. Prices oversight is currently undertaken by the ACCC and the Minister for Communications and the Arts. The price of standard letter services must be approved by the Minister and proposals to increase prices or change terms and conditions for reserved letter services must be notified in advance to the ACCC.

The MMUA has noted that services which are not reserved to Australia Post should not generally be subject to pricing oversight unless there is a supplier with a dominant market position, in which case it argued:

*...there should be a form of price control, or price justification, simply because the Australian market place has no valid alternative service, notwithstanding the legal niceties which might suggest that alternatives can be provided (MMUA, submission 33, p. 20).*

Australia Post stated that it:

*...(does not) see any justification for the application of any pricing regulation, monitoring or oversighting for goods or services which are not reserved to Australia Post, unless this also applied to competitors so as to preserve competitive neutrality (Australia Post, submission 99, p. 89).*

On the topic of reserved services, the MMUA argued for a:

*...more formal and rigid approach to price control of anything connected to the Reserved Services and all elements of discretion to Australia Post should be removed and the process be firmly controlled by the external pricing authority (MMUA, submission 33, p. 20).*

The MMUA has suggested that the process also:

*...be amended so as to provide for close examination, questioning and full and proper disclosure of all relevant accounting and costing elements within the application....the “inquiry” conducted by the PSA should be formal, working papers should be made available at least 14 days in advance of any hearing commencement, and attendance open to stakeholders at either an individual level or on a representational basis (MMUA, submission 33, p. 20).*

The Commonwealth Treasury has suggested that regulation of Australia Post’s charges be reviewed and that a CPI-X price capping arrangement be considered as an alternative to the current method of price regulation. The Commonwealth Treasury commented:

*Clearly, the need for a cap to be applied to the price of standard postal articles supplied by AP is linked directly to the level of competition it faces in their delivery. Hence, if AP was exposed to greater competition in the delivery of standard postal articles, the pricing discipline this could be expected to impose would lessen the need for a cap. However, a reduction in reserved services protection may not result in strong competition developing in the short term. Consequently, a price cap regime may still be required as a transitional mechanism while sufficiently robust competition to ensure price restraint developed. This would be a similar situation to Telstra which is still subject to price caps on a range of services in markets where competition is weak or non-existent (Commonwealth Treasury, submission 52, p. 20).*

The Competition Principles Agreement requires that all Governments consider establishing sources of prices oversight for all significant GBEs that are monopoly or near monopoly suppliers of goods or services. The Industry Commission has suggested that should legislative barriers to competition in postal services be removed, a review of current prices regulation should have regard to Australia Post’s level of market dominance. The Industry Commission stated:

*Prices surveillance is not likely to be needed if the reserved service is abolished. However, a less intrusive form of prices*

*oversight, such as prices monitoring, should be applied temporarily. Under prices monitoring, Australia Post would only be required to provide certain price and cost data at regular intervals to the ACCC. This requirement would only need to be imposed on services where there is particular doubt about the significance of barriers to entry or until such time as competition fully develops (IC, submission 58, p. 33).*

The Council considers that future regulation of Australia Post's charges should be dependent on the bounds of Australia Post's letter service reservation. The Council has recommended that the reserved services be narrowed to cover only mail sent by households, thereby excluding business mail from the reserved services and allowing greater competition in this market segment. As noted by the Industry Commission, the pricing discipline this could be expected to impose on business mail lessens the need for price regulation. As the Council does not consider that barriers to entering the postal services market are high, it is of the view that direct regulation of charges for non-reserved services is unnecessary<sup>7</sup>. However, the Council sees merit in a temporary prices monitoring regime for non-reserved services to assist the ACCC in administering general and specific provisions in the TPA applicable to the postal services market, while competition in this market develops.

### ***Recommendation***

**The Council recommends that the reserved services be subject to the same method of prices surveillance as currently applies. That is, proposals to change prices or terms and conditions for reserved letter services should continue to be notified in advance to the ACCC and the price should continue to be subject to approval by the Minister.**

**The ACCC should undertake regular prices monitoring of non-reserved services for the first five years of deregulation. The need for this provision should be reviewed in 2005.**

<sup>7</sup> The Council notes that business customers will be subject to a maximum charge set at the price of the reserved services, so that all customers will have access to services which are protected by price regulation.

## **9.7 Regulatory Functions**

The principles underlying the National Competition Policy require that where competition is to be introduced to a sector traditionally supplied by a public monopoly, any responsibilities for industry regulation should be removed from the incumbent before competition is introduced. The rationale for this principle is that responsibility for regulatory functions should rest with an entity free of any conflict of interest.

For example, partial deregulation of the telecommunications industry was introduced in 1989 along with the creation of an independent regulator, AUSTEL, responsible for technical and commercial regulation of the industry. Prior to this, the incumbent telecommunications carrier, Telecom (now Telstra), was responsible for technical regulation. However, with the introduction of competition it was considered in the public interest that new regulatory arrangements be introduced to prevent Telstra from using its control over technical regulation to frustrate prospective competition. These new regulatory arrangements also addressed consumer protection and universal service delivery issues.

### **9.7.1 Regulatory Functions for Postal Services**

At issue in a more liberalised postal services market is what institutional framework should be put in place to address regulatory issues. With more competition, a number of issues concerning competition, consumer protection, international obligations, community service obligations and service provider interconnection will require some level of independent oversight.

In most areas the regulation of postal services has already been separated from the operation of Australia Post. For example, prices oversight for reserved services is the responsibility of the ACCC and the Minister for Communications and the Arts. As discussed in the previous section, the price of standard letter services must be approved by the Minister and proposals to change prices or terms and conditions for reserved letter services must be notified in advance to the ACCC. In addition, the Act currently enables regulations to be made giving the ACCC the power to inquire into disputes over postal interconnection, and to report to the Minister for the purpose of resolving such disputes. These interconnection arrangements would be removed under the Council's reform

package. However, the ACCC would retain prime responsibility for administering new legislated access arrangements.

The Council considers that legislated access arrangements and prices oversight should continue to be administered by the ACCC. In addition, the ACCC should continue to be responsible for competitive conduct issues and broad consumer regulation concerning postal services, consistent with its role under the TPA and the *Prices Surveillance Act 1983*.

There are, however, some other regulatory functions concerning postal services which will need to be addressed in a more liberalised postal services market. These functions, which are discussed in the following sections, concern:

- Australia's Universal Postal Union obligations;
- the protection of Australia Post's right to supply reserved services;
- Universal Service Obligations for postal services; and
- other postal interconnection and service standards issues.

As discussed below, the Council has considered who would be appropriate to manage these functions.

#### *Australia's Universal Postal Union obligations*

As a member of the Universal Postal Union (UPU), Australia is subject to international treaty obligations arising under UPU Conventions and Agreements.

The UPU provides for harmonisation and simplification of international mail procedures, as well as technical co-operation and development, quality standards and security regarding international mail delivery.

Australia's UPU obligations are currently managed by Australia Post and the Department of Communications and the Arts in accordance with a Memorandum of Understanding between these agencies. At present, Australia Post pays for Australian membership of the UPU. The Department of Communications and the Arts provides for overall coordination of government policy in postal matters and Australia's UPU membership responsibilities. Australia Post has responsibility for operational and commercial matters arising out of UPU membership. This includes representing Australia on the Postal Operations



Council of the UPU and in respect of obligations arising from UPU Conventions and Agreements. The Postal Operations Council is a technical and operational body of the UPU.

TNT has commented on the implications of Australia's obligations arising under UPU Conventions and Agreements:

*The Australian Government has in the past allowed Australia Post to lead delegations to the Universal Postal Union (UPU) and other international treaty organisations to which the Government, rather than Australia Post, is the contracting party. We understand that the Government now takes the position that where policy and regulatory matters are to be negotiated, Government officials will lead the negotiations and Australia Post's status will be confined to that of advisor. It is not clear to us that this principle has been fully implemented. In any case, in the interests of competitive neutrality it should be open to other operators to participate as advisors to Australian delegations to the UPU as it is the Government, not Australia Post, that is the contracting party (TNT, submission 43, p. 13).*

TNT also argued that:

*It needs to be emphasised that the UPU is an intergovernmental treaty organisation to which Governments are signatories not postal authorities. While many of its activities amount to the simple commercial conduct of an international business cartel, the UPU also increasingly exercises an important policy role. Allowing Australia Post to exercise these policy and regulatory functions in relation to a market where it is the dominant participant is utterly anachronistic and inappropriate. (TNT, submission 87, p. 12).*

Australia Post has identified Australia's UPU obligations as an issue requiring consideration in a more liberalised postal services market:

*At present our competitors are not directly involved in UPU matters - and this would need to be addressed were a different regulatory regime to emerge (Australia Post, submission 8, p. 32).*

In its second submission, Australia Post made the following comments regarding Australia's UPU obligations:

*The Australian Government is a signatory to the UPU Constitution, UPU Convention and UPU Postal Parcels Agreement.*

*Australia Post has been nominated by the Australian Government to fulfil the obligations of these treaties.*

*In the case of the UPU Convention, which provides for a single postal territory, Australia Post reports under recovery (a loss) of its inward delivery costs for letter class mail.*

***Regulatory functions within the UPU are the responsibility of the Australian Government - not Australia Post.***

***Private operators are represented through a UPU contact committee. They are not generally held accountable for the fulfilment of treaty obligations eg. universal service, and are hence not afforded a role at UPU meetings. These meetings are usually attended by representatives of government and/or the public postal authority (Australia Post, submission 99, p. 78, emphasis in original).***

As discussed above, the UPU is ostensibly a standards body providing for harmonisation of international mail procedures and technical co-operation between publicly owned postal administrations. It does not directly determine standards for private postal service providers.

As discussed by Hinds:

*So, what is the best way to describe the UPU? Perhaps a more useful analogy would be to examine it as an international standards body. The Regulations of the UPU are in fact a set of interface standards for international mail. They specify in very low level detail the way that postal administrations transfer mail to each other (Hinds 1993, p. 40).*

Leavey has characterised the UPU as follows:

*To enable their postal administrations to provide universal worldwide delivery services, national governments maintain membership in an intergovernmental organisation, the Universal Postal Union. The UPU is a specialized agency of the United Nations which governs and develops the basic international services their governments expect their postal administrations to provide to citizens and businesses (Leavey 1993, p. 3).*

However, Leavey also comments that:

*The majority of functions of the UPU are “commercial” in the sense that they are the same functions that would be undertaken by a similar group of private companies trading with one another. However, certain key functions partake of a “governmental” or “regulatory” nature in that they represent the exercise of authority reserved for government.*

*Many of these governmental functions tend to protect postal administrations from competition, both competition from private delivery services and competition from other postal administrations. To this end, the UPU permits or encourages postal administrations to allocate markets, fix prices, give preferential prices to selected customers, and boycott private carriers - all in a manner that would be illegal for private companies similarly situated (Leavey 1993, p. 20).*

The Council is of the view that Australia Post should continue to be designated as Australia’s official postal administration to the UPU, considering its ability to provide national universal service coverage and its domestic obligations in this regard. However, this arrangement should be reviewed in the future having regard to the extent of private sector involvement in the provision of CSO services and the ability of private postal service providers to provide a universal service.

On the issue of who should manage Australia’s UPU obligations, the Council considers that given that these obligations are those of the Australian Government, as signatory to UPU treaties, and do not involve direct regulation

of private postal service providers, it is appropriate that the Department of Communications and the Arts continue to fulfil this role.

However, in performing this role, and specifically in assigning Australia Post responsibility for representing Australia in matters arising out of UPU membership, regard should be given to the regulatory and market structure for postal services in Australia and the principles of competitive neutrality. In particular, arrangements which permit private postal service providers input to UPU matters, where appropriate, should be considered in a more liberalised postal services market.

***Recommendation***

**The Council recommends that Australia Post should continue to be designated as Australia's official postal administration to the UPU. This should be reviewed in 2005 having regard to the ability of private postal service providers to supply a universal service.**

*Protection of Australia Post's right to supply reserved services*

Section 31 of the Act allows Australia Post to apply to the Federal Court for relief where there has been an infringement of Australia Post's right to supply reserved services. The relief which may be provided includes an injunction and, at the option of Australia Post, either damages or an account of profits.

There has been significant criticism of the position of Australia Post as both regulator and supplier of reserved services. It has been suggested in several submissions that it may be necessary to have an independent regulator to avoid the types of criticisms leveled by Australia's Post's competitors.

Dunhill Madden Butler argued that:

*The provisions of section 31 of the Act, effectively place Australia Post in the position where not only is it a participant in the market place, but it is also the regulator of that market place in that it is the body charged with the effective enforcement and administration of the Act. It is suggested that it needs to be*

*examined whether this is an appropriate role and whether, for example another body should take on this role, or whether Australia Post ought to be charged with an obligation to ensure that it at all times enforces the provisions of the legislation, rather than doing so on a selective basis (Dunhill Madden Butler, submission 41, p. 3).*

TNT Australia has said:

*Australia Post is both the service provider and the market regulator. This is an unusual situation for a Government owned monopoly, ... (TNT, submission 43, p. 3).*

The issues raised concerning Australia Post's role in the market place will be largely resolved through pro-competitive elements of the Council's reform package, and specifically its proposals for:

- a clearer and more concise letter definition;
- a narrower range of reserved services, so that potential areas for dispute are lessened;
- a licensing system for postal service providers, which would prohibit providers other than Australia Post from supplying reserved services; and
- an independent regulator charged with administering and monitoring compliance with postal service provider licences.

Notwithstanding this, the Council considers that where Australia Post believes there has been an infringement of its right to supply reserved services, it should not be prevented from raising this matter with the independent regulator and/or before a court. This is standard commercial practice for companies that believe there has been a breach of legislation which disadvantages them.

#### *Universal Service Obligations*

Section 28C of the Act enables the Minister to set minimum performance standards applicable to the frequency, speed or accuracy of mail delivery; or the availability or accessibility of:

- post-boxes or other mail lodgment points; or
- offices of Australia Post or other places from which Australia Post products or services may be purchased.

As performance standards have not to date been set through this process, Australia Post has set its own standards for mail delivery. Australia Post has advised that standards are set after consultation with users of postal services. For example, the Postal Services Consultative Council was established in 1991 as a forum for consumer needs in respect of postal services.

Australia Post has been criticised for being responsible for setting its own standards and for itself monitoring its performance against these standards. This issue is linked integrally to Australia Post's USO responsibilities, which are discussed in Chapters Six and Seven. The Council's reform package includes a requirement for an independent body to administer the assessment, and possibly the funding, of the postal USO and monitor compliance with its set service standards. This role will also entail dealing with systemic issues about non-compliance with the USO, as well as administering licensing for Australia Post and other postal service providers.

A question that arises is whether an independent body should be created to deal with individual complaints about non-compliance with the USO or whether, as currently provided for, the Commonwealth Ombudsman's office should fulfil this role. In some industries, it has been considered necessary to create a specialist complaints office to deal with individual complaints, for example because of the requirement for specialist technical or industry knowledge or because it is more likely that such bodies will be adequately resourced to deal with complaints.

The Commonwealth Ombudsman has created a position of Senior Assistant Ombudsman with responsibility for dealing with complaints in relation to Australia Post. The Ombudsman's office reported that the office had received 654 complaints about Australia Post in 1995-96. The Council notes that the Consumer Law Centre of Victoria has advised that it believes the low number of complaints about Australia Post's standard of service may be related to the fact that people are not confident that their complaints will be dealt with adequately by Australia Post.

The Council considers that in view of:

- the Council's proposal not to liberalise the market for postal services provided to residential customers;
- Australia Post's position as the sole USO postal service provider; and

- the relatively low number of complaints regarding Australia Post which are received by the Commonwealth Ombudsman's office; the Commonwealth Ombudsman should continue to deal with individual complaints about non-compliance with the USO.

Notwithstanding this, the Council believes that an independent body will be required to monitor compliance with service standards set for the USO, which will involve monitoring complaints matters so as to determine systemic issues about non-compliance.

The Council considers that the issue of internal complaints handling by Australia Post should be addressed in its service charter. The need for complaints handling covering other postal service providers should be addressed through the regulatory regime for postal services discussed below.

*Postal interconnection and service issues not pertaining to competition*

There are a number of practical interconnection and service issues not pertaining directly to competition which will also need to be addressed in a deregulated postal services market. Australia Post has advised that a number of issues will need to be resolved if alternative postal service providers are to be able to deliver letters to business and residential addresses in the future (Australia Post, submission 99, p. 20-27). These issues include:

- redirection and holding of mail;
- return to sender letters;
- security and privacy of postal articles;
- responsibility for lost, damaged or delayed mail; and
- other 'standards' aspects of interconnection, such as the types of letter containers used for interconnection with Australia Post's network.

Australia Post has provided information to illustrate the extent of these matters and their possible implications for consumers and service providers in a deregulated postal services market. In particular, Australia Post noted that:

*Approximately 15% of the Australian population moves each year. In 1996/97, 1.8 million Change of Address (COA) notices were received covering 1.2 million permanent relocations, and*

*0.6 million temporary redirections or holding of mail. On average, one notice covers 2.4 people per household (Australia Post, submission 99, p. 20).*

and:

*In 1996/97, more than 100 million letters were returned to sender (RTS). These were returned using the sender's address if printed on the outside of the envelope, or if not, by an Australia Post dead-letter office authorised to open mail (Australia Post, submission 99, p. 21).*

In addition, Australia Post commented that:

*Letters often contain the most private and confidential information about persons and businesses. This includes personal financial, medical and legal details, which if compromised could cause severe embarrassment or damage to the persons concerned (Australia Post, submission 99, p. 22).*

and observed that:

*It is not yet clear how alternative postal operators will "brand" letters delivered through their own networks. However, some method of unique marking will be required so that recipients are able to accurately allocate responsibility for damaged and delayed items (Australia Post, submission 99, p. 26).*

The Council is mindful of such issues. Experience of other multi-service provider environments involving interconnection arrangements shows that agreed industry protocols are usually necessary if service providers are to conduct their business with each other and with their customers efficiently and effectively.

The Council notes that many such arrangements will be dealt with by the ACCC through its assessment of an access undertaking for postal services, as discussed previously. However, interconnection arrangements derived through commercial negotiation will not be considered formally by the ACCC, nor would arrangements for unregulated services. Consequently, the Council believes that an independent regulator of postal services will be required to, where appropriate, oversee the establishment of protocols by the providers of



postal services, and ensure they are in the public interest. Specifically, these arrangements will need to achieve a balance between the needs of consumers and those of industry, while ensuring that competition is not impeded by administrative and technical matters. If agreement is not reached, the regulator would need to determine standards.

The industry protocols could cover arrangements such as:

- establishing a national information system to enable postal service providers to readily access and record mail redirection and change of address information.
- formal arrangements which assign responsibility for return to sender, damaged or delayed letters.
- mechanisms to identify the postal service provider responsible for pieces of mail.
- agreed industry arrangements for dealing with damaged or delayed letters.

***Recommendation***

**The Council recommends that if the protocols *critical* to protecting customers and enabling interconnection to function are not in place at the time of market liberalisation, the regulator for postal services should itself determine standards applicable to such matters, in consultation with stakeholders. This should occur within six months of market liberalisation.**

*Regulatory oversight*

The functions and expertise necessary to implement the Council's reform package for the postal USO, as well as the proposed licensing and industry protocol arrangements for new postal service providers, could be dispersed amongst several entities or performed by a single industry regulator.

For example, it is conceivable that administration of the postal USO, as well as licensing of postal service providers, could be undertaken by the Minister for Communications and the Arts or his Department. It is also possible that the Minister or his Department could deal with industry protocol issues not directly related to competition. Further, complaints and compliance monitoring

concerning the postal USO could be dealt with by the Commonwealth Ombudsman and the Commonwealth Auditor General, respectively. However, neither entity would have the appropriate mandate nor the expertise to singularly deal with all of these regulatory functions. Moreover, using a Minister or government department to regulate matters which affect both Australia Post and other postal service providers may create concerns that the government owner of Australia Post is also responsible for broad industry regulation, resulting in a conflict of interest.

It is important in a newly deregulating industry that consumers potentially affected by change have the ability to acquire information and assistance from an entity with a broad industry focus. In particular, the Council recognises the benefits of regulatory expertise in consumer and technical matters which can be quickly developed by a single entity with a broad regulatory scope. The existence of a single focussed regulator can also benefit commercial stakeholders in a newly deregulating industry.

Having considered these issues, it is the Council's view that the regulatory functions for postal services outside those performed by the ACCC should be undertaken by a specific regulator for the postal services industry.

Industry self-regulation for postal services has also been considered by the Council. However, reliance on industry self-regulation, without regulatory oversight, could not ensure the outcomes required by consumers and industry stakeholders in a liberalised postal services market. Nevertheless, as industry developed regulation can minimise the administrative and compliance cost of regulation, the Council believes that key elements of industry involvement in regulation should be included in the future regulatory framework for postal services.

The Post Office Agents Association cautions that:

*In the ... event of the creation of an industry-specific access regime, it is to be hoped that it would encompass all carriers, and not simply Australia Post. To do otherwise would be inequitable ...*

*We do not support the idea of industry self-regulation in the form of an industry code of practice (Post Office Agents Association, submission 84, p. 28, emphasis in original).*

While the Council considers that industry codes of practice should be a feature of the future regulatory framework for postal services, it believes that these arrangements should be backed by a regulator which can establish and enforce mandatory industry standards where appropriate.

### 9.7.2 An Industry Specific Regulator for Postal Services

To avoid the cost of establishing a new body to regulate postal services, the Council has considered Commonwealth agencies which could realistically take up the functions required of a postal services regulator. The Council has had regard to agencies that clearly possess functions and expertise which have synergies with those which will be required by a postal services regulator.

Telecommunications is now regulated by a combination of an industry specific regulator and the ACCC. Under reforms introduced in 1997, the Australian Communications Authority (ACA, previously AUSTEL) is the regulator responsible for consumer and technical matters concerning telecommunications. Its former competition functions have been transferred to the ACCC.

TNT commented that it:

*...considers that broadening the scope of the Australian Communications Authority's responsibilities to include postal services would be an effective and low cost method for achieving administration of Australia Post's regulatory functions. In the transition to competition there would be considerable merit in vesting the regulatory functions in this body given its extensive experience in a related sector. (TNT, submission 87, p. 9).*

The Major Mail Users of Australia Ltd has also expressed support for the ACA being appointed as the postal service regulator (MMUA, submission 121, p. 13), as has Readers Digest who noted that:

*Whilst setting up a new regulator may be an ideal option but costly, broadening the Australian Communications Authority to include postal services would seem to have advantages (Readers Digest, submission 116, p. 4).*

The Council has considered the ACA's previous role as a regulator responsible for competition, consumer and technical matters in a newly deregulating industry between 1989 and 1997. Consideration has also been given to the ACA's current role as an industry specific regulator with a consumer focus, operating nationally and responsible for matters concerning:

- CSO administration and compliance (for telecommunications);
- licensing of telecommunications service providers; and
- industry codes of practice and standards affecting consumers and telecommunications industry stakeholders.

Having had regard to this, the Council is of the view that the ACA's functions have direct synergies with the role envisaged for a postal services regulator, and its expertise is sufficiently robust that its charter could be broadened to include postal services.

***Recommendation***

**The Council recommends that in a deregulated postal services market, the ACA administer postal services regulation outside the ambit of the ACCC. Specifically, the ACA's charter should be expanded to give it responsibility for administering:**

- **the assessment and funding of the postal CSO, if there is an industry levy;**
- **monitoring systemic issues associated with Australia Post's compliance with the CSO;**
- **enforcing CSO compliance;**
- **licensing of Australia Post and other postal service providers;**
- **monitoring and enforcing compliance with postal service provider licences; and**
- **administering the establishment and enforcement of industry codes of practice covering service standards.**

**The Commonwealth Ombudsman should continue to deal with individual complaints about Australia Post's non-compliance with the USO.**

The Council considers that the ACA's responsibility for industry codes of practice not dealt with by the ACCC (and where appropriate mandatory industry standards) should cover, but not be limited to, industry protocols for dealing with:

- redirection and holding of mail;
- return to sender letters;
- security and privacy of postal articles;
- lost, damaged and delayed mail;
- technical aspects of interconnection not dealt with by the ACCC; and
- the internal handling of consumer complaints by postal service providers and, if necessary, an industry scheme for complaints handling and resolution.

The Council also envisages that the ACA would have a broad role in raising consumer awareness about reform of the postal services market and related issues affecting users and providers of postal services.

## **9.8 Public Ownership of Australia Post**

Australia Post is wholly owned on behalf of the Australian community by the Commonwealth Government. The Terms of Reference require the Council, in considering practical courses of action to improve competition, efficiency and consumer welfare in the postal service sector, to have regard to the Commonwealth Government's commitment to maintaining Australia Post in full public ownership.

Accordingly, the Council has considered issues concerning public ownership of Australia Post and has raised several of these in the following discussion.

### **9.8.1 Issues For Public Ownership**

While privatisation of many public businesses has been favoured for a variety of reasons by governments in Australia and overseas in recent years, it is the Council's position that changing the form of ownership of a business is not an imperative for improving competition, efficiency and consumer welfare.

In particular, where the unfair advantages and disadvantages a public business may possess - by virtue of its public ownership or longstanding legislative monopoly - are analysed and addressed, public ownership will diminish as a competition issue. In framing its reform package for postal services, the Council believes that it has considered and addressed these advantages and disadvantages.

There is evidence however that privatisation can increase the efficiency of many businesses, which is consistent with the objectives of the National Competition Policy. Accordingly, there is merit in considering whether all activities currently undertaken by Australia Post should be maintained in full public ownership in a more liberalised postal services market.

In having regard to these issues, it is instructive to consider that Australia Post already has considerable private sector involvement in its operations. For example, in 1996, licensed post offices and post office agents numbered 2873 (Australia Post 1996, p. 63). The staff working in these agencies are employed by the licensee, not Australia Post. Further, nearly four thousand private mail contractors, particularly in rural and remote areas, handle Australia Post delivery. In addition, some parcel delivery services are contracted out.

The internal efficiencies currently being pursued by Australia Post through this private sector involvement would most likely continue to evolve following market liberalisation.

As discussed in Chapters One and Two, Australia Post is increasingly operating in a broad communications market which is largely deregulated, fiercely competitive and highly dynamic. Telstra, which is a major competitor to Australia Post in this broad market, has undergone partial privatisation and consequently will experience the ongoing scrutiny of the financial markets that this implies. In a rapidly changing communications market, consideration may in the future need to be given as to whether Australia Post should be subject to the same market disciplines in order to maintain or improve its ability to compete.

# Chapter Ten: Non-Reserved Services of Australia Post and Competitive Neutrality

*In addition to its monopoly letters service, Australia Post provides a broad range of non-reserved services in direct competition with private operators. A number of private operators, and some retail outlets, claim that Australia Post's extensive network, developed to provide the monopoly letters service, gives it an automatic advantage in other markets.*

*Proposals to address Australia Post's perceived advantage include removing those provisions in the legislation that advantage or disadvantage Australia Post, financially separating Australia Post's monopoly and competitive businesses, subjecting Australia Post to all taxes and charges paid by private sector competitors and developing a competitive neutrality complaints mechanism.*

Clause 3 of the Competition Principles Agreement requires governments to review significant government owned businesses to identify, and remove where necessary, the advantages and disadvantages businesses have solely because of their public sector ownership - in other words, ensure that the businesses are competitively neutral.

The Council's Terms of Reference require it to look at:

*the scope, extent and organisational structure of commercial activities undertaken by Australia Post other than the reserved letter service. The competitive neutrality issues that may arise including the associated benefits and costs from these activities, should be identified and addressed as necessary (Terms of Reference, 4(c)).*

Accordingly, in the review of Australia Post, the Council is required to address any competitive neutrality issues that may arise in relation to Australia Post's commercial activities.

This chapter examines:

- the types of services Australia Post provides in competition with other businesses;
- issues associated with a government business competing with private businesses, particularly when it has a legislated monopoly over related services; and
- the specific advantages or disadvantages Australia Post has over its private sector competitors.

## **10.1 Non-reserved Services**

As noted in Chapter Five, Australia Post is able to provide non-reserved services provided such services fall within the powers set out in section 18 of the *Australian Postal Corporation Act 1989*. This includes services which are specifically exempt from the reserved services and any other postal services. Section 18 is broad enough to avoid imposing any obvious constraints on Australia Post. Any person or business can compete with Australia Post to provide non-reserved services.

Services provided by Australia Post which can also be provided by competitors are set out in Box 10.1.

### *Box 10.1 Non-reserved services provided by Australia Post*

#### *Postal services*

- Express Post - urgent items, letters and parcels, delivered the next business day within a guaranteed delivery network.
- Print Post - a publications delivery service.
- Business Post International - Business Air Mail, Express Post International and EMS International Courier services.
- Parcel Services - Parcel Post for household and small-parcel delivery, Multi Parcels for business-to-business delivery and a new pre-paid Parcel Post Satchel.



*Retail services*

- PostPak - a range of decorative gift boxes.
- Bookabout - children's books sold in retail post offices.
- Sale of stationery and other products.

*Electronic services*

- FaxPost - used mainly by private and small business customers.
- EDIPost - a national electronic-to-physical mail service.
- ePost - the international version of EDIPost intended to be introduced in 1998.

*Financial services*

- giroPost - on-line banking for customers of nine banks.
- Pay it at Post - a bill payment service allowing customers to pay various household bills, such as electricity, telephone and insurance accounts, at retail post offices.
- EFTPOS - facilitates bill payment services and other purchases.
- Money orders - non-account-based means of funds transfer.
- KeyPost - electronic commerce and message service.

*Fulfilment and warehousing services*

- Fulfilment services - provision of storage facilities, receiving orders, picking, packing and sending products for both domestic and international customers.

*Other services*

- Passport Interviews - on behalf of the Department of Foreign Affairs and Trade.
- Tax Pack Express - customers can lodge their tax returns electronically.
- Address Post - electronic service that assists business mailers in improving the accuracy of their mailing lists.

*Subsidiaries and Joint Ventures*

- these include Australian Air Express Pty Ltd, Geospend Pty Ltd; Austrapay Ltd, International Datapost, and Postcorp Developments Pty Ltd (see Chapter Three).

Australia Post faces significant competition in a number of these areas including the sale of books (competition mainly from book stores and newsagents) and stationery (office product retailers and newsagents), the delivery of parcel post, express post and international post (couriers such as TNT and Mayne Nickless) and the provision of electronic services (Optus, Telstra and other service providers).

The Council has been presented with different views about whether:

- the reserved services affect Australia Post's ability to compete in other areas;
- Australia Post's prices in competitive markets are cross-subsidised; and
- there are any other specific advantages or disadvantages arising from government ownership.

These issues are discussed in this chapter. Many of them raise specific competitive neutrality issues.

## **10.2 The Requirements of Competitive Neutrality**

Competitive neutrality is about introducing those changes needed to ensure that government businesses do not have any advantages or disadvantages simply because of their government ownership. This will mean that they will be on an equal footing when competing with private businesses.

The Council will be looking to ensure that the benefits of fair competition between public and private enterprises are realised in relation to postal services in Australia. The Council has noted previously that the competitive neutrality policies and principles outlined in the Competition Principles Agreement, where properly implemented, will have benefits for consumers and for business: for example, in terms of the price and quality of government services and improved customer focus. The removal of advantages available to government businesses because of their public ownership will enhance the ability of private businesses to compete with those owned by governments (see NCC 1997, p. 3).

*Box 10.2 Examples of Potential Advantages and Disadvantages affecting Government Businesses*

*Potential advantages*

- Exemptions from Commonwealth taxes and State and Local taxes.
- No requirement to return a profit, rate of return on investments or account for depreciation expenses.
- Exemptions from various Commonwealth and State legislation (for example, environmental regulation).
- Cheaper capital financing (no risk premium where the agency is backed by an explicit or implicit government guarantee).

*Potential disadvantages*

- Difficulty in accessing taxation benefits of depreciation, investment allowances and other deductions (for example, through the transfer of taxation losses).
- Lower degree of managerial autonomy, for example due to the requirement to comply with Ministerial directives.
- Lack of flexibility in reducing or restructuring corporate overheads.
- Constitutional and legal constraints, including being subject to Administrative Law.
- Capital constraints - high debt/low equity.

*Corporatisation*

Under the Competition Principles Agreement, all governments, including the Commonwealth, have committed to:

*Subject to subclause (6), for significant Government business enterprises which are classified as “Public Trading Enterprises” and “Public Financial Enterprises” under the Government Financial Statistics Classification:*

- (a) *the Parties will, where appropriate, adopt a corporatisation model for these Government business*

*enterprises (noting that a possible approach to corporatisation is the model developed by the intergovernmental committee responsible for GTE National Performance Monitoring); and*

- (b) the Parties will impose on the Government business enterprise:*
  - (i) full Commonwealth, State and Territory taxes or tax equivalent systems;*
  - (ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and*
  - (iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment, and planning and approval processes, on an equivalent basis to private sector competitors.*

Therefore, under the Competition Principles Agreement, governments are encouraged to corporatise their significant business enterprises. Corporatisation of a government business activity involves separating the business from the day to day control of government, with the aim of imposing commercial pressures similar to those faced in the private sector.

If the cost of corporatisation cannot be justified, however, governments must ensure that the business enterprise put in place effective pricing reforms. Pricing reforms aim to neutralise any competitive advantages that a government enterprise may enjoy relative to its private sector competitors. This is achieved by ensuring that production costs incurred by a government business activity are reflected in the prices charged for its goods and services, that is, prices are set on a commercial basis. These costs include direct costs such as wages and raw materials and a proportion of indirect costs such as office overheads and depreciation. In addition, prices should reflect implicit costs such as debt guarantee fees, tax equivalent payments, and a commercial rate of return.

### 10.2.1 Competitive Neutrality Complaints

Under the Competition Principles Agreement, the Commonwealth (and the States and Territories) has agreed to incorporate a mechanism for handling competitive neutrality complaints. This mechanism is an important aspect of competitive neutrality reform as it provides a means for any party which considers itself adversely affected by advantages only available to its government owned competitors, to have its objection dealt with effectively.

The objective of the complaints mechanism is to provide a means for interested parties to pursue concerns that government ownership confers competitive advantages or disadvantages on government-owned businesses. The mechanism is not intended, however, to address concerns about any anti-competitive *behaviour* of government businesses, as such concerns should be pursued through avenues such as industry regulators, the *Trade Practices Act*, ombudsmen and the court system.

The Commonwealth is free to develop its own approach to handling competitive neutrality complaints. There are a number of characteristics, however, which should be included in a complaints mechanism. These are:

- a first-step filter to promptly address simple misunderstandings and to help identify frivolous complaints;
- access should be user friendly so as to not unduly deter complainants;
- the arbitrator of genuine complaints should have a clear responsibility to be fair and independent from the enterprise about which the complaint is made;
- formal advice and written reasons supporting an arbitrator's decision should be provided to complainants and the relevant government businesses; and
- where the complaint is found to have substance, action should be taken promptly to rectify the problem.

The Council notes that a bill to establish a mechanism for handling competitive neutrality complaints has been drafted by the Commonwealth Government but has yet to be passed by parliament. Until such time as the bill is passed, however, there is no forum to which persons can take competitive neutrality complaints concerning Commonwealth Government owned businesses, including Australia Post.

***Recommendation***

**The Council recommends that the mechanism for handling competitive neutrality complaints that arise in relation to businesses owned by the Commonwealth Government be formalised as soon as possible.**

## **10.3 Competitive Neutrality and Australia Post**

### **10.3.1 Implementation to Date**

Since corporatisation in 1989, Australia Post has made considerable progress toward becoming competitively neutral. Australia Post has a Commonwealth borrowing levy of 0.125 per cent and is liable for all Commonwealth taxes and most state and local taxes (see section 10.5) as well as paying a dividend to the Commonwealth as its owner. In 1996-97, the dividend payment was \$219.9 million, equivalent to approximately 63 percent of after-tax profit.

### **10.3.2 Current Competitive Neutrality Concerns**

Chapter Nine has already outlined the risks faced when a company operates in both competitive and monopoly markets. Several submissions to this review have raised specific concerns about the reserved services and whether they give Australia Post an automatic advantage in competing in other markets. Five competitive neutrality issues have been raised in this regard, relating to:

- general advantages enjoyed by Australia Post as a result of reserved services;
- products sold at retail post outlets;
- joint venture arrangements;
- differences in taxes and charges between Australia Post and its competitors; and
- other legislated advantages.

### **10.3.3 General advantages**

Several submissions suggested that Australia Post gains general advantages in competitive markets because of its market power associated with the

comprehensive provision of its reserved services. The association between the reserved and non-reserved services is complex, however, and it is not clear whether Australia Post's advantage is a commercial or an unfair advantage.

Australia Post's comprehensive network, which extends throughout Australia, is widely accepted as being of benefit to Australia. The scope of the network, however, makes it difficult for other operators to become effective competitors in the postal industry.

According to Mayne Nickless, Australia Post is able:

*...to leverage its non-reserved services off its considerable publicly funded investment in its reserved area (Mayne Nickless Limited, submission 14, p. 8).*

The Queensland Commercial Independent Stationers (QCIS) noted that Australia Post is able to provide services such as financial services only because of its entrenched network and that such alliances are to the disadvantage of all concerned except Australia Post (Queensland Commercial Independent Stationers, submission 15, pp. 5-6).

Similarly, Streetfile argued that there is a lack of differentiation between services provided by Australia Post's employees (Streetfile, submission 10, p. 25). As a result employees carry out both reserved and non-reserved services with no apparent financial distinction made between them.

The Federal Member for Forrest, Mr Geoff Prosser, claimed that other businesses, such as shopping centres, recognise the value of being associated with Australia Post because Australia Post can be relied upon to bring in customers.

*An excellent example of Australia Post's advantage over the retail sector is illustrated by the fact that shopping centres actively encourage Australia Post to set up an outlet in the centres as they recognise it as a monopoly supplier (Geoff Prosser MP, submission 112, p. 1).*

Major Mail Users argued that Australia Post should account for the role its "monopoly gained resources of plant and equipment, staff, network interconnection and general marketplace position both in the direct and indirect

usage” has in providing its non-core services (Major Mail Users, submission 33, p.19).

Whether Australia Post’s advantages result from commercial economies of scope or from its legislative monopoly is debatable. From Australia Post’s perspective it makes perfect sense commercially to rely on and use available economies of scope. According to Australia Post:

*It is both good business sense, and efficient, in the public interest, for Australia Post to realise the benefits of any available economies of scope. So long as Australia Post prices those products in line with its costs (including achievement of a reasonable rate of return), and competes fairly in the market place, there ought not to be any reservation about Post engaging in the relevant activities (Australia Post, submission 99, p. 91).*

Australia Post, in its first submission, noted that:

*...because the non-reserved services are delivered through a retail and distribution network which is simultaneously used to provide letter services, Post is able to capture cost savings due to economies of scope. In this respect, it is worth noting that a number of competitors (eg. multinational transport companies, banks, newsagents and chemists) also maintain extensive distribution networks offering multiple product lines (providing the potential for similar cost savings) (Australia Post, submission 8, p. 111).*

The Australian Local Government Association (ALGA) supported Australia Post’s reliance on economies of scope. According to ALGA:

*... it is entirely appropriate and desirable for Australia Post to use available economies of scope to provide services [as a government agent and/or a commercial body] or in its own right in areas closely related to its core business.*

*In many areas, these services represent essential infrastructure to support other businesses. The provision of agency services, stationery lines and the like seeming[ly] entail low sunk costs which would, on the face of it, ensure appropriate levels of*



*contestability. Remedies for the potential for predatory pricing using reserved services can be sought through application of the Trade Practices Act (Australian Local Government Association, submission 29, p. 5).*

However, QCIS took exception to this view and stated that Australia Post

*... has forgotten the real issue, that no other business relies on an exclusive, reserved product or service, or is government owned (QCIS, submission 90, p. 3).*

The Council agrees that many of Australia Post's economies of scope are commercial and recognises that many of the existing commercial economies of scope derive from historical arrangements for reserved services. However, what is important for optimising the use of Australia's resources in the future is not whether past legislation favoured Australia Post but to ensure similar advantages are not built into the new arrangements.

In Chapter Nine, the Council considered that the benefits of structural separation of Australia Post do not outweigh the costs. The Council recognises it is important that Australia Post be able to take advantage of economies of scope, especially to enable it to provide a broader range of services than would otherwise be available in rural and remote areas. Therefore, on balance, the Council considers that Australia Post should be free to provide services in reserved and non-reserved areas.

The Council recommendations made previously in this Report address many of the competitive neutrality issues raised above. However, it is important that more direct approaches to achieving competitive neutrality are applied, including the establishment of the Commonwealth's complaints mechanism, to address the problems raised above.

A number of the Council's recommendations - such as deregulating business mail, introducing strict and transparent accounting separation and access regulation - work to reduce the ability of Australia Post to use its reserved services to unfairly advantage it in competitive markets. But no further constraints should be imposed on Australia Post's ability to adopt normal commercial practices, including taking advantage of available economies of scope.

#### **10.3.4 Retail Post Products**

As discussed in Chapter Three, Australia Post has almost completed its roll-out of investment in its retail network. Services that are available at, or through, retail post offices include:

- postal services and related services such as packing containers and fax services;
- financial services such as bill payment and banking services;
- the sale of stationery, greeting cards, and books; and
- other services such as passport interviews on behalf of the Department of Foreign Affairs and Trade.

Two specific issues have been raised with the Council in relation to Australia Post's retail shops. One concerns the sale of stamps and the other is concerned with advantages Australia Post enjoys in the sale of stationery products by virtue of its reserved services.

Australia Post stated that its retail merchandise is not subsidised by its reserved service (Australia Post 1997a). QCIS, however, claimed that

*It is highly doubtful if Australia Post can successfully argue that they can separate the cost of delivering monopoly services, when those overheads are also an integral part of the cost of delivering non-reserved services (QCIS, submission 90, p.3).*

QCIS stated that while it expects competition in the office products/stationery industry, the competition from Australia Post is unfair. Customers visiting an Australia Post Retail Shop for reserved services purposes, find a broad variety of cards and stationery products displayed for purchase. In contrast, newsagents have no reserved services to attract customers into their stores but must rely on store merchandising and marketing techniques (QCIS, submission 15, p. 2).

Sunbury Office Supplies supported this view and agreed that Australia Post does not have to incur additional costs on commercial marketing strategies as does its competitors. Further, Sunbury Office Supplies claimed that Australia Post is able to expand its line of products sold through postal outlets without having to consider the cost.

*As an example, in Sunbury, it is proposed to significantly expand the retail floor space available for the sale of stationery items, as a new mail delivery centre has just been opened at a separate location in the town. Clearly, the significant cost of the new building, and subsequent refurbishment of the existing post office, will not impact on the retail price of stationery (Sunbury Office Supplies, submission 91, p. 2).*

In addition, the Australian Newsagents' Federation Ltd claimed that Australia Post manipulates its cost accounting system and this is evidenced by the fact that:

*In general, the selling price of many Australia Post retail items, in particular stationery, is lower than what any competitive retailer would consider sustainable if he is to remain in business (Australian Newsagents' Federation Ltd, submission 109, p. 4).*

The competitive neutrality issues raised by the sale of stationery products is directly related to the issues discussed in section 10.3.1. As such, the recommendations made by the Council in that section have relevance to the concerns raised about any advantages Australia Post may enjoy in the sale of stationery products.

In particular, the implementation of strict and transparent accounting separation would require Australia Post to clearly identify and separate:

- costs associated with its reserved services from its other services, including retail services; and
- the costs associated with its retail services from all other services.

This would ensure that Australia Post could not use its reserved services to the benefit of its non-reserved services.

#### *Newsagents and Australia Post*

The Australian Newsagents' Federation believes newsagents suffer a double disadvantage from the proliferation of Australia Post retail post offices. According to the Australian Newsagents' Federation, while Australia Post can compete freely in the stationery industry, only agents licensed by Australia Post can sell stamps on commission and then only under stringent conditions (The Australian Newsagents' Federation Ltd, submission 109, p. 3).

Likewise, the Federal Member for Warringah, Mr Tony Abbott believes that:

*Australia Post's monopoly over the sale of stamps does give it an unfair advantage and privileged access to a customer base in competition with small private businesses (Tony Abbott MP, submission 53, p.1).*

In contrast, Ms Williams, who owns a licensed post office, does not believe newsagents are disadvantaged by not being able to sell stamps in competition with Australia Post and licensees. According to Ms Williams:

*...as Licensed Post Office operators we have no access to the sale of the newsagent core business of magazines and newspapers (Augathella Licensed Post Office, submission 49, p. 2).*

Newsagents have enjoyed an exemption under the *Trade Practices Act* since 1982 by which they effectively control the sale of newspapers and magazines, including home delivery, within designated areas. In effect, this exemption grants newsagents a monopoly within a designated area and restricts customers from choosing a preferred newsagent, particularly for home delivery.

The Council has considered the possibility of explicitly requiring Australia Post to allow other businesses to sell stamps on commission. When analysing this proposal, the Council considered the potential cost of putting such an arrangement in place and the possible repercussions it could have on post office agents, including whether it would significantly undermine the property rights of agents.

This issue requires the Council to weigh:

- the benefits of increased access to stamps, given the monopoly enjoyed by Australia Post and the universal service requirement;

against

- the commercial norm that any company should be free to choose the way it distributes its products and should not be required to sell through particular outlets.

The Council considers that the availability of stamps should be addressed through USO requirements and that additional restrictions should not be imposed on Australia Post's ability to decide how to best sell its services.

The Council also notes that newsagents and other competitors to Australia Post are not constrained from purchasing 45 cents stamps at face value for on-selling to their customers.

### 10.3.5 Joint Ventures

As discussed in section 10.3.1, Australia Post is perceived to have advantages derived from its market power. It is arguable, for instance, that Australia Post is only able to enter into its *joint* venture arrangements because of its size and comprehensive network. Some participants in the review have suggested it is inappropriate for Australia Post to be involved in diverse businesses such as property development and fulfilment services. Again, there is an issue as to whether the benefit which Australia Post's network provides to Australians is sufficient to offset the difficulties confronted by potential competitors.

As an example, it has been implied that Australia Post enjoys a distinct advantage through its joint ownership with Qantas of Australian air Express (AeE). AaE controls a large share of the domestic air freight supply. Issues have been raised about the difficulty of competitors to Australia Post having to negotiate with an Australia Post joint venture enterprise for air freight space. According to Ansett, the establishment of the joint venture has had a number of consequences including:

- *denial of opportunity for Australian [a]ir Express competitors to tender for the bulk of linehaul mail shipments*
- *lack of clarity as to the basis upon which costs are allocated between Australia Post and Australian [a]ir Express in the case of joint products, whether within or outside the "reserved" categories*
- *use by Australian [a]ir Express, in the production of products outside the reserved categories, of Australia*

*Post's privileges derived from the reserved categories, such as access to customers' Post Office boxes, kerbside street letterboxes and so forth*

- *reluctance by Australian [a]ir Express to “compete against itself”, in the sense of seeking work that could impact adversely upon Australia Post's interests (Ansett Australia, submission 83, p. 2).*

While AaE has countered these claims by denying any interference in its business by the joint venture parties or special treatment of these parties, the suspicion lingers. It is arguable that since Australia Post is the largest user of interstate air freight it is more likely to be able to negotiate much lower rates than its competitors.

*It is well known that [AaE] utilises Australia Post's services such as linehaul, pick up and delivery, and Post Office pick up point facilities. In essence, [AaE] is interconnecting to the Australia Post network free of charge and in all probability, vice versa (Mayne Nickless Limited, submission 14, p. 7).*

Australia Post denied any suggestion that it is providing a commercial advantage to AaE. According to Australia Post:

*Freight rates charged to Post by AaE are commercial rates as are rates charged by Post to AaE (Australia Post, submission 99, p. 96).*

In addition to Ansett, TNT observed that AaE is the only courier allowed access to private post office mail boxes:

*Private sector courier services are prevented by Australia Post from delivering mail to private mail boxes at Post Offices. This effectively excludes private couriers from tendering for any bulk mail business that includes items addressed to private mail PO boxes. Only one courier, Australian [air] Express, is permitted access to the PO box system. Australian [air] Express is 50% owned by Australia Post and 50% privately owned (TNT, submission 87, p. 10).*

Australia Post stated that private couriers are not excluded from accessing the post office box system and that:

*Private sector courier services may access delivery to private mail boxes by lodging mail with appropriate postage (Australia Post, submission 99, p. 96).*

A similar issue has been raised in relation to Sprintpak, Australia Post's business unit. The key feature of Sprintpak's activity, for example, is warehouse management. The delivery service is provided by Australia Post as part of its ordinary course of business. The activity is not unrelated to postal services and it is difficult to identify where or how Australia Post could provide a more competitive service than other providers. However, Australia Post could give Sprintpak a cheaper postal rate compared with postal rates charged to other fulfilment service providers. Further, Sprintpak services are used by post offices for their office supplies.

The Sprintpak investment, therefore, raises issues of cross-subsidisation between users of the reserved services and the fulfilment services and the allocation of shared costs between competitive and reserved activities. According to Australia Post, however:

*There is no cross subsidy between reserved services, and Sprintpak's services and separate fully costed accounts are maintained (Australia Post, submission 99, p. 96).*

The Council believes that the introduction of strict and transparent accounting separation measures and independent audit procedures to Australia Post's business will reduce the suspicions of cross-subsidisation and provide sufficient information for the ACCC to investigate any accusations of abuse of market power. Further, the Council believes that legislated access to post office boxes, as recommended in Chapter Nine, will overcome one of the competitive advantages identified in this area.

## **10.4 The Act and Australia Post**

Australia Post has established and consolidated its extensive network through decades of holding a legislated monopoly in the postal industry. In addition to those issues addressed above, it is necessary for the Council to address any

other specific advantages or disadvantages to which Australia Post is subject under its enabling legislation and other legislation.

Because Australia Post is government-owned there are many differences in its relationship to its shareholders compared with that of a private company.

*Government ownership is in some respects a source of disadvantage for Australia Post. In particular, Post is required to do certain things not required of the private sector eg meet community service obligations, to operate under some public service conditions, and to submit to the government's direction on a number of matters (Australia Post, submission 8, p. 111).*

For example, Australia Post is required to appear before a Senate Estimates Committee. This Committee scrutinises Australia Post's business including its commercial dealings, and the often sensitive financial nature of those dealings.

#### **10.4.1 Australia Post Act provisions**

The following sections summarises the obligations and rights under the *Australian Postal Corporation Act* that can work either to Australia Post's disadvantage or advantage in providing its non-reserved services.

##### *Section 32*

Section 32 provides, in part, that in circumstances where Australia Post and a customer cannot agree on the terms and conditions upon which an Australia Post service should be supplied, terms and conditions provided by the Board of Australia Post will apply to the supply of that service to the customer.

Where a customer relies on Australia Post's reserved services to provide part of a service, the exclusivity of the reserved services gives Australia Post substantial bargaining power. In a competitive environment, private operators are unlikely to have the power to unilaterally impose their own terms and conditions on their customers.

Some major customers suggest that Australia Post relies on its reserved services and the network by which it provides those services to refuse



to negotiate commercially acceptable bulk mail discounts. For example, TNT noted that:

*Australia Post currently has a relatively large degree of freedom in setting the terms and conditions of service and in particular the terms and conditions of access to its network for its competitors (TNT, submission 43, p. 3).*

While in AUSDOC's opinion:

*Potential competition has been prevented by Post's ability to impose inappropriate terms and conditions on users of the interconnection service ... (Ausdoc, submission 9, p. 10).*

Further, Mayne Nickless claimed that the ability of Australia Post to set the terms and conditions of access has resulted in Australia Post introducing increasingly restrictive terms and conditions (Mayne Nickless, submission 120, p.11).

Removing business mail from the reserved services will increase the level of competition in the business mail segment of the postal market. As a result, Australia Post's ability to be able to unilaterally impose its own terms and conditions on other parties to an agreement will be significantly reduced.

Removal of section 32 would be unlikely to have a significant impact on the terms and conditions by which Australia Post provides the remainder of its reserved service. In relation to its negotiations with its larger customers, however, such as major mail users, bulk mail houses and businesses, removal of this provision would require Australia Post to negotiate with those customers to reach an agreement that would reflect the commercial interests of both parties. This is because Australia Post would no longer have the legislated power to impose its own terms and conditions regardless of the other party's commercial position. This outcome is consistent with the Council's recommendation to remove business mail from the reserved services.

***Recommendation***

**The Council recommends that section 32, which gives Australia Post the right to impose its own terms and conditions upon which its service can be supplied, be removed from the Act.**

*Section 34*

Section 34 of the Act provides, in part, that Australia Post is not liable for any loss or damage suffered due to an act or omission by Australia Post in relation to the carriage of any article by means of Australia Post's letter service.

The definition of 'the letter service' indicates that Australia Post's immunity is possibly limited to the provision of its reserved service. It is unlikely, however, that a private operator would be able to contract itself out of its potential liability, particularly where negligence can be established. In the event a private operator purported to do so, it is possible a court would find it invalid under section 68 (Application of Division to contracts not to be excluded or modified) of the *Trade Practices Act 1974* as being inconsistent with section 74 (Warranties in relation to the supply of services) of that Act. Being immune from liability in some areas is likely to reduce Australia Post's insurance costs which also provides it with a competitive advantage against its competitors.

Removing this provision from the Act would remove Australia Post's protection from liability. This would not mean that Australia Post would be exposed to unsubstantiated claims any more than existing private operators would be, or are, so exposed. Any potential claimant seeking compensation for damage or loss he or she claimed was caused by Australia Post would need to prove that claim in accordance with accepted judicial criteria. However, Australia Post would be more likely to quickly address an underlying problem that can result in loss or damage. Further, Australia Post's insurance costs would be likely to reflect the fact that Australia Post would be subject to claims in the event a customer suffers loss or damage. The costs incurred by Australia Post in this respect will be comparable to insurance costs faced by private operators.

***Recommendation***

**The Council recommends that the protection provided by section 34, which exempts Australia Post from liability for any loss or damage suffered due to an act or omission by it, be removed from the Act.**

### Section 46

Section 46 provides that Australia Post must notify the Minister if it proposes to engage in significant business activities, such as acquiring a major shareholding in a company or undertaking a major new business activity, and the Minister may issue guidelines toward influencing Australia Post's final decision.

The Commonwealth Government proposes to restructure its relationship with each of its government business enterprises (GBEs), including Australia Post, with the aim of having GBEs become more commercially oriented. As part of this restructure, the relationship between the GBE and the Government will be changed to that of business to shareholder with the Board of Australia Post being answerable to two shareholder Ministers. Under the proposed arrangements, however, it is not clear how much control will be retained by the Government over Australia Post.

The Council is of the view that Australia Post should be free to act within the same commercial constraints and subject to the same laws and obligations as private operators. The removal of section 46 would remove the ability of the Government to make decisions for Australia Post. Upon the restructure of the relationship between the Commonwealth Government and GBEs, however, Australia Post would be answerable to the Ministers as its shareholders. This would ensure that Australia Post did not engage in any activity that could adversely affect the interests of the Government as owner.

#### *Recommendation*

**The Council recommends that the obligation imposed by section 46, which gives the Minister the power to influence whether Australia Post undertakes significant business activities, should be removed from the Act.**

*Section 48*

Section 48 provides that the Minister may notify Australia Post of Commonwealth Government general policies to apply to Australia Post and Australia Post must ensure that those policies are carried out.

The Commonwealth Government, as the owner of Australia Post, has the right to assist Australia Post formulate the CSO and financial target elements of its corporate plan. The Council, however, also considers that Australia Post must not be unduly hindered in developing its corporate plan. It is important, therefore, to balance the rights of the Commonwealth Government, as owner of Australia Post, with the right of Australia Post to run its business with minimal Government interference. The Council believes that this provision should remain but should be amended to ensure that any general policy the Minister wants Australia Post to incorporate into its business practice, first must be tabled in Parliament.

***Recommendation***

**The Council recommends that the obligation imposed by section 48, which requires Australia Post to comply with general policies of the Commonwealth Government if notified to do so by the Minister, be amended to ensure that the Minister must first table the applicable general policies in Parliament.**

*Section 90B*

Section 90B provides that any State or Territory laws that would discriminate against Australia Post do not apply.

Removal of this provision from the Act would be unlikely to have a significant impact on Australia Post or its competitors. None of the submissions raised any issues that could be traced to Australia Post's immunity under this provision.

Most likely this section was inserted into the Act to assist Australia Post in its transition from a Commonwealth statutory body to a corporation. The purpose for which the section was inserted, however, is no longer relevant. The

Council's preference is to remove any provision from legislation that serves no current purpose.

***Recommendation***

**The Council recommends that the protection provided by section 90B, which prohibits any State or Territory law from discriminating against Australia Post, be removed from the Act.**

*Section 90D*

Section 90D applies to any Australia Post building owned or under construction by Australia Post prior to 1 January 1991 and provides that State and Territory laws do not apply in relation to:

- (a) *the standards applicable to the design or the construction of buildings;*
- (b) *the approval of the construction of buildings;*
- (c) *the occupancy or use of buildings;*
- (d) *the alteration or demolition of buildings.*

Removal of this provision from the Act would be unlikely to have a significant impact on Australia Post or its competitors. Any construction, approvals, occupancy, alteration or demotion of buildings to which the provision applies are likely to have been completed some time ago. The provision does not enable Australia Post to avoid any existing State or Territory laws.

Similarly to section 90B, this section was most likely inserted into the Act to assist Australia Post in its transition from a Commonwealth statutory body to a corporation. The purpose for which the section was inserted, however, is no longer relevant. The Council's preference is to remove this provision from legislation as it serves no current purpose.

***Recommendation***

**The Council recommends that the protection provided by section 90D, which restricts the application of State and Territory building and construction laws to Australia Post prior to 1 January 1991, be removed from the Act.**

*Section 90V*

Section 90V provides that where Australia Post has opened an article pursuant to Division 3, Part 7B and that article is returned to the normal course of delivery, Australia Post must place a notification on the article that it has been opened by Australia Post.

An article opened for the purpose of obtaining information to return an undeliverable letter, or for customs purposes, is legally opened. Australia Post has advised that it “*considers that the customer should be informed of the fact that the article has been opened on lawful grounds*” (Australia Post, submission 99, p. 98).

The Council agrees that it is in the interests of the consumer that he or she is informed, by way of notice placed on the article, that the article has been opened. One of the benefits of increased competition in the postal industry is that consumers will have available to them a wider range of services as well as a choice as to who can provide those services. At the same time, however, it is important that the integrity of the postal industry remains intact. If postal service providers open mail, albeit for legitimate reasons, and do not inform customers that they have done so, trust in the industry will erode. The erosion of trust could have a negative impact on competition in the postal industry as customers could move to alternative means of communication.

***Recommendation***

**The Council recommends that the obligation imposed by section 90V be extended to all participants in the postal industry and that all participants be required to place notification on an article that has been opened for any purpose or reason.**

*Division 2, Part 7B*

Division 2, Part 7B is concerned with the use and disclosure of information and documents to which employees have, and ex-employees had, access at Australia Post which are additional to the usual confidentiality obligations. Basically, an employee/ex-employee is prohibited from using or disclosing information acquired or received during the course of his or her employment. Relevant information and documents include the contents of letters and the details of services supplied to another person by Australia Post or the affairs or personal particulars (including name or address) of another person. These privacy obligations apply in respect of all services provided by Australia Post.

The privacy of communications is particularly important to the Australian community. In addition, the cost incurred by Australia Post in complying with these provisions is unlikely to be significant. It is worth noting, however, that no similar privacy obligations are imposed on the private sector. The use of customer information by private operators largely depends on self regulation and customer feedback.

According to the Australian Council of Trade Unions:

*Australia Post employees ... are subject to legislation to promote security and privacy of mail, which private sector competitors are not subject to. The community should be protected by privacy obligations on private mail operators (Australian Council of Trade Unions, submission 130, p. 11).*

The Council agrees that it is in the interests of the community that the privacy of postal communications be protected. While increased competition will increase the availability of services to the consumer, it is important that customer privacy not be compromised in the process. The erosion of trust which may result if customer privacy is not protected could have a negative impact on competition in the postal industry as customers could move to alternative means of communication.

***Recommendation***

**The Council recommends that the obligation imposed by Division 2, Part 7B be extended to all participants in the postal industry and that all participants be required to comply with general privacy requirements.**

*Section 95*

Section 95 provides that Australia Post may erect, maintain and use post-boxes in any public road, street or highway or in any other public place.

Pursuant to this provision, Australia Post has erected red post-boxes as part of its reserved service throughout Australia. According to Ansett:

*... not only are the “red” letterboxes, designed for ordinary mail, including reserved articles, equipped with an opening sufficient to receive non-reserved articles but “yellow” letterboxes are specifically intended to receive non-reserved articles. In this regard, it should be understood that the benefit of Australia Post’s rights is not only to erect the letterbox at sites of its choosing but also the “no-parking” status of the adjacent kerbside which results from the installation (Ansett Australia, submission 83, p. 3).*

Australia Post enjoys a significant advantage in being able to place post-boxes wherever it chooses. While competitors are not constrained by the Act from erecting post-boxes, the approval of the local council is required before they can do so. Often a local council requirement is that rates must be paid for the land on which a post-box is to be placed. The Council has been advised that, in most cases, Australia Post does not pay local council rates for its post-box placements.

According to Australia Post, most of its post-boxes are located on footpaths and this privilege is shared with facilities such as telephone boxes, electricity poles and public transport shelters. Australia Post claims that footpaths are part of the roadway, under most state legislation, and roadways are Crown land. As an example, Australia Post notes that in Victoria:

*the land occupied by SPB’s [Street Posting Boxes] is not rateable as they both occupy land owned by the Crown and are used exclusively for public purposes (Australia Post, submission 99, p. 27).*

There is nothing in the Act that restricts the ability of a local council from charging Australia Post rates for land used nor is there anything in the Act that



obliges local councils to provide a “no parking” area adjacent to the post boxes to enable Australia Post to readily access its post-boxes.

As discussed in its recommendation set out in Chapter Eight, section 8.4.4, the Council believes it is important that Australia Post continue to be able to erect new post-boxes where necessary, provided its power to do so is restricted to post-boxes for reserved services purposes.

### *Section 101*

Finally, section 101 provides that any article being carried by post or under the control of Australia Post is the property of Australia Post for the purpose of any legal proceeding or action in relation to that article.

The Council understands this provision is in place to cover situations where articles are subject to legal proceedings or actions but Australia Post is unable to identify the senders of the articles. Private operators, however, are unlikely to have the power to unilaterally impose a similar condition on their customers. Further, in the event any damage or loss occurs which gives rise to Australia Post suing as owner, it is unclear as to what property rights are retained by the customer affected.

The Council, however, recognises the importance of postal service providers being able to take legal proceedings or actions in relation to postal articles as necessary and to be able to do so where the sender of that article cannot be identified. This right will be particularly important given the Council’s recommendations to remove Australia Post’s immunity from liability under section 34 in relation to the carriage of any article and to extend the privacy obligations set out in Division 2, Part 7B to all industry participants.

To require a postal provider to track down a sender of an article for legal proceeding purposes could create a barrier to any legal proceeding being undertaken or, in fact, could discourage a postal provider from initiating any action. With Australia Post immunity from liability being removed, however, and this obligation being extended to all industry participants, it means all postal service providers are more likely to take the necessary action to protect its customers interests. In the event a postal service provider undertakes any legal proceedings, the extension of the privacy obligations becomes critical

then to ensuring customer communications and personal information are protected during those proceedings.

Accordingly the Council believes this right be extended to all postal industry participants but that the property rights of the customer affected be clearly identified.

***Recommendation***

**The Council recommends that the right granted by section 101, which grants title to all postal articles to Australia Post for the purpose of any legal proceeding, be extended to all participants in the postal industry and that the property rights of customers be clarified.**

#### **10.4.2 Other legislation and Australia Post**

The *Australia Postal Corporation Act* is not the only piece of legislation under which Australia Post is advantaged or disadvantaged: provisions in other legislation can have similar consequences. As discussed in Chapter Four, it is possible that some of the non-reserved services may fall within the ambit of the *Telecommunications Act 1997*. Australia Post is neither advantaged nor disadvantaged by government ownership under that legislation as the *Telecommunications Act* applies to all participants in the telecommunications market.

While Australia Post is the owner of a significant number of buildings that are classified under State, Territory or Commonwealth heritage legislation, there is nothing in this legislation which imposes controls on Australia Post which are more onerous than those on private sector owners of heritage properties. The Council's recommendation in relation to Australia Post's ownership of heritage buildings is set out in Chapter Six.

Finally, specific exemptions in State and Territory road traffic and safety legislation and regulations grant Australia Post employees and contractors the right to ride their motorcycles on footpaths for the purpose of delivering postal articles door-to-door.

The National Road Transport Commission (NRTC) has advised the Council that it is aware that this issue needs to be addressed for NCP purposes. The NRTC advises that it intends to seek to have the relevant legislation and regulations amended so that exemptions can apply to any person who is authorised to deliver postal articles provided they satisfy any relevant criteria. The Council notes that States and Territories will be reviewing the relevant legislation granting Australia Post privileges in relation to the operation of motorcycles on footpaths over the next two years.

***Recommendation***

**The Council recommends that any provisions which grant Australia Post employees and contractors an exclusive right to operate motorcycles on footpaths be amended to ensure other postal deliverers can obtain similar exemptions when required.**

## **10.5 Rates, Taxes and Charges**

Australia Post is subject to all Commonwealth taxes. According to Australia Post it:

*...is subject to Commonwealth, State and Local Government taxation, and, as indicated previously, has paid \$2.5 Billion since 1989 (Australia Post, submission 8, p. 110).*

The Council has written to the State and Territory Governments asking them if there are any State or Local Government taxes or charges to which Australia Post is not subject.

Most jurisdictions advise that Australia Post receives no taxation benefits and fully meets its State/ Territory and local government taxes and charges obligations. Tasmania, however, advises that while Australia Post is subject to the full range of State and local government taxes and charges, as a Commonwealth owned corporation, it is exempt from paying general rates under the *Local Government Act 1993*. The Local Government Association of South Australia notes that while Australia Post pays all applicable rates in relation to its buildings, it does not pay rates for the land occupied by its post boxes.

Some of Australia Post's competitors, however, believe that there remain some State and Commonwealth charges to which Australia Post is not fully subject. For example, Mayne Nickless stated that:

- (a) *in Tasmania, courier companies such as Mayne Nickless are required to obtain a cartage licence. Australia Post is not required to incur this expenditure, and hence, receives a cost advantage;*
- (b) *in the customs area, Australia Post receives the following advantages:*
  - (i) *a formal Customs entry is required for air freight consignments with a value for duty in excess of \$250. For Australia Post's Parcel Post, the value for duty is \$1,000 ... (Mayne Nickless, submission 14, pp. 15-16. See also TNT, submission 43, p. 12).*

Department of Transport in Tasmania has advised the Council that Australia Post contractors must have a cart licence to operate. However, regulation 22AA of the *Tasmanian Traffic (Public Vehicles) Regulations 1967* provides that a vehicle owned and operated by Australia Post, for the purpose of mail or courier item deliveries, does not require a public vehicle licence provided it does not carry any item weighing more than 30 kilograms. In contrast, competitors providing similar services are required to have a public vehicle licence regardless of the weight of the item carried. The Council notes that Tasmania is due to review the relevant legislation shortly and suggests that this issue be addressed in its review.

Other submissions have provided further information about the disparity in customs duties which Mayne Nickless raised in its second point. According to Capec Pty Limited (Capec), the *Customs Act 1901* (Cwlth) contains explicit provisions favouring items imported and exported via Australia Post (Capec, submission 89. See also TNT, submission 87, p. 11). Section 68 of the *Customs Act*, among other things, excludes those import consignments of less than \$1,000 in value, that arrive through Australia Post, from the formal Customs import entry obligation. In contrast, imports consigned other than by post are excluded from this obligation only if the value is less than \$250.

The Council understands that the different treatment for customs services between Australia Post and other operators, is due to cease on 1 April 1998 when Australia Post's threshold is to be lowered to \$250. However, according to Capec, this date was extended from 1 April 1997 and could be subject to further extension. Capec claimed that:

*Speculation of a further extension has been heightened due to the timetable for a current Joint Committee of Public Accounts inquiry into internet commerce which is also addressing the 'threshold' issue. That process is not expected to be complete until well after 1 April 1998 (Capec, submission 89, p. 3).*

Section 113 of the *Customs Act* provides for similar differences in charges to apply to goods being exported via Australia Post as opposed to other operators. According to Capec there is no move by the Government to amend the legislation to remove this unnecessary distinction between Australia Post and other postal operators (Capec, submission 89, p. 3).

***Recommendation***

**The Council recommends that the *Customs Act* be amended promptly to ensure that all postal operators are subject to a threshold to the same value.**

In relation to the remaining issues raised in this section:

***Recommendation***

**The Council recommends that if there are any taxes, rates and charges remaining to which Australia Post is not currently subject, these should be imposed on Australia Post without delay in accordance with the Competition Principles Agreement.**

# Chapter Eleven: Contracting Out and Leasing Services

*There are a wide variety of ways of tapping into the benefits of competition in postal services. Many of these have been discussed already, including removing restrictions on the reserved services, structural reform of Australia Post and increasing access to some of Australia Post's facilities. Contracting out and leasing offer other ways of gaining the benefits of competition. Australia Post is no stranger to these concepts and has already contracted out many services and processes.*

*In seeking to contract out some functions it is important that the methods used to let and manage contracts lead to effective and fair outcomes. This extends from the choice of function through to the dealings with the successful tenderer after the completion of the tender process.*

In this chapter there is a discussion of the concepts of contracting out and leasing and how they can provide some competitive outcomes in an otherwise restricted market. These devices have been used by Australia Post (and its predecessors) for over a century and their use is discussed in the third section of this chapter. The future of contracting, particularly in a more competitive market is addressed in the final sections.

## 11.1 Competition and Contracting Out

Leasing generally denotes the provision of a facility or other means of production, such as buildings and equipment, whereas contracting out involves the provision of a service. The parties which gain the right of supply under a contract sometimes, though not always, provide the means of providing that service as well. However, some contracts may be for the operation of equipment owned (or leased) by the enterprise letting the contract. Leases and contracts may or may not be the result of a tender process.

Contracting out and leasing are generally employed to gain some of the benefits of competition, when competition would not normally be possible. For example, there may be significant economies in the vertical integration of a production process, so that it is not possible to get effective competition. However, it may be possible to contract out part(s) of the process, and in the process of letting the contract, attract competitive bids. In this way, some of the benefits of competition can be captured in a process which would otherwise not be open to competition.

In addition, contracting out and leasing may give an enterprise more options to reduce its costs. For example, leasing equipment rather than buying it may mean that the enterprise can update the equipment more frequently and at a lower cost.

## **11.2 Advantages and Disadvantages of Contracting Out and Leasing**

While recognising the gains possible from contracting out it is also important to weigh up the costs and benefits of using these devices, and take into account that savings generated by competitive tendering may not always be passed on to the consumer. If there is little or no competition in the end market, there may be no incentive to pass on the savings to consumers by way of a lower price, or better services.

The advantages of contracting out and leasing include:

- increased flexibility in service delivery;
- shifting the focus from inputs to outputs/outcomes;
- freeing management to focus on strategy (allowing it to concentrate on core business and responsibility);
- encouraging innovative solutions and cost savings; and
- that those responsible for delivering the contract, particularly if they are small businesses, may have a more proprietorial attitude to the service delivery.

On the other hand, there are costs to be weighed up against any gains. These include:

- costs associated with specifying, awarding and monitoring contracts;

- potential adverse effects on accountability, quality, jobs, wages and conditions;
- potential problems caused by a lack of bargaining power when small contractors are dealing with large organisations; and
- loss of in-house expertise.

Some of the potential costs can be reduced by careful tendering processes, including having clear objectives, strong management of the contract and well-defined and enforceable performance standards. However, some of these effects are difficult to contain. For example, it is difficult to fully arrest the loss of direct process knowledge in-house. If this is lost, future tendering could be less rigorous, particularly if the contracts cover complex tasks. Additionally, if, for example, the performance of the contractor cannot be measured or otherwise guaranteed, it may be that contracting out is not appropriate for that particular service.

At Australia Post the critical issues are credibility (of Australia Post), reliability and image, as well as cost.

### 11.3 Contracting Out and Leasing at Australia Post

Contracting out and leasing are not new at Australia Post. Post Office Agents existed before federation, horse-drawn passenger coaches carried mail between towns and cities and, more recently, carrying the mail was one of the symbols of success and advancement for the first commercial flights in Australia by Qantas.

Currently, a wide range of services and facilities are contracted out or supplied on lease to Australia Post. Australia Post stated in its annual report:

*It is the Corporation's policy to lease assets where such arrangements are cost effective (Australia Post, 1997a, p. 56).*

Some of the services and facilities leased or contracted out are discussed below.



### *Contracting Out Post Office Services*

Australia Post contracts out some of its retail activities through Licensed Post Offices (LPOs), Post Office Agencies (POAs) and Community Postal Agencies.

LPOs are privately owned and operated post offices. Nearly all postal services are available from LPOs. LPO operators receive fees, commissions and discounts from Australia Post for the work they perform.

*There are over 3000 LPOs which represent 77% of all Australia Post outlets (Newstead Licensed Post Office, submission 114, p1).*

POAs preceded the LPOs. Essentially, like the LPOs, they are non-corporate post offices. However, they operate under a different agreement with commissions calculated in a different way. There are only a handful of POAs still in operation. They are situated on defence force establishments and in the Antarctic.

Community Postal Agencies are a more basic retail facility. They usually operate in small rural areas and provide the community with access to postage stamps and other related products, postage assessment and lodgement and sometimes distribution of the community's incoming mail.

Australia Post often uses LPOs in areas where the volume of business is such that the LPO's costs are lower than Australia Post's costs would be. In these cases, the LPO may combine postal services with some other business venture, such as a newsagency, pharmacy or gift shop. It thus has lower costs because it is able to use its staff more flexibly.

In many instances, the licensees deliver some of Australia Post's CSO services.

*In general the CSO of Australia Post relates to rural and remote activities. Many of these activities are already handled by private contractors (California Gully Licensed Post Office, submission 104, p.4).*

Because they are local residents, licensees often understand local needs and work to accommodate these. For example, the Council is aware of some LPOs which provide services well outside normal business hours, even if on an informal basis. Evidence presented to the Council suggests that in nearly all cases, LPOs provide a responsive and flexible approach to meeting their community's needs.

*Table 11.1 Australia Post's Retail Network*

	1994 <sup>1</sup>	1995 <sup>1</sup>	1996 <sup>1</sup>	1997 <sup>1</sup>
LPO/POA	2789	2822	2873	2925
Community Postal Agency	350	363	417	534
Corporate post office	1203	1132	1084	1009
<b>Total</b>	<b>4342</b>	<b>4317</b>	<b>4374</b>	<b>4468</b>

<sup>1</sup> as at 30 June  
Source: Australia Post 1995, 1996 and 1997a

Australia Post has embarked on a program of converting corporate post offices to LPOs. By the end of June 1997, LPOs, agencies and community postal agencies accounted for 77 percent of postal outlets (Table 11.1).

When post offices were first contracted out, there were some concerns about the level of service that would be available at LPOs. However, in most instances, the close ties of the licensee to the local community and its needs has encouraged a high quality service.

*The quality of postal services provided by contractors is high due to commitment to the community and a work ethic which sees them give service to their customers way beyond that which could be expected. There is also the point that when payment depends on results, the attention and care to customers is even greater (Post Office Agents Association Limited (POAAL), submission 12, p. 12).*

### *Mail delivery contractors*

In most rural and remote areas, mail delivery is contracted out by Australia Post. In 1997 there were 4741 mail contractors servicing the Australia Post network. Contractors serve a wide range of mail runs, including some street delivery as well as roadside deliveries. Some contractors combine their mail delivery with other deliveries such as milk, newspapers and so on. Many of the routes serviced by mail contractors are CSO routes. In addition, Australia Post uses 620 parcel delivery contractors for delivery of large parcels, mainly in the capital cities and large regional centres (Australia Post, submission 8, p. 64).

### *Delivery performance measurement*

In 1992, Australia Post engaged KPMG to assess its letter delivery performance. This task had previously been carried out in-house. However, Australia Post was cognisant that such a process lacked credibility. KPMG, in consultation with the Australian Bureau of Statistics, has developed a more comprehensive survey of letter performance. The contracting out of this task has thus increased the credibility of Australia Post for those areas surveyed, through independent performance assessment, as well as improved quality of the data through the improved survey.

### *Air transport*

Australia Post is Australia's largest interstate airfreight user. During 1996-97 Australia Post accounted for 39 million kilograms of the freight carried on Qantas and Ansett domestic passenger flights and Australian air Express (AaE) dedicated freight flights.<sup>1</sup> In addition, some 8.7 million kilograms of outgoing international mail was carried by 29 airlines.

### *Property*

Australia Post operates an extensive property portfolio. At the end of June 1997 it owned 841 properties and leased a further 674.

## **11.4 The Future of Contracting Out**

In its first submission, Australia Post commented on the future of contracting out.

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<sup>1</sup> AaE is a joint venture between Australia Post and Qantas (see Chapter Three). AaE uses the cargo space on Qantas domestic flights as well as its own dedicated cargo flights to carry air freight for a wide variety of customers, including Australia Post

*Post is not a newcomer to outsourcing. Extensive outsourcing in postal delivery and retail operations is well established and has been used to good effect. Increasingly however, decisions to further outsource, whilst seeking to maintain a well managed network, become a matter of fine judgment, both commercially and from an industrial relations point of view (Australia Post, submission 8, p. 99).*

In expanding on this issue, Australia Post has stated in its second submission, that it believes there are benefits to be had from retaining some corporate post offices.

*Benefits include the ability to benchmark performance, provision of a training ground for managers of the future, trial of new retailing products and processes, on-going knowledge of all aspects of the business and continuity of experience (Australia Post, submission 99, p. 102).*

Several issues in regard to contracting out have been raised in submissions to the Council:

1. the current system of contracting out and its effect on the contractors;
2. whether contracted services meet the needs of customers; and
3. whether the Council should recommend compulsory levels of contracting out.

#### 11.4.1 Contracting Out Processes

##### *Tender Processes*

The level of benefit actually derived from contracting out will depend to a large extent on the quality of the tendering process<sup>2</sup>. The geographically dispersed nature of the Australia Post network means that many of the contracts

<sup>2</sup> For example, if the successful tenderer has been chosen purely on the basis of price, performance standards may be compromised if they cannot be precisely guaranteed in the terms of the contract. Australia Post and its customers will suffer the consequences, causing additional costs to be borne by these parties. If the contract is subsequently revoked because of failure to meet acceptable standards of service delivery, there will be an additional cost in repeating the tender process. In cases like this, the benefits of contracting out may be lost under the weight of the additional costs incurred by Australia Post and its customers. If the tendering process had recognised that the bid was too low to accommodate the required level of service standards, these additional costs could have been avoided. In addition, the bid may have been too low because the contractor did not have full or adequate information about the services required to make a bid based on the necessary resources to fulfil the contract.

let by Australia Post will be at a regional or possibly even a local level. There is therefore a need to ensure that all those responsible for letting contracts understand how to specify, solicit, evaluate, let and monitor the performance of tendered services. Consistency of approach is also important.

The methods used to let and manage contracts are very important for effective and fair outcomes. For contracting out and leasing to be effective, it is important to ensure that the process of tendering is open and that documentation is clear, accurate, contemporary and complete. The tender and contract process also needs to take into account the low bargaining power of the successful tenderers once the contract has been let. Meetings and correspondence have provided anecdotal evidence that this has not always been the case with Australia Post.

### *Negotiations*

Australia Post has reduced the costs of negotiating the terms and conditions of contracts by negotiating only with POAAL, the industry association for the owners and operators of LPOs and mail contractors.

*POAAL negotiates directly with Australia Post in regard to the fees, commissions and discounts received by Licensees of LPOs. It is impractical for individual Licensees to negotiate with a Government Business Enterprise such as Australia Post when the ...[licensee]... can be thousands of kilometres away from Australia Post Headquarters, and when the Licensee cannot afford to spare the time to be away from their LPOs (POAAL, submission, 12, p. 2).*

Concerns have been raised about the system of using one organisation to negotiate on behalf of LPOs.

While administrative costs are saved in the present system, the range of business situations being covered by the umbrella group is extensive. Local costs and conditions may not always be taken into account. For example, LPOs in remote areas are covered in the same way as suburban LPOs in the capital cities. Remote mail runs may require different terms and conditions compared to outer urban runs. Community mail services provided in some remote Aboriginal communities also appear to have terms and conditions which may not accurately reflect local conditions.

Furthermore, each LPO operates differently, drawing its income from different combinations of services. Thus, individual post office operations vary not just between urban, regional and remote locations but from post office to post office. Several submissions raised the need for contracts to recognise the different business conditions facing each licensee.

*Therefore the revenue earning capacity of an office might rely principally on post office box revenue whilst the neighbouring office relies on the sale of stamps or acceptance of agency payments and the next office down the road may rely principally on something altogether different or a combination of two, or three or more payment sources to realise a profit. For this reason there seems to me to be good grounds, despite the complexity of the task, to indicate that individual contracts are necessary or at least an alternative method of determining fair remuneration to licensees which reflects their individual effort in the varying tasks they perform (Bungalow Postal Agency, submission 46, p. 6).*

It is possible for individual LPOs who feel that their circumstances are not adequately catered for in the agreement to negotiate special conditions.

As well, the POAAL negotiated contracts do have a clause (clause 24) allowing for the hearing and resolution of disputes. This has the potential to alleviate the problems outlined above, although the Council has received some evidence to suggest that this clause does not always work effectively for all LPOs (LPOAL submission 88, p. 33). The Council believes that some of these problems could be addressed if the LPO which is in dispute could be represented in the dispute resolution process by the party of their choice. The Council would expect that in most instances the representative would be a POAAL member.

A Bill currently before the Commonwealth Parliament will amend the *Trade Practices Act* in several ways. The amendments arise from the Government's considerations of recommendations in the Fair Trading Inquiry, which aimed to deal with small firms suffering as a result of 'unfair' commercial conduct on the part of larger firms. In particular, the Committee identified the following problems faced by some small businesses in their dealings with large businesses:

- obtaining full information on a venture prior to entering into it;
- understanding complex regulation;

- having terms and conditions of contracts imposed, rather than being given an opportunity to negotiate them;
- harsh business conduct within a commercial environment; and accessing the justice system.

The amendments will insert new sections into the TPA, one dealing with unconscionable conduct with respect to small business in their dealings with large business enterprises and another dealing with industry codes of conduct. Section 51AA of the TPA deals with unconscionable conduct and is based on common law. The new section (s51AC) will define unconscionable conduct in respect of small business. This should make matters clearer and possibly make it easier for LPOs to bring action against Australia Post. However, the unconscionable conduct must be intentional and this may limit the application of this section to the circumstances discussed.

A new section (51AD) will also be inserted into the TPA with the primary aim of providing a mechanism to address specific fair trading issues in defined sectors. These provisions will establish a framework for the prescription, through the TPA regulations, of industry codes of conduct. These could provide enforceable protection for small business.

However, the onus to protect their investment still remains on those entering into the contract to discuss the proposal and obtain advice from accountants and lawyers before entering into agreements.

Many of the problems raised by LPOs in this inquiry relate to the organisation of LPOs as a group. It is beyond the scope of the Terms of Reference of this inquiry to make recommendations about such matters.

#### *The Mix of Licensed and Corporate Post Offices*

The Council has received varied opinions on the mix of corporate and licensed post offices. Currently 77 percent of Australia Post's post offices are privately owned. This is high by international comparison although in the UK 97 percent of post offices are privately owned (Australia Post, submission 8, p. 131).

The problems identified relate mainly to competition and margins. Some LPOs have suggested that Australia Post sales staff may 'poach' good customers built

up by the LPO over time. Australia Post knows the business of the LPO and can identify customers with mail volume growth that makes them attractive to Australia Post as business customers. LPOs cannot offer the same service and products to these customers as Australia Post can with its business centres and bulk mail centres and so the LPOs lose them to Australia Post.

LPOs also claim that Australia Post corporate post offices operate on a different margin to the LPOs.

One submission claimed that:

*In provincial and metropolitan areas Australia Post is in direct competition with Licensed Post Offices. ... One only has to look at the advertising campaigns entered into by Australia Post where free pick up of parcels, free delivery of stationery and free postage promotions direct customers to corporate offices. ... . Product promotions, such as 'Stamp Month' in October each year sees Licensees asked to purchase window decals and give away promotional items if they wish to participate, and whilst corporate offices pay for these items also, the price is significantly cheaper, the corporate office commissions are significantly higher, and from an accounting point of view this simply amounts to "robbing Peter to pay Paul" in the big picture (Bungalow Postal Agency, submission 86, p 7).*

These concerns of equity and fairness in running the network are commercial matters for Australia Post to resolve. One way of addressing these problems would be to increase even further the number of LPOs. In addition, the Council's recommendation on separating the retail accounts of Australia Post from other accounts should assist LPOs in assessing their position and may increase their bargaining power.

#### 11.4.2 Customer Service

The general response in submissions has been that the commitment of the licensees and contractors to their business and the community ensures a high level of service. Many customers felt that contracts had worked well.



*There was general satisfaction over the contracting out of services and the operation of licensed retail outlets. The quality and level of customer service provided by licensed Post Offices in rural towns was favourably commented on by their representative communities (Eastern and Central Regional Development Organisation, submission 28, p. 1).*

Still, some submissions raised the need for good quality assurance and the provision of training for contractors and licensees, where sensible, as necessary to achieve the best outcomes.

The NSW Farmers' Association noted:

*...in some instances at least, the quality of service has deteriorated with the introduction of contracting services.... The standards and quality of services to be provided by contractors must be clearly specified in the tender and contract and be regularly assessed. Benchmarks should be set and adhered to in this process to ensure that the CSO is being delivered appropriately (NSW Farmers' Association, submission 31, p. 4).*

Overall, the submissions have indicated that customers are happy with the quality of service provided by contractors. The problems identified tended to be restricted to circumstances in a few specific locations.

### **11.4.3 Compulsory Contracting Out**

Several submissions, including the Australian Council of Commerce and Industry, TNT and the Major Mail Users of Australia expressed the view that Australia Post should be subject to compulsory competitive tendering to improve its competitiveness.

*The ACCI argued in its primary submission there are few, if any, activities undertaken by Australia Post in the postal handling chain which could not be contracted out to the private sector. The Chamber noted contracting out is already used extensively in the operations of post offices and the like, and in mail collection and delivery. There is no apparent reason why*

*such basic activities (or mail sorting and distribution centres) must remain under the responsibility of a public authority. The ACCI reiterates all postal service activities currently undertaken by Australia Post should be subject to competitive tendering from the private sector (ACCI, submission 85, p.9-10).*

Mayne Nickless suggested a slightly different approach:

*Australia Post should be subjected to “market testing” targets to improve efficiency levels. However, if a fully deregulated environment results, Mayne Nickless would expect Australia Post’s commercial strategy to drive this issue (Mayne Nickless, submission 120, p. 5).*

In a restricted market, there may be considerable benefits which flow from requiring the incumbent to open up part of the market to competition through contracting out. However, in a more liberalised market, there needs to be freedom to meet competition in the best way, without undue constraints on how to organise the business. Therefore, given that the Council’s recommendations would result in a substantial level of competition, it has not recommended that services be required to be contracted out.

## **11.5 Contracting Out in a Competitive Environment**

The Council notes there are benefits of contracting out and leasing, particularly where competition is limited. Australia Post has pursued contracting out in many areas, most visibly in its retail operations, although a number of other functions are regularly contracted out. While there seem to be some problems at the local level with the contracting out process, the high customer regard for many of the contractors, including LPOs, suggests that overall the process works well. Amendments currently before the Parliament to the *Trade Practices Act*, dealing with unconscionable conduct may also impact on the negotiations and contracts formed between Australia Post and its contractors.

There may be scope for further extending the contracting out of some activities, such as the LPOs. While this would need to proceed with industrial relations implications in mind, there are unresolved issues of equity and fairness with the present mixture of corporate and licensed post offices. In addition, the Council’s recommendation on separating the retail accounts of Australia Post

from other accounts should assist LPOs in assessing their position and may increase their bargaining power.

In terms of contracting out and leasing generally, however, the decisions are commercial ones for Australia Post. It is unlikely that any external body would be in a position to judge the appropriate levels of contracting out.

In a more open competitive environment, the restrictions and prescriptions on Australia Post need to be minimised for the efficient functioning of the market. Contracting out is just one of the ways Australia Post can respond to the challenges of the changing market.

# Appendix One: Submissions and meetings

## Submissions

The Council has received submissions from the following organisations and individuals:

1. Kingsgrove Cards and Stationery
2. Kevin Coogan
3. Dorothy Ross
4. Dr Kunwar Raj Singh
5. Isolated Children's Parents' Association of Australia (Inc.)  
(Federal Council)
6. Commonwealth Services Delivery Agency
7. ACROD Limited
8. Australia Post
9. AUSDOC Group Limited
10. Streetfile
11. Shire of Wongan-Ballidu
12. Post Office Agents Association Limited
13. withdrawn
14. Mayne Nickless Limited
15. Queensland Commercial Independent Stationers
16. Communications Electrical Plumbing Union
17. Isolation Children's Parents' Association (Northern Territory)
18. Shire of Jerramungup
19. KEEP Australia Post PUBLIC
20. Country Women's Association of Victoria, Inc.
21. Australian Council of National Trusts
22. Shire of Katanning
23. Public Interest Advocacy Centre
24. Pastoralists & Graziers Association of Western Australia (Inc)
25. Gingin Shire
26. Bulloo Shire Council
27. Shire of Moora
28. Eastern and Central Regional Development Organisation
29. Australian Local Government Association

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30. Shire of Kojonup
  31. NSW Farmers' Association
  32. Regional Financial Services Taskforce - Ministry of Fair Trading (Western Australia)
  33. Major Mail Users of Australia Limited
  34. Town of Albany
  35. R Crocker
  36. Shire of Kellerberrin
  37. Merbein Parish Council
  38. Redlynch Village News Pty Ltd
  39. National Farmers' Federation
  40. M Murray
  41. Dunhill Madden Butler
  42. George Thompson
  43. TNT Australia Pty Limited
  44. Outback Regional Development Organisation Inc.
  45. Australian Chamber of Commerce and Industry
  46. Bungalow Postal Agency
  47. Local Government and Shires Associations of NSW
  48. Town of Narrogin
  49. Augathella Licensed Post Office
  50. Michael J Elijah
  51. Noel J Dundas
  52. The Treasury, Commonwealth
  53. Tony Abbott M.P., Federal Member for Warringah
  54. Kinglake Licensed Post Office
  55. Australian Heritage Commission
  56. Reader's Digest (Australia) Pty Limited
  57. Edmonton Licensed Post Office
  58. Industry Commission
  59. Shire of Carnamah
  60. Shire of Gnowangerup
  61. John Bradshaw, MLA, Member for Murray - Western Australia
  62. Shire of Ravensthorpe
  63. Shire of Mount Magnet
  64. Cotton Tree Licensed Post Office
  65. JAMK Pty Ltd
  66. J R Fenner
  67. Shire of Dardanup

68. Mukinbudin Shire Council
69. Red Hill Licensed Post Office
70. Yungaburra Licensed Post Office
71. Inverell Shire Council
72. Thargomindah Licensed Post Office
73. Shire of Victoria Plains
74. King Island Council
75. Plenty Food Store
76. Strathfieldsaye Licensed Post Office
77. Batlow Licensed Post Office
78. Australian Philatelic Federation
79. Western Australian Municipal Association
80. Crookwell Shire Council
81. Bland Shire Council
82. Campbells Creek Licensed Post Office
83. Ansett Australia
84. Post Office Agents Association Limited
85. Australian Chamber of Commerce and Industry
86. Bungalow Postal Agency
87. TNT Limited
88. Licensed Post Officers of Australia Ltd
89. CAPEC Pty Limited
90. Queensland Commercial Independent Stationers
91. Sunbury Office Supplies
92. Duaringa Licensed Post Office
93. Isolated Children's Parents' Association of Australia  
(Inc.) (Federal Council)
94. Cowra Shire Council
95. Mid West Development Commission
96. The Country Women's Association of Western Australia (Inc.)
97. Small Business Development Corporation
98. Elizabeth McLeod
99. Australia Post
100. Shire of Wyndham- East Kimberley
101. Oxley Licensed Post Office
102. Combined Pensioners and Superannuants Association  
of New South Wales Inc
103. North Bendigo Licensed Post Office
104. California Gully Licensed Post Office

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105. Bendigo Area Licensed Post Offices Group
  106. Matthew J Green
  107. Jonathan H Sive
  108. Strathdale Licensed Post Office
  109. Australian Newsagents' Federation Ltd
  110. Department of Education Training and Employment, South Australia
  111. Fish Creek Licensed Post Office
  112. Geoff Prosser M.P., Federal Member for Forrest
  113. Biggenden Licensed Post Office
  114. Newstead Licensed Post Office
  115. R A Bull
  116. Reader's Digest (Australia) Pty Limited
  117. Balanced State Development Groups
  118. SALMAT
  119. Catholic Women's League, New South Wales
  120. Mayne Nickless Limited
  121. Major Mail Users of Australia Limited
  122. Trinity Beach Licensed Post Office
  123. Plenty Food Store
  124. NSW Farmers' Association
  125. Townsville Region Home and Community Care Forum
  126. National Farmers' Federation
  127. Communications, Electrical and Plumbing Union
  128. Public Interest Advocacy Centre
  129. Department of Premier and Cabinet, Queensland
  130. Australian Council of Trade Unions
  131. Brian Buglar
  132. Northern Territory Government
  133. Australian Heritage Commission
  134. Insurance Council of Australia Ltd
  135. Western Australian Municipal Association
  136. Department of Industry Science and Tourism,  
Consumer Affairs Division
  137. Town of Port Hedland

## Meetings

The Council would like to thank the following people and groups who took the time to discuss this review with the Council:

Robert Albon - Australian National University  
Senator Richard Alston

Aboriginal and Torres Strait Islander Commission - Cairns  
Aboriginal and Torres Strait Islander Commission - Canberra  
Aboriginal and Torres Strait Islander Commission - Darwin  
Aboriginal and Torres Strait Islander Commission - Port Hedland  
American Express  
ANZ Bank  
Attorney-General's Department - South Australia  
Ausdoc Group Limited  
Australian Communications Authority  
Australian Local Government Association  
Australia Post - Bendigo  
Australia Post - Cairns  
Australia Post - Castlemaine  
Australia Post - Central Office  
Australia Post - Mt Isa  
Australia Post - North Queensland  
Australia Post - Northern Territory  
Australia Post - Queensland  
Australia Post - South Australia & Northern Territory  
Australia Post - Tasmania  
Australia Post - Western Australia  
Australia Post Agency - Yalgoo  
Australian Consumers' Association  
Australian Chamber of Commerce and Industry - National Office  
Australian Direct Marketing Association  
Australian Heritage Commission - Commonwealth  
Australian Newsagents' Federation Ltd

Bureau of Transport and Communications Economics -  
Commonwealth



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Cairns Chamber of Commerce Inc  
Cape York Peninsular Development Association Inc  
Chamber of Commerce and Industry - Tasmania  
Chamber of Commerce and Industry of Western Australia  
Chamber of Commerce and Industry of Western Australia  
- Port Hedland  
Collier Newfield  
Commonwealth Bank of Australia  
Communications, Electrical and Plumbing Union  
Consumer Law Centre  
Consumers Federation of Australia  
ContacMail  
Coopers and Lybrand  
Corporate and Public Relations  
Crown Solicitors Office - Adelaide

Department of Aboriginal Affairs - Western Australia  
Department of Commerce and Trade - Western Australia  
Department of Communications and the Arts - Commonwealth  
Department of Contract and Management Services - Western Australia  
Department of Family and Children's Services  
- Western Australia, Port Hedland  
Department of Finance and Administration - Commonwealth  
Department of Industry, Science and Tourism - Commonwealth  
-Consumer Affairs Division  
Department of Premier & Cabinet - New South Wales  
Department of Premier & Cabinet - Queensland  
Department of Premier & Cabinet - Queensland  
- Cairns Regional Office  
Department of Premier & Cabinet - South Australia  
Department of Premier & Cabinet - South Australia Rural  
Communities Office  
Department of Primary Industries and Fisheries - Northern Territory  
Department Primary Industry and Fisheries - Tasmania  
Department of Tourism, Small Business and Industry - Mt Isa  
Department of Transport and Regional Development - Commonwealth  
Department of Treasury - Commonwealth  
Department of Treasury - Northern Territory  
Department of Treasury - Queensland

Department of Treasury - Western Australia  
Department Treasury and Finance - Tasmania  
Department of Youth and Community Care - Townsville  
Doubleday

Federal Publishing Company- New South Wales

Gulf Local Authorities Development Association  
Gulf and Western Queensland Indigenous Council - Mt Isa

Hannanprint  
Harlequin Enterprises (Aust) Pty Ltd  
Hedland Business Enterprise Centre  
Hermes Precisa Australia Pty Ltd  
House of Representatives Standing Committee on Communications,  
Transport and Microeconomic Reform - Commonwealth  
Hutcheons Solicitors - Queensland

Industry Commission  
Isolated Children's Parents Association

John Fairfax Group

Licensed Post Office - Maldon  
Licensed Post Office - Marong  
Licensed Post Office - Newstead  
Licensed Post Office - Paynesville  
Licensed Post Officers of Australia Ltd  
Local Government and Shires Associations of New South Wales  
Local Government Association South Australia  
Local Government Association of Tasmania  
Local Government Association of Northern Territory

Mail-All  
Mail Management  
Major Mail Users of Australia Limited  
Malone, Richard  
Mayne Nickless Limited

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Mount Isa to Townsville Economic Development Zone  
Mt Alexander Shire Council  
Municipal Association of Victoria  
Ministry of Fair Trading - Western Australia

National Australia Bank  
National Farmers' Federation  
NRMA Information Services Limited - New South Wales  
NSW Farmers' Association  
Northern Land Council  
Northern Queensland Economic Development Board  
Northern Regional Office of the Department of Education  
- Queensland  
Northern Territory Chamber of Commerce and Industry  
Northern Territory Minerals Council

Office of Aboriginal Development - Northern Territory  
Office of Consumer & Business Affairs -South Australia  
Offset Alpine Printing  
Ombudsman - Commonwealth  
Open Road  
Optus  
Outback Queensland Tourism Authority

Pastoralists & Graziers Association of Western Australia  
Pastoralists & Graziers Association of Western Australia  
- Kimberley Region  
Permail Pty Ltd  
Pilbara Development Commission  
Post Office Agents Association Limited  
Power and Water Authority - Northern Territory  
Public First  
Public Interest Advocacy Centre

QM Industries

Reader's Digest (Aust) Pty Ltd  
Retail Delivery Service  
Royal Flying Doctor - Queensland Section

South Australian Employers' Chamber of Commerce & Industry  
SALMAT  
School of Distance Education - Mt Isa  
School of Distance Education - Cairns  
School of Isolated and Distance Education - Western Australia  
Security Mailing Services  
Streetfile

Telstra Corporation Limited  
The Mailing House  
Town of Port Hedland  
Townsville City Council  
TNT Australia Pty Limited

UPS

Western Australian Chamber of Commerce  
Western Australian Municipal Association

# Appendix Two: Post Workshops

The Council held workshops on Letter Definition, Access to the Postal Network and the Universal Service Obligation (USO) in Melbourne in December 1997. Each discussion was facilitated by Graeme Samuel, the Council's President. Workshop discussion papers were circulated by the Council prior to each workshop. These included a brief background paper written by the Council and documents provided by some other participants.

## Letter Definition Workshop

The purpose of the workshop was to discuss the circumstances under which the current definition of a letter would need to change; and what type of changes would be necessary.

The following organisations attended.

- Australia Post
- Communication Electrical Postal Union
- Department of Communications and the Arts
- Dunhill Madden Butler
- Major Mail Users of Australia
- Mayne Nickless
- Post Office Agents Association
- Readers Digest
- Salmat
- Streetfile

## Outcomes

It became obvious during the workshop that much of the concern in the mailing industry centred on the extent of the reserved services rather than the actual definition of letter in the Act. The Act currently uses the definition of a letter as the basis for defining the reserved services so that disputes about what was a letter were really focussed on what should be reserved to Australia Post.

A number of comments were made about the letter definition.

- Some argued that the definition was outdated because technological change has meant that the range of communications which now fall under the definition were not intended to be considered as letters when the legislation was originally drafted.
- Some attendees questioned whether there was a need for a definition in a completely de-regulated market as the definition's only purpose was to determine the reserved services. However, it was suggested that, because the definition is incorporated into other Acts, it remained appropriate to define a letter - no matter what the Council eventually recommended (for example the Act was referred to in Defence Force regulations the Commonwealth Crimes Act).
- It was noted that the definition of letter was needed to give meaning to the Universal Service Obligation of Australia Post.

When discussing appropriate changes to the definition of a letter the following suggestions were made.

- No change.
- Several participants favoured removing business mail from the definition.
- A few felt that because of the size of the business sector, and the difficulty in defining what was meant by business mail, that it was better to define a letter using size and weight parameters, but that these should be reduced.

It was noted that removing business mail from the letter definition would be effective deregulation as 86 per cent of mail originated with business.

There was considerable discussion about how you would define business mail if it was to be excluded from the definition of a letter. The options proposed included the following:

- bulk pre-sort mail ie 2 500 articles. This would assist people in the direct mail business to personalise mail-outs without the fear of infringing the monopoly;
- anything originating from an entity with an ACN number (although it was later accepted that this definition would be too narrow);

- a hand written or printed communication generated by an identifiable individual;
- anything without a stamp on it;
- anything without a stamp, and with reference to size and bulk, thereby avoiding the need for the letter to be personalised; and
- using weight, price and size.

One concern was that the definition chosen should not pull things into the reserved services that were not there before. For example, articles such as loyalty magazines.

## Access Workshop

The terms of reference for the review required the Council to look at, among other things, the operation of the current mail interconnection arrangements and the possible application of the general access arrangements under the *Trade Practices Act* to postal services. The purpose of the workshop was to obtain industry views on:

- the extent to which requirements on Australia Post to provide certain interconnection and bulk discount arrangements should be retained in a deregulated postal services market;
- the extent to which postal service activities (that is, mail collection and delivery, sorting, and transportation) should be unbundled as separate access services;
- the most appropriate pricing methodology for access to Australia Post's network under regulated access arrangements; and
- whether the pricing methodology employed should change with changes in the extent of the reserved services.

The following organisations attended.

- Ausdoc Group
- Australia Post
- Communications Electrical Plumbing Union
- Department of Communications and the Arts
- Department of Finance and Administration
- Major Mail Users of Australia
- Mayne Nickless

- Post Office Agents' Association
- Readers Digest
- Streetfile
- TNT

## Outcomes

On the issue of future access arrangements for postal services, views were broadly divided into two positions.

A number of attendees held the view that Australia Post's established network, existing relationship with customers and status as the official provider of postal services gave it considerable strength in the postal services market, and therefore an extensive access regime was needed to enable new entrants to compete effectively.

Attendees supporting this position believed that extensive regulated access arrangements should apply to Australia Post's network, encompassing access to mail collection and delivery, sorting, and transportation activities. Within the group supporting these arrangements, one party proposed that an extensive access regime was needed to enable new entrants to compete effectively, while another believed that access arrangements for various levels of Australia Post's network could be commercially negotiated provided regulatory safeguards were in place to deal with disputes. The latter party did not believe Part IIIA, nor section 46, of the *Trade Practices Act* would provide sufficient legislative support for access to Australia Post's network.

Another group held the view that it was difficult to be prescriptive about future access arrangements for postal services, given that new postal service providers would, in a deregulated market, have differing agendas on access arrangements depending on their business strategies and the existing coverage of their respective networks. This group favoured the use of access arrangements akin to those currently in place, provided that access pricing was reviewed.

A general point made in discussions was that, other than for CSO services, Australia Post's network was not static and would become more fluid in a liberalised postal services market. It was also noted by some that access other than at Mail Sorting Centres may not be practicable given the technology and systems Australia Post intends to use to sort mail. It was stressed that in future, *delivery* centres, for example,



may not be able to support third party access given that bar-coded mail will be 'round' sorted at a Mail Sorting Centre before it reaches a delivery centre.

There was general consensus that the segment of Australia Post's network involved in local letter delivery contained the strongest monopoly characteristics. In discussing the areas that new entrants would be unable to service in the absence of access arrangements, mail delivery services to rural and remote areas and post office boxes were both identified. It was noted that:

- in many rural and remote areas, having more than one letter deliverer would be impractical and inefficient;
- physical access for letter delivery to many of Australia Post's post office boxes is not possible;
- most mail delivery and counter services provided in rural and remote areas are supplied by mail contractors; and
- Australia Post does not appear to hold exclusivity over the mail contractors that operate in rural and remote areas.

On issues of pricing, discussion focussed on:

- retail and wholesale pricing in a deregulated postal services market, and the related issue of discriminatory pricing;
- the pricing methodology used for access pricing; and
- pricing issues associated with aggregated mail lodgements.

On the issue of retail and wholesale pricing in a deregulated postal services market, the ability of Australia Post to commercially negotiate different retail, wholesale and interconnect rates with different customers and other service providers (that is, price discriminate) was discussed at length. One view was that the ability to price discriminate provides a dominant market player, providing both retail and wholesale services, with considerable capacity to disadvantage its competitors. Another view was that the ability to price discriminate rightly provides any business with the capacity to defend its market, and that the postal services market is generally contestable given its low barriers to entry. Some considered that a dominant market player engaging in discriminatory pricing which is predatory could be regulated through trade practices laws.

Two approaches to the pricing methodology used for access pricing were discussed. One supported a methodology that derived the actual cost of providing a particular access service. This approach favoured the unbundling of postal access services,

with the calculation of access prices to be non-discriminatory - that is, based on the costs incurred by an access provider in supplying an access service. Another approach supported access prices being based on a discount off the uniform rate of postage (that is, averaged), with a proviso that this approach would be appropriate while there is a uniform rate.

It was noted that arrangements would need to be put in place between interconnecting mail service providers to deal with issues such as lost and delayed mail and complaints about such matters.

Discussions on pricing concluded on issues associated with aggregated mail lodgements. It was noted that there would be different costs associated with processing homogeneous and non-homogeneous aggregated mail lodgements, and that access pricing and standards for mail lodgement would need to reflect this. There were strong and differing views on whether aggregation should be allowed.

## **Universal Service Obligation Workshop**

The purpose of the workshop was to examine the issues relevant to whether Australia Post should be required to offer new USOs (alternatively called CSOs) in relation to:

- financial services;
- post offices; and
- parcel delivery.

Participants were also invited to discuss the quality of Australia Post's letter delivery service (particularly in rural and remote areas).

The following organisations were invited to attend the workshop.

- Aboriginal and Torres Strait Islanders' Commission
- Australia Post
- Australian Consumers' Association
- Australian Local Government Association
- Australian Pensioners' and Superannuants' Federation
- Communications Electrical Plumbing Union
- Consumer Law Centre

- Country Women's Association
- Department of Communications and the Arts
- Department of Finance
- Industry Commission
- Isolated Children's Parents' Association
- Licensed Post Officers of Australian Limited
- Major Mail Users of Australia
- National Caucus of Disability Consumer Organisations
- National Farmers' Federation
- Post Office Agents' Association Limited
- Streetfile

Of these organisations, the Department of Finance, Industry Commission, Isolated Children's Parents' Association, Aboriginal and Torres Strait Islanders' Commission, and the Australian Local Government Association were unable to attend. The Council had, however, also discussed USO issues with all of these groups in separate meetings.

## Outcomes

Overall the workshop stressed the importance of the Universal Service provided by Australia Post and stressed that the current standards of service should not be reduced.

### *Parcel USO*

The view was expressed and widely supported, including by community groups, that the letter delivery USO put in place a delivery network which enabled Australia Post, through ordinary commercial means, to provide many other services including parcel delivery. Therefore the key issue behind ensuring parcel delivery was preserving the letter delivery USO.

The point was made that a specific USO relating to parcels would distort competition in the market for parcel delivery.

Some participants suggested that there are more efficient ways of providing a parcel CSO targeted at rural areas and limited to say educational and health materials, eg for the educational institution posting the materials to obtain a subsidy from the

government. Further, receipt of educational materials by post is only one of a range of issues involved in considering the most efficient way to provide rural education.

There was general consensus that a specific Parcel USO was not necessary.

### *Financial Services USO*

Post offices provide a number of services besides postal functions. These include bill paying, money transactions and supplying information. All agreed on the importance of these services. However, most felt that Australia Post and the post office network should not have to carry a CSO to provide these types of services; The view was expressed that “How can you expect Australia Post to provide these services just because other services have left a town?”.

A few argued that Australia Post should carry a financial services USO.

Australia Post does not have a long history in the provision of financial services, and it has only ever acted as an agent for financial institutions. If Australia Post was obliged to provide these services, its negotiating power with the financial institutions would be severely weakened.

Alternatively, as the USO requires Australia Post to provide reasonable access to postal services the network Australia Post uses to meet this obligation would act as a building block to provide a range of other services such as financial services. If this alternative view were accepted it would be important that the regulations did not stifle Australia Post’s ability to manage its business in the most efficient way.

Some thought that while financial services should be provided through the mechanism of a CSO it was the government’s responsibility and not Australia Post’s. According to this view, the Government might wish to pay Australia Post to provide these services.

### *Post Office USO*

It may be possible to introduce a requirement to have a specified minimum number of post offices. However, it makes little sense to require post offices to be in specified places because it would be too inflexible to take into account shifts in population and demand. The emphasis should be on providing the letter delivery service, and access

to that service. In practice this has meant the retention of an extensive network of postal outlets.

### *Australia Post's letter delivery USO*

In general, people are reasonably content with the level of Australia Post's performance in letter and parcel delivery.

Postal services have not been displaced by the growth in the electronic messaging market.

There was no support for the idea to limit the CSO to deliveries in rural and remote areas. The purpose of the USO is to bind the nation. Further, the notion of a postal CSO relates to end-to-end delivery of an article, whether one end is in the bush or overseas. Therefore it makes little sense to limit the USO to rural and remote areas. There were some concerns about the frequency of mail delivery.

There was little support to require Australia Post to contract out further segments of its operations. The view was taken that this was a commercial decision for Australia Post to make, and that Australia Post have already contracted out most of the operations where there were cost savings to be made from contracting out.

In relation to complaint handling, the Commonwealth Ombudsman only has power to examine the actions of Australia Post and its employees. It cannot examine the actions of contractors. However, it can criticise Australia Post for failing to take action against a contractor that breaches the terms of its contract with Australia Post. In the service charter, Australia Post takes full responsibility for the actions of contractors. Some argued that if the letter delivery industry were deregulated there may be a need for more extensive regulation in relation to complaints handling. Others argued that the marketplace would provide its own disciplines on poor performers in that customers would switch to other operators.

Business would prefer performance standards to be defined as part of a partnership between business and Australia Post. One argued that setting performance standards was a difficult but necessary task. Australia Post argued that the flexibility needed to provide the letter delivery service precluded the use of rigid standards.

There was general support for retaining cross-subsidy funding of the CSO. A concern with direct funding was that funding was unstable and could be cut. A concern with

an industry levy was that (1) there are few ways of accurately measuring the market-share of participants on which to base collection of the levy; (2) measurement would be further complicated if many competitors entered the market.

# **Appendix Three: Consultant's Report on the Financial Impact on Australia Post of Reducing the Reserved Service**

The Council selected Arthur Andersen to undertake a review of the financial impact on Australia Post of a reduction in the reserved services.

Arthur Andersen examined the implications of reducing the services reserved to Australia Post under sections 29 and 30 of the Australia Postal Corporations Act 1989 (the Act). Arthur Andersen looked at four scenarios for reducing the reserved services: three times the price of the standard letter, two times, equal to the price of the standard letter rate and removing reserved services completely. Arthur Andersen also provided comments on the extent to which Australia Post's business would be open to competition, the likely types of services provided by new entrants, those aspects of Australia Post's business which would be most affected, and the impact on Australia Post's ability to deliver its CSOs.

The Council has used this consultancy report to assist it in determining the effect of reform on Australia Post's financial performance. The Executive Summary of the Report is reproduced below.

## **Executive Summary**

The National Competition Council review of the Australian Postal Corporations Act 1989 (the Act) forms part of the Commonwealth Government's commitment to review by the year 2000 legislation that restricts competition or imposes further costs on business. The Council has commissioned Arthur Andersen to support this review by providing an assessment of the financial impact on Australia Post of partial or complete deregulation. Specifically, we have been asked to examine the implications this will have for Australia Post's ability to deliver CSOs and whether further reforms to the scope of reserve services under section 30 of the Act is warranted.

In examining the services reserved to Australia Post under sections 29 and 30 of the Australian Postal Corporations Act 1989, this consultancy report identifies and assesses the main cost drivers, competitive forces and barriers to entry in a future staged deregulation or full competition postal service market. A series of robust contestable market scenarios are thereby formulated, in each instance the projected financial performance of Australia Post is examined.

The report aims to capture the dynamic nature of relationships between a market incumbent such as Australia Post, existing competitors and potential new entrants given the relaxation of reserve service restrictions to 3 times, 2 times, 1 times the standard letter rate and open competition respectively. As a consequence issues of competitive advantage, niche market strategies and network pricing are recurrent themes in our analysis.

Our report's findings can be summarised as follows.

In a 3 times scenario, fairly insignificant additional competitive pressure will be placed on Australia Post. There is no evidence of firm price or strategic incentives existing for any competitor to warrant an expansion in their current range of activities. Nor will potential competitors find enough market opportunities to feasibly compete for business. Consequently there is expected to be little change to Australia Post's current financial position from both price and volume factors.

Under a 2 times reserve services regime, directly contestable markets were identified as being limited to high volume business to household mail routes already established by competitors such as mailing houses. The expected volume losses to Australia Post from these niche markets are low, given existing interconnection conditions with the incumbent network. It is also expected that Australia Post will attempt to realign



the large letter discount rates with the new reserved services threshold. The effect of both these price and volume effects on Australia Post's financial position is minimal. In the 1 times scenario, a broader range of strategic responses are available to a competitor stemming from 1) an enhanced ability to price postal services on a fully cost reflective basis and 2) an assumption that the restrictions on aggregating pre-sorted mail by Australia Post competitors would be lifted at this point. It is anticipated that the ability of a competitor to be price competitive would translate to market share losses to the incumbent in high volume business mail routes of around 10% in small letters and 15% in large letters. The ability to aggregate bulk mail results in a 30% shift from full rate mail volumes into the discount rate category. Apart from a 10% realignment of the large letter discount rate to reflect the cost of bulk mail carriage and delivery, no other price movements would be anticipated (assuming current technologies).

Under open competition, the addition of competitive pressure from a rival full service networks is introduced. The addition of this competitive strategy magnifies the competitive pressures earlier identified in the 1 times scenario. Our assumptions reflect actively contestable markets arising in Metro-Metro and other high business to household mail routes. Net volume leakages from the Australia Post network of 20% to 5% are anticipated as a consequence.

The immediate implication for the financial model of these assumptions is the dominance of revenue effects over volume effects. The rationale behind this lies in the ability of aggregation as a competitive strategy to take hold much faster than a competitor setting up a comparable full carriage network.

The Financial Model we have constructed is based principally on the various base case assumptions incorporated in an internal model developed by Australia Post. While our model adopts some of the key variables adopted by Australia Post, our main assumptions, parameters and competition scenarios were derived independently, after extensive discussions/analysis with active industry players and several research bodies.

On the basis of our modelling methodology, we have found no material impacts on the financial performance of Australia Post by reducing the letter monopoly to 3 times the standard letter rate. Similarly there is a limited impact on Australia Post financials from relaxing the reserve services to 2 times the standard rate. Over the projection period considered in the 2 times scenario, by 2005 a revenue loss of \$22 million (for small bulk volume letters) and a revenue loss of \$8 million (on large bulk letters) was envisaged compared to the base case, effectively this represents 0.8% of total revenues for just the year 2005.

In a 1 times scenario we consider both the impacts of aggregation strategies as well as price and volume effects from increased competition. A net result of a \$177 million loss in net revenues is attributable to these factors, compared to the 2005 year base case projection. The model also forecasts a \$35 million reduction in labour costs and an additional \$17 million in redundancy costs benchmarked on the base case scenario. The principal results suggest that whilst Australia Post's financial performance is significantly affected (particularly shareholder returns) in a 1 times scenario, its operations still remain viable. Specifically, the impacts of aggregation cause significant margin loss over the modelling timeframe relative to other competitive impacts.

Under the open competition scenario, Australia Post still remains financially viable given the assumptions adopted, although there appears to be a significant impact on its projected profitability and cashflows. The principal implication is the uncertainty these results raise on Australia Post's ability to deliver adequate returns to its shareholders.

Compared to the Australia Post base case, overall revenues in the open competition scenario decreased by \$347 million, principally due to a decline in small full rate letter revenues of \$275 million and the large letter full rate category by \$83 million, partially offset by a \$37.5 million increase in discount letter revenues. Further declines in operating costs (\$83 million in labour costs, \$16 million in carriage costs) are also anticipated. The decline in Australia Post's Economic Rate of Return from an initial 14% to 8% by 2005 was also noted.

A trend analysis for key performance indicators was also undertaken. The key results raise issues concerning profit margins under an open competition scenario (considering the continuing margin erosion in EBIT and NPAT in excess of 4.5% over a seven year period) and the general decline in margins under all the scenarios considered. This margin erosion is predominantly a function of revenues being volume dependent whilst costs are a joint product of volumes and inflationary outcomes.

Given the extent of margin erosion anticipated by our model, further competition in volumes or high value added services will exacerbate this position in the absence of counter strategies undertaken by Australia Post to impede this projected decline. Considering the substantial revenue losses in the letter business projected in our scenarios in comparison to other Australia Post business lines, we anticipate that the return on assets we obtained for the whole Australia Post business will understate the full impact on rates of returns solely on the letters business. Given insufficient cost

and asset structure information on Australia Post's individual lines of business we cannot fully quantify the extent of this effect.

Further sensitivity analysis of our model indicates that the reported Australia Post's financial viability positions, at the operating revenue and EBIT level, are fairly sensitive to assumption changes, future volume growth rates and sensitivities in operating cost structures. We have undertaken rigorous analysis to ensure that the scenarios reflect a realistic assessment of likely market developments. However, it must be acknowledged that variations in key parameters included in the scenarios will have a significant impact on the overall results.

*A3.1 Financial Impact on Australia Post of Reducing the Reserved Services*

<b>BASE CASE PROJECTIONS</b>								
	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Operating Revenue \$m	3201.53	3382.84	3553.65	3688.49	3834.46	3994.92	4153.87	4319.89
EBIT Margin %	11.24	10.32	11.86	12.97	14.23	13.11	12.41	11.66
Dividends \$ m	135.80	123.1	2132.56	159.66	186.46	195.83	189.94	186.14
Special/Capital Payments \$ m	80.00	80.00	-	40.00	100.00	120.00	120.00	20.00
Return on Total Assets %	14.02	12.79	14.65	15.93	17.75	16.61	16.09	15.48
Return on Equity %	25.62	21.75	24.35	26.62	29.90	28.43	27.81	27.10
Return on Capital %	27.76	25.37	30.64	34.75	39.64	38.07	37.46	36.60

<b>TWO TIMES SCENARIO</b>								
	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Operating Revenue \$m	3201.53	3382.84	3544.91	3670.91	3807.56	3966.94	4124.94	4289.97
EBIT Margin %	11.24	10.25	11.71	12.74	13.99	12.88	12.18	11.44
Dividends \$ m	135.80	122.68	130.87	156.31	182.04	191.10	185.07	181.17
Special/Capital Payments \$ m	80.00	80.00	-	20.00	100.00	120.00	120.00	120.00
Return on Total Assets %	14.02	12.70	14.44	15.52	17.31	16.20	15.69	15.11
Return on Equity %	25.62	21.60	23.89	25.62	28.90	27.50	26.95	26.32
Return on Capital %	27.76	25.20	30.17	33.97	38.71	37.12	36.51	35.65

**ONE TIMES SCENARIO**

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Operating Revenue \$m	3201.53	3382.84	3505.75	3587.56	3677.72	3831.92	3985.35	4145.64
EBIT Margin %	11.24	10.16	10.70	10.95	11.52	10.39	9.70	8.96
Dividends \$ m	135.80	122.11	123.23	134.66	146.16	148.26	141.29	136.16
Special/Capital Payments \$ m	80.00	80.00	-	-	20.00	100.00	80.00	100.00
Return on Total Assets %	14.02	12.58	13.26	13.20	13.79	12.68	12.09	11.50
Return on Equity %	25.62	21.41	21.76	21.38	21.79	20.55	19.66	19.06
Return on Capital %	27.76	25.98	27.49	28.56	30.80	28.93	28.09	27.00

**OPEN COMPETITION SCENARIO**

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Operating Revenue \$m	3201.53	3382.84	3457.68	3488.13	3523.00	3670.94	3818.74	3973.73
EBIT Margin %	11.24	9.91	9.76	9.11	9.08	7.93	7.26	6.54
Dividends \$ m	135.80	120.46	113.78	112.10	110.71	106.00	98.64	93.49
Special/Capital Payments \$ m	80.00	80.00	-	-	-	-	60.00	60.00
Return on Total Assets %	14.02	12.24	11.93	10.89	10.74	9.34	8.76	8.10
Return on Equity %	25.62	20.86	19.39	17.37	16.45	14.00	13.43	12.52
Return on Capital %	27.76	24.36	24.53	23.08	23.24	21.16	20.15	18.89

# Appendix Four: Consultant's Report on Overseas Experience with Reform in Postal Services

The Council selected National Economic Research Associates (NERA) to undertake a review of overseas experience with reform in Postal Services. This appendix includes a copy of the introductory sections of the NERA report. A copy of the full report is available from the Council on request.

NERA was required to describe international experience in the regulation and delivery of postal services in seven countries: Canada; Finland; New Zealand; the Netherlands; Spain; Sweden; and the United Kingdom. Its report draws on lessons from these countries relevant to Australia. In doing so, it identifies factors that might affect the relevance and application of such experiences in Australia, for example, differences or similarities in geography and population spread, political factors.

NERA's report focuses on the following issues:

- reductions in the scope of services, where those services are reserved to the postal authority, and the impact of such changes on service quality and price;
- the types of community service obligations and universal service obligations provided by postal organisations and regulatory or other mechanisms for provision and funding of these services;
- structural reform, particularly vertical and horizontal separation of parts of the postal authority;
- access by third parties to the facilities and networks of the postal authority; and
- any other notable initiatives being taken in these nations (either in postal delivery operations or in reform of the regulatory environment).

## **OVERSEAS POSTAL REFORM**

**Final Report for the  
National Competition Council  
Prepared by NERA**

October 1997  
London

**Project Team:  
Phillipa Marks  
George Siolis  
Pinar Bagci  
John Dodgson  
Rachel Goodyer  
Jose Maria Rodriguez  
Pedro Luis Sanchez**

**National Economic Research Associates**  
Economic Consultants

15 Stratford Place  
London W1N 9AF  
Tel: 0171 629 6787  
Fax: 0171 493 5937

A Marsh & McLennan Company

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## INTRODUCTION

In July 1997, NERA was commissioned by the National Competition Council (NCC) in Australia to provide a study of overseas experience with postal reform. This study is part of a broader review of the Australian Postal Corporation Act 1989 conducted by the NCC as part of the Commonwealth Government's commitment to review all legislation which restricts competition.

The NCC's objective was to collect international experience in the regulation and delivery of postal services. The countries chosen for this study were Canada, Finland, the Netherlands, New Zealand, Spain, Sweden, and the UK. The NCC were particularly interested in the regulatory experience in the selected countries and its impact on the capacity of their postal services to deliver standard letters. The main issues to be addressed by the study, as requested in the Terms of Reference (see Appendix 8) are:

- reductions in the scope of services reserved to the postal authority, and the impact of such changes on service quality and price;
- the types of community service obligations provided by postal organisations and the regulatory or other mechanisms for provision and funding of these CSOs;
- structural reform, particularly vertical and horizontal separation of parts of the postal authority;
- access by third parties to the facilities and networks of the postal authority; and
- any other notable initiatives introduced in the countries studied.

Information on the reforms in each country was collected from a number of sources including the Annual Reports of postal authorities, legislation relating to postal services, government papers and reviews, and other published documents. This information was supplemented by interviews with senior managers in postal authorities and relevant government departments.

The rest of this report is structured as follows:

- in chapter 2, we provide a summary of the detailed country studies given in the Appendices. The relevance of each country to the Australian situation is also highlighted;
- in chapter 3, we discuss the major issues in overseas postal reform, focusing particularly on liberalisation;
- in chapter 4, we draw out the relevant lessons for Australia.

The detailed country studies are provided as Appendices to this report.

## **SUMMARY OF OVERSEAS EXPERIENCE**

This Chapter briefly summarises the more detailed country information provided in Appendices. It includes information about the reserved service, universal service obligations (USO), and access arrangements. It also summarises the lessons that the Australian Government could draw from the reforms introduced in each country.

### **Canada**

Canada Post Corporation (CPC) is a government owned corporation created from the Post Office Department in 1981. The responsibilities and legal requirements of CPC are found in the Canada Post Corporatisation Act 1981 and the Financial Administration Act (1985).

Canada Post Corporation enjoys an exclusive privilege for the collection, transmission and delivery of letters within the country. Competitors that wish to enter the market for letters are required to charge at least three times the rate of postage payable for delivery in Canada of similarly addressed letters weighing 50 grams. The CPC also has exclusive control over apartment building mail boxes for delivery purposes. Profits from the reserved service are used to fund the USO, which although not specifically mandated in the Canada Post Corporatisation Act 1981, has been defined by CPC to mean the requirement to provide a universal letter service at affordable and uniform rates.

Canada Post Corporation was subjected to a recent review (the Mandate or Radwanski Review). The Review noted a number of concerns with the competitive behaviour of the CPC, specifically cross subsidising 'competitive' activities from its exclusive privilege, as well as with the financial viability of the CPC (including its inability to earn a commercial rate of return). The review also found that the CPC faced a number of conflicting objectives which affected its ability to provide its public core services and a commercial rate of return.

Canada Post offers discounts to customers who pre-sort their mail. There is some downstream entry of parcels, publications and advertising mail because of zone pricing, but most mail enters the network at the point of preparation.

There are a number of lessons that Australia could draw from the Canadian experience:

- competition policy implications will become important as private sector companies enter into markets where the postal authority is present. Clear accounting separation of competitive and non-competitive activities is required in order to monitor the postal authority's behaviour; and
- postal authorities need to be clear about their roles, responsibilities, and objectives. Canada Post Corporation was able to eliminate its deficits and earn profits once they were provided with a clear set of objectives from the government.

### **Finland**

Finland Post is a limited liability company wholly owned by the state. It is a subsidiary of PT Finland which also comprises Telecom Finland and PT Automotive Services.

Finland was the first country in the world to liberalise its postal services. In 1991, Finland Post no longer held the exclusive right to convey personal messages against payment. While Finland Post suggest that there has been competition for letter services since the early 1970s, their market share of the letter mail traffic in 1996 stood at 85 per cent.

The Postal Services Act (1994) requires Finland Post to provide nation-wide delivery of postal items (addressed item with maximum dimensions of 25 × 40 × 3 centimetres and with a maximum weight of 2 kilograms) every working day.

Finland Post did not oppose liberalisation in 1991 and remains supportive of that decision. It has remained profitable and has maintained its market share. It has also been cleared by the competition authorities of complaints of unfair trading against its competitors.

Finland Post provides volume-based discounts to businesses for pre-sorting their mail.

The lessons Australia could draw from the Finnish experience are:

- the importance of cost based tariffs. Finland Post is required to offer cost-based tariffs which are closely monitored by the regulator for some of the most competitive services (such as newspapers and parcels);
- Finland Post saw liberalisation as a necessary step to meeting customer demands and improving their own management systems; and
- Finland Post consider the threat from new technologies as greater than that posed by liberalisation.

## Netherlands

PTT Post - the postal services business of KPN in the Netherlands - was corporatised in 1989 and privatised in 1994 and 1995. Although KPN provides both telecommunication and postal services, the company plans to split the group into two independent businesses. PTT Post is regulated by the Minister for Transport and Public Works who monitors compliance with the conditions of the Postal Act (1988).

PTT Post has a monopoly over mail delivery, collection from road-side boxes and sale of postage stamps for letters weighing up to 500g. Express mail services are, however, allowed to compete in the reserved area provided they charge a higher price than that charged by PTT Post. PTT Post also has a statutory obligation to carry addressed items weighing up to 10 kilograms at uniform rates and under the same terms and conditions for everyone in the Netherlands. The USO is funded from the reserved service.

Access to third parties of PTT Post's network is provided on a commercial basis. Customers (including competitors) receive a discount based on avoided costs when they deliver their mail at the sorting centre. PTT Post is strongly against regulations intended to ensure downstream access.

PTT Post differs from the other postal authorities in this study in two ways: first, they are the only postal operator which has been privatised, and second, they are entering into a wide

range of new businesses that move the focus of their activities away from letter mail. In 1996, PTT Post acquired the Australian firm TNT to become a leader in the market for time sensitive distribution of documents, parcels and goods.

The lessons for Australia are:

- privatisation of postal services is not inconsistent with the provision of universal services;
- a privatised postal service can be required to meet price and service standards determined by government; and
- the reserved letter mail market may in time become less important to postal authorities in terms of growth and profits contribution.

## **New Zealand**

New Zealand Post is a limited liability company owned by the state and headed by a board of directors. The (amended) Postal Services Act 1987 and a Deed of Understanding between the Government and the postal authority set out the responsibilities of New Zealand Post.

New Zealand Post's core business activities are the conveyance of letters, distribution of courier and parcel items, and financial transactions. It also provides stamps and telegram services as well as data processing and mail production services.

New Zealand Post currently has a monopoly on the delivery of letters weighing less than 200 grams and priced at under 80 cents. This reserved service or exclusive privilege provides the funds required to support the universal service obligation - defined as 5 or 6 day delivery to most delivery points and delivery to remote rural areas. In April 1997, the Government announced that it would remove the reserved service for New Zealand Post. The legislation has not yet been passed. The USO, estimated to be between NZ\$3-4 million, is expected to be financed from the continued profitability of the postal authority as well as through the financial benefits associated with its official designation for UPU purposes. A requirement to provide a universal service will be included in the revised Deed of Understanding.

New Zealand Post allows third party access to its network. Currently, discounts are available to large customers who pre-sort their own mail. As part of the proposed changes in New Zealand, third party access arrangements will be widened. New Zealand Post and its competitors are expected to agree on prices, terms and conditions (including, for example, downstream access) subject to the provisions of competition law. New Zealand Post will, however, be required to provide access to its competitors on 'fair and reasonable terms'.

The features of the New Zealand experience of most relevance to Australia are:

- New Zealand Post has been expecting the reserved service to be removed and have focused on improving their performance to meet any forthcoming competition;
- New Zealand Post is highly profitable unlike the pre-corporation situation;
- the current deregulation proposals have the support of New Zealand Post and the

unions; and

- privatisation has been explicitly ruled out.

## Spain

Correos y Telégrafos, the public postal authority in Spain, has faced competition for many of its postal services since 1960. However, many private operators did not enter the market until the late 1980s. At that time, Correos was a General Directorate within the Spanish Central Administration. That organisational structure did not allow Correos to compete effectively in the market for postal services. The inability to manage its resources, a lack of investment and inadequate economic incentives combined to cause Correos to lose significant share of the market for liberalised services to private postal operators. As a result, greater commercial freedom was provided to Correos in 1991.

There is an important distinction between inter-urban and intra-urban mail in Spain. Inter-urban mail refers to the collection, transport and distribution of letters *between* cities and villages in Spain. Intra-urban mail refers to the collection, transport and distribution of letters *within* cities and villages. At present, the only reserved services in Spain are the collection, transport and distribution of letters between cities and villages (that is, inter-urban mail) and international destinations<sup>1</sup>, post office boxes, stamps, money orders and the use of the name "Correos". Other services specified in the law (art 99.2 of the 31/1990 Law) can be provided by private or state-owned companies by obtaining an administrative authorisation. The reserved services will be further reduced in late 1997 when competition will be allowed for inter-urban services provided the price is five times higher than the public tariff for ordinary consignments.

Currently, the USO in Spain is not well defined. However, it appears that Correos is required to deliver cards and letters to all mailboxes in Spain. The USO is financed from the reserved service and from a subsidy received from the Government. The proposed new postal law will provide a firmer definition of the universal service obligation. It will be defined as the collection, transport and distribution of consignments (provision of basic communications services) across the whole Spanish territory at affordable prices for users.

Access by third parties to Correos' infrastructure is allowed. Discounts (as a percentage of the postal tariff) are available for large customers who generate large amounts of post traffic (10 million deliveries to one specific city or 40 million deliveries to several places) in return for complying with certain requirements related to pre-sorting and classification of mail.

The Spanish experience offers the following lessons for Australia:

- postal authorities require commercial freedom in order to meet competition from private operators in an effective way; and
- there is no uniform tariff in Spain. The cost to consumers of mailing a letter in Spain will depend on whether it is being delivered within the same urban area or to another urban area in Spain.

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<sup>1</sup> International express courier services, however, have been liberalised since 1992.

## **Sweden**

In March 1994, Sweden Post was converted from a public enterprise into a limited company with a parent company (Sweden Post) and a number of subsidiaries. A new regulator, the National Postal and Telecom Agency, was also established to ensure that Sweden Post meets the requirements of the Postal Services Act (1993) and the terms of the agreement between Sweden Post and the Government.

Sweden Post's exclusive right to mail conveyance was removed by the Postal Services Act 1993. Competitors can enter the market for mail subject to licensing under the Act (licensing depends on reasonable demands of reliability and security). Unlike most other countries in this study, the responsibility for providing the USO rests with the Government although Sweden Post has currently been contracted to meet it. There is also a requirement to maintain a uniform tariff. The USO refers to nation-wide mail services ensuring that letters, other addressed mail items weighing less than 2 kg and parcels can reach everyone regardless of address locality.

When it removed the reserved service, the Government expected Sweden Post to be able to maintain the USO out of its profits. However, lower interest rates, local competition and the growth of electronic communications have reduced Sweden Post's profitability to such an extent that the Government has recently commissioned a study into options for the long-term financial position of Sweden Post. Sweden Post is, however, confident that it can meet the competition if it is allowed to offer discounted 'local prices' based on costs (alongside the uniform price) in those areas where competition has been established. Sweden Post recently won a court case allowing differential prices in the delivery of newspapers. However, while the critical question of whether local prices will be allowed for all mail is currently before the Court, the government has indicated it may allow local prices to be introduced in 1998.

Access arrangements for third party access to Sweden Post's network were widened in March 1997 to include downstream access.<sup>2</sup> Special tariffs were introduced for mailings which are handled at a regional sorting centre for distribution within the same region or at a lower sorting centre for distribution within the same locality.

The Swedish experience offers the following lessons for Australia:

- Sweden Post have noted the importance of price flexibility (including the need to rebalance tariffs) as a way of effectively meeting competition;
- Sweden Post is concerned about the threat posed by electronic communications;
- the support of unions was critical to the reforms in Sweden. The union representatives on the Board of Sweden Post understood the need for liberalisation and were able to convince the workforce of the need for change;
- the Government was aware of the cost of the USO and noted that an alternative means of meeting the USO (such as a universal service fund) may be introduced if

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<sup>2</sup> Downstream access allows consumers or competitors to interconnect with the postal authority closer to the final delivery point.

Sweden Post suffers a significant decline in profitability; and

- as in New Zealand, the Government has chosen to liberalise without privatisation.

## United Kingdom

The Post Office in the United Kingdom has been a public corporation since 1969 and consists of three major businesses - Royal Mail, Parcelforce, and Post Office Counters. The general duties of the Post Office are defined in the British Telecommunications Act (1981).

Since 1981, Royal Mail has enjoyed the exclusive privilege of conveying all letters valued under £1 (the price of a first class stamp in the UK is currently 26p). In return, Royal Mail must provide a nation-wide letter and parcel service with daily delivery to every address in the country and provide a uniform and affordable structure of prices. Although Royal Mail has previously expressed a view that they could remain viable if the reserved service were reduced to £0.50, they are concerned that 'cream skimming' by competitors would affect their ability to maintain the USO.<sup>3</sup> At present, there are no estimates of the cost of the USO in the UK.

Royal Mail currently offers discounts to large customers who wish to pre-sort their mail before handing it to Royal Mail for delivery. This type of arrangement - known as Mailsort - provides customers with discounts for carrying out some of the work that would otherwise have been undertaken by Royal Mail.<sup>4</sup> However, without consolidation<sup>5</sup>, these arrangements will continue to have a limited impact in terms of promoting competition.

The operating conditions and major issues facing Royal Mail in the UK differ from those in Australia. Currently, the major areas of concern for UK postal services are the following:

- the extent of commercial freedom given to Royal Mail: Royal Mail has been critical of government restrictions on its activities (such as restrictions on its freedom to enter into joint ventures);
- the future of Post Office Counters: the Labour Government has expressed concern about the trend towards agency status for Crown Post Offices;<sup>6</sup>
- developments at a European level: liberalisation of postal services in the UK will, to a large extent, be driven by developments from the European Commission which is proposing that, *inter alia*, a universal service be available at affordable prices, and that a reserved service be allowed to ensure the maintenance of the reserved

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<sup>3</sup> See page 2 of the response of the United Kingdom Post Office to the 'Green Paper on the Development of the Single Market for Postal Services'.

<sup>4</sup> Royal Mail (1997) *Mailsort Inside View* London: Royal Mail., p. 5.

<sup>5</sup> Consolidation occurs when a third part is allowed to collect the mail of other companies, sort it, and deliver it to the point of the final sort for delivery.

<sup>6</sup> Department of Trade and Industry Press Release P/97/332.

service.<sup>7</sup> The Directive also requires the reserved service to be reviewed no later than the first half of the year 2000;<sup>8</sup> and

- industrial unrest: the ability to reform postal services in the UK has been made difficult due to unhealthy relations between the management of Royal Mail and the unions. There have, for example, been national and local one day strikes throughout 1996 and 1997 respectively.

In May 1997, the Labour Government announced a comprehensive review of the Post Office to consider, among other things, the issue of commercial freedom for the Post Office.

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<sup>7</sup> Official Journal of the European Communities (1995) "*Proposal for a European Parliament and Council Directive on Common Rules for the Development of Community Postal Services and the Improvement of Quality of Service*". (95/C 322/10).

<sup>8</sup> A key factor in evaluating whether a reserved service is required will be the extent to which postal operators require compensation to fulfil any USO imposed on them by government.



# Appendix Five: Report on Future Technological Developments in the Australian Communications Market

The Council selected National Economic Research Associates (NERA) to undertake a review of technological developments in the communications market. This appendix includes a copy of the introductory sections of their report. A copy of the full report is available from the Council on request.

NERA was required to identify technological developments and assess the extent to which these developments are anticipated to reshape competition in services provided by the postal sector.

NERA's report focuses on analysing the extent and speed of these changes and assesses the impact and rate of convergences, as measured by the:

- scope for differentiation/convergence in postal services within the communications market; and
- complementary advantages of postal networks.

The report provides insights into the extent to which traditional postal services will meet people's communication needs in the future, the way traditional postal services will change with the incorporation of new technology, and the extent to which service providers in the telecommunications market will provide direct competition to traditional postal services.

**FUTURE TECHNOLOGICAL  
DEVELOPMENTS IN THE  
AUSTRALIAN  
COMMUNICATION  
MARKET**

**Final Report for NCC  
Prepared by NERA**

November 1997  
London

**Project Team:  
Phillipa Marks  
Rachel Goodyer  
Ian Senior  
Mark Shurmer  
Usman Saadat  
Michael Buckland  
Jonathan Sandbach**

**National Economic Research Associates**  
Economic Consultants

15 Stratford Place  
London W1N 9AF  
Tel: 0171 629 6787  
Fax: 0171 493 5937

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## **GLOSSARY OF TERMS**

## **EXECUTIVE SUMMARY**

### **Objectives and Approach**

1. The purpose of this study, prepared by National Economic Research Associates (NERA) for the National Competition Council, is to identify developments in the communications market 5, 10 and 20 years in future and assess their possible impact on traditional postal services.
2. The main forms of electronic communications considered in this report are: telephony; facsimile (fax); e-mail; the internet and the WWW; electronic funds transfer (EFT); electronic data interchange (EDI); broadcasting, including interactive television; and virtual reality. We use the term internet in a fairly broad sense to mean the Internet, on-line services and other electronic means of communications, such as communication between closed user groups (CUGs) and Intranets.

3. Our approach to analysing the impact of future technology change on the Australian postal sector is based on an assessment of the relative advantages/disadvantages of letters versus electronic means of communication for four broad mail categories:
  - business to business;
  - business to households;
  - household to household;
  - households to business.

Within each of these categories we have considered the effect of new technologies on correspondence, financial transactions and direct mail. In each case, we have sought to identify those factors most likely to drive a transfer of communication from letters to electronic media and those factors most likely to impede such a transfer.

### **Background**

4. In 1960, Australia Post carried 50 per cent of 3 billion messages. By 1996, that share had fallen to 16 per cent of 24 billion messages with traffic volumes increasing from 1.5 billion to 3.8 billion items.
5. The physical letter market can be dissected in terms of destination and origination. Over the last eight years, the business to household segment has more than doubled but letter mail flowing from households, on the other hand, has almost halved. Business to business mail has grown by 23 per cent over that period, but has declined in recent years.
6. The penetration of telephony and other electronic communications media in Australia is high relative to other OECD countries. Penetration of relatively new services, such as mobile telephony and the internet, is growing rapidly albeit from a low base. For example, household internet penetration in 1996 was 10 per cent. The real price of using the fixed telephone network has been falling and further real price reductions can be expected now that the market has been fully liberalised. This, together with the general increase in competition in the telecoms market, should further stimulate the use of telecommunications services.

### **Advantages of Letters**

7. Letter mail currently has the following major advantages against e-mail and fax (either because the differences are significant or because they are important to users):
  - near universal delivery;
  - security - authenticity and privacy;
  - appearance, including colour;
  - reliable delivery (particularly relative to e-mail);
  - no reception costs borne by recipient.

However, these advantages will diminish in future.

8. The significance of universal delivery will be eroded as internet connections increasingly penetrate businesses and households. By analogy with telephones, there may remain a small number of households that do not wish or cannot afford to connect to the internet. In such cases, public policy solutions may need to be found. If, say, only five per cent of homes remain outside the internet, letter mail's unique selling point of universality will, for practical purposes, have disappeared.
9. Security considerations, privacy and authenticity, are particularly important for business communications which may be legally binding and/or which are of a financial or commercial nature. Already some of these communications may be sent through a more secure mail service than the standard letter service (e.g. courier or registered mail) which provide assurance of safe delivery. The advantage of letters will be further eroded when e-mail communications become more secure through standardised encryption methods. We expect this to occur within the next five years.
10. The appearance advantage of a letter will be eroded somewhat by the advent of high speed colour printers and the ability to send formatted e-mails. However, the following considerations will maintain the advantages of letters:
  - full colour printing will remain considerably slower than monochrome printing by inkjet or laser printer;
  - direct mail advertisers, for whom colour is an essential tool, cannot expect their recipients to colour-print leaflets of the sort that comprise their standard advertising material.
11. The imposition of reception costs upon the recipient may limit the effectiveness of electronic media for direct mail purposes. Although, this negative impact may be partly mitigated by the ability to closely target the needs and interests of the user.
12. Congestion on the internet and the lack of certainty about whether e-mails have arrived (and are read) means that letter mail currently offers advantages of delivery reliability, particularly for business communications. Although, in some circumstances, fax transmission will provide a good substitute to letter mail. Over the longer term, it is likely that many of these problems will be overcome as the demand for a reliable means of electronic communication grows.

### **Technology Developments**

13. In considering the impact of technological developments on letter services, we assessed the potential future changes in and impact of:
  - hybrid postal services (combining electronic and physical delivery);
  - faxes;
  - user terminals and other equipment;
  - telecommunications access, switching and transmission technologies; and
  - services that might be provided over electronic communications networks.

14. The need for manual final delivery will mean that the speed of delivery for hybrid services will never rival that of e-mail and faxes. Currently, there are six sites equipped with EDIPost printing facilities and Australia Post has no plans to increase these at this stage. Cost reductions may however encourage use of the service, assuming the quality of remote printing is comparable to that of own printing.
15. Fax machines are a mature technology and are approaching saturation penetration in the Australian business market. In the residential market there may be some room for growth, but we expect that in most cases their use will be superseded by that of PCs and e-mail communications.
16. The range of terminals and other equipment used to access electronic media will increase and their real costs will fall. In the business environment, Net PCs will be used in addition to standard PCs. NetPCs are a low cost alternative to a PC and act as a dumb terminal with all the processing done online via the network. In the household environment, WebTVs and digital television sets (or a digital set top box for an analogue TV set) will provide a relatively low cost means of access to the internet, when combined with a modem and telephone link for the return path.
17. The first digital terrestrial television (DTT) services (available in metropolitan centres) are expected to come on air by the end of 1999, with consumer receivers on the market from late 1999. Mass marketing is not expected to occur until later in the year 2000. By this time, digital television sets will be available commercially as digital terrestrial television services will be operating in the UK, Sweden, the US and elsewhere. Consumer adoption of DTT to, say, 75 per cent of penetration of households is expected to happen in 6-8 years on an optimistic view but is most likely to happen in 10-15 years from the year 2000.
18. The provision of interactive services over digital broadcasting systems is potentially of great significance in stimulating the penetration of internet services to the home, since television set penetration of homes currently stands at 99 per cent compared to 30 per cent for PCs. The advent of interactive advertising over digital broadcasting systems may also result in the substitution of certain types of business to household letter traffic.
19. Over a 5 to 10 year time frame, over 50 per cent of Australian residential and business sites are likely to have access to broadband telecommunications access in excess of 2Mb/s (either through ADSL upgrades of existing copper pairs, or new optical fibre, mobile or fixed radio based connections). This will improve the speed and quality of electronic communications. In addition, costs should also fall considerably.
20. This will allow the development of a wide range of new services which may be accessed from almost any location. Those services which seem most likely to compete with paper based letter communications include:
  - Home/office shopping
  - Home banking

- Advertising on the internet
  - Electronic publishing
  - e-mail.
21. The main drivers of the growth in e-mail traffic will be the penetration of PCs and PC like terminals and the penetration of internet access in homes and businesses. The value of using e-mail as a means of communications increases with the number of users connected to the same network. It is widely expected that the penetration of internet access will grow very rapidly over the next 10 to 20 years, possibly approaching that of the telephone today.
22. Better software, more reliable transmission of e-mail, and increased familiarity will enable longer, more sophisticated documents to be sent by e-mail. Encryption will in time address the problem of security and so allow even more documents to be sent by e-mail rather than in printed format. The impact on business to business mail could be very large indeed. In addition, some business to household mail (e.g. bills) could also be diverted to electronic transmission, though this will clearly depend on the extent of internet penetration in the household sector.
23. Major developments of EDI have already taken place in different market sectors such as banking, distribution and certain manufacturing industries such as cars. Industry observers believe that most EDI systems are in decline and will have to be put on the internet or retreat to small niche markets in order to survive.
24. In summary, the main factors that we expect to have an impact on the future growth in letter traffic are:
- the declining cost and increased user friendliness of PCs, and the advent of new cheaper forms of internet access through NetPCs and digital TVs within the next 5 years. Widespread diffusion of PCs and PC like terminal equipment in the household sector could be possible in 10 years' time;
  - over a 5-10 year time frame, the widespread deployment of broadband high speed access networks, particularly in urban areas;
  - the development of parallel internets for high speed communications, charged for on a usage basis, alongside the flat rate fee, more congested, networks; and
  - the solution of encryption issues on the internet probably within a 5 year time frame.

#### **Scenarios for Future Growth in Postal Services**

25. A number of possible future scenarios are described in the report and we provide quantitative estimates of future growth in letter traffic under these scenarios. These estimates are necessarily somewhat speculative, given that many of the electronic media which may affect future traffic growth have still to enter the market and/or are in an early stage of development.
26. The "base case" scenario assumes that letter traffic volumes continue to grow at

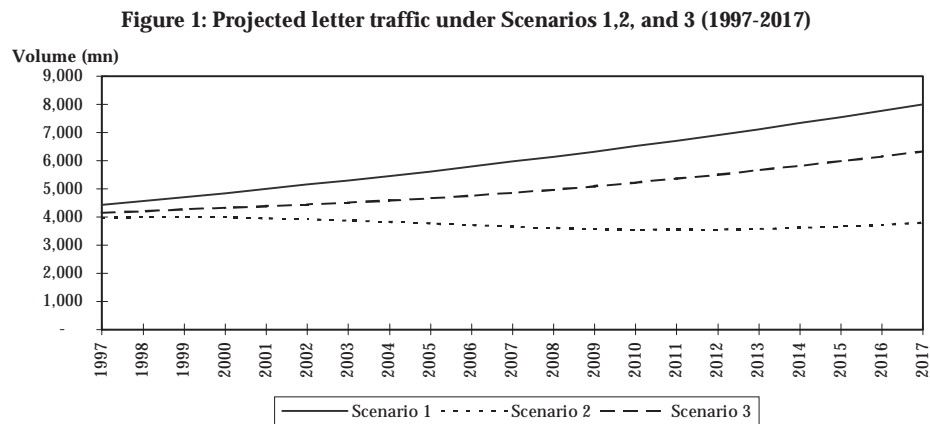


historic growth rates estimated to be 3 per cent p.a. The base case therefore assumes that the future impact of electronic communications will be the same as in the past. This can be thought of as an *optimistic no change* scenario.

27. We then considered two further scenarios which are principally defined by:
- the extent of internet penetration, in particular the extent of household penetration, as business penetration is assumed to be approximately 100% by 2017 in both the high and low penetration scenarios;
  - the diversion of traffic to electronic communications.

The impacts assumed in these scenarios are *additional* to those established in the base case scenario. The base case scenario captures the effects of technologies and services other than the internet.

28. Under the high impact scenario (scenario 2) it is projected that 24 per cent of total domestic letter traffic will be diverted to the internet by 2002; 38 per cent by 2007; and 52 per cent by 2017. Under the low impact scenario (scenario 3) it is projected that 13 per cent of total domestic letter traffic will be diverted to the internet by 2002; 18 per cent by 2007; and 21 per cent by 2017. The impact on future letter growth can be seen in Figure 1.



Source: NERA estimates

## Conclusions

29. The projections reported above suggest that with high rates of penetration and use of electronic media, the volume of domestic letter traffic is not likely to decline significantly over the next 20 years. In our high impact scenario AP's letter traffic will decline at an average of 0.2 per cent p.a., with negative traffic growth expected to occur between years 3 and 13. In the low impact scenario letter traffic will grow at an average of 2.2 per cent p.a., with a slowdown in the growth rate occurring in the first 10 years.

30. The high impact scenario represents a significant change from the experience of the last 15 years when letter volumes grew on average by 4.9 per cent p.a. This historic growth has enabled AP to achieve economies of scale (for example in delivery), which in turn has helped keep unit costs and final prices down. The opportunity for real unit cost reductions from scale effects would be lost under our high impact scenario, given that it is projected that traffic volumes will decline at an average rate of 0.2 per cent p.a. Indeed, if the number of postal addresses continues to grow, there will be some upward pressure on costs, reducing the competitiveness of postal services relative to electronic media whose real costs are expected to fall substantially.
31. Thus, while our projections suggest that over a 20 year time horizon electronic media are unlikely to lead to the demise of postal services, AP could face a much more difficult competitive environment than hitherto, losing as much as 50 per cent of its future postal traffic to electronic media.

## **INTRODUCTION**

### **Study Objectives**

This Draft Final Report prepared by National Economic Research Associates (NERA) is for a study on Future Technological Developments in the Communications Market.

The objectives of this study are to:

- 1) identify developments in the communications market 5, 10 and 20 years in future, including analysis of the extent and rapidity of changes;
- 2) assess the impact of these developments on the extent to which traditional postal services will meet people's communications needs in future;
- 3) assess the way in which technological developments will impact on the nature of traditional postal services, including the provision of hybrid (electronic and physical delivery) services; and
- 4) assess the implications of these changes on the growth in demand for postal services 5, 10 and 20 years in future.

This Draft Final Report provides qualitative and quantitative analysis of current and likely future developments in communications markets. A number of possible future scenarios are described and we provide estimates of future growth in letter traffic under these scenarios. These estimates are necessarily somewhat speculative, given that many of the electronic media which may affect future traffic growth have still to enter the market and/or are in an early stage of development.

## Approach

### Scope

Under the Australian Postal Corporation Amendment Act 1994, Australia Post (AP) has a reserved service (monopoly) of “letters” up to 250g in weight unless the tariff of a competing carrier is more than four times that of a standard letter (i.e. A\$1.80 compared with 45 cents for a standard letter). Postal items of up to 250g may be flat and consist of documents, but can also be three-dimensional, for example rolls of film.

Throughout this report it is assumed that electronic communications offer the potential to substitute for paper based communications - principally letters - but that “objects” (i.e. most parcels) will continue to require physical collection, sorting and delivery. We assume that electronic communications compete with letter services<sup>1</sup> and that these services roughly align with the definition of the reserved service in Australia.

For the purposes of this study, we take the key characteristic of a letter as being that it is *addressed to a specific recipient*. This means that unaddressed mail, even if in an envelope, is not a letter. The definition is practical because unaddressed mail is excluded from the reserved service in Australia. Similarly advertising media such as television, radio, poster sites and the World Wide Web (WWW) are not considered to be letter substitutes, although to the extent that they generate electronic rather than postal replies they may divert certain types of letter traffic.

The main forms of electronic communications considered in this report are: telephony; facsimile (fax); e-mail; the internet and the WWW; electronic funds transfer (EFT); electronic data interchange (EDI); broadcasting, including interactive television; and virtual reality. We use the term internet in a fairly broad sense to mean the Internet, on-line services and other electronic means of communications, such as communication between closed user groups (CUGs), and Intranets.

### Framework

Our approach to analysing the impact of future technology change on the Australian postal sector is based on an assessment of the relative advantages/disadvantages of letters versus electronic means of communication for four broad mail categories:

- business to business;
- business to households;
- household to household;
- households to business.

Within each of these categories we have considered the effect of new technologies on correspondence, financial transactions and direct mail. In each case, we have sought to identify those factors most likely to drive a transfer of communication from letters to

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<sup>1</sup> The Australian Postal Corporation Act 1989 defines a letter as “any form of written communication that is directed to a particular person or address, and includes any standard postal article, any envelope, packet parcel, container or wrapper containing communication, and any unenclosed written communication that is directed to a person or address.”

electronic media and those factors most likely to impede such a transfer. The main service characteristics we have considered are:

- cost - to the sender and the recipient;
- security - privacy and authentication;
- universality;
- speed of delivery;
- reliability of delivery;
- ease of use;
- ease of storage; and
- appearance, including visual quality and colour capability.

In preparing this Draft Final Report we have principally drawn on information in the public domain. We have also obtained confidential information from Australia Post concerning the breakdown of postal traffic by letter category which is presented in the next section.

## **Context**

For centuries communication specific to individual senders and recipients was paper-based: the “letter”. Telephony and telegraphy, when they were invented in the nineteenth century, were largely complementary to letters. Telex, which was limited to larger businesses and never reached residential users, was the first form of electronic letter, but the cumbersome, slow and expensive technology made no impact on letter traffic as the universal means of business and private communication. Facsimile, which is also largely used by businesses for communications, has become far more prevalent and is thought to have substituted for some postal communications. However, overall growth in the communications market has meant that total postal volumes have continued to rise.

All that is now changing. It is clear that the new forms of electronic communication will increasingly compete with paper-based letters. It is also clear that the former have developed a huge market that letters did not and could not supply. One view is that the new technologies will replace paper-based letters entirely, but little work has been done to provide a robust analysis to predict when — and indeed if — the demise of letter mail will take place. The alternative view is that the future will not be very different from the past: postal traffic will account for a diminishing share of the total communications market, but will nevertheless experience positive growth. These views are tested in Chapter 4.

## **Postal services**

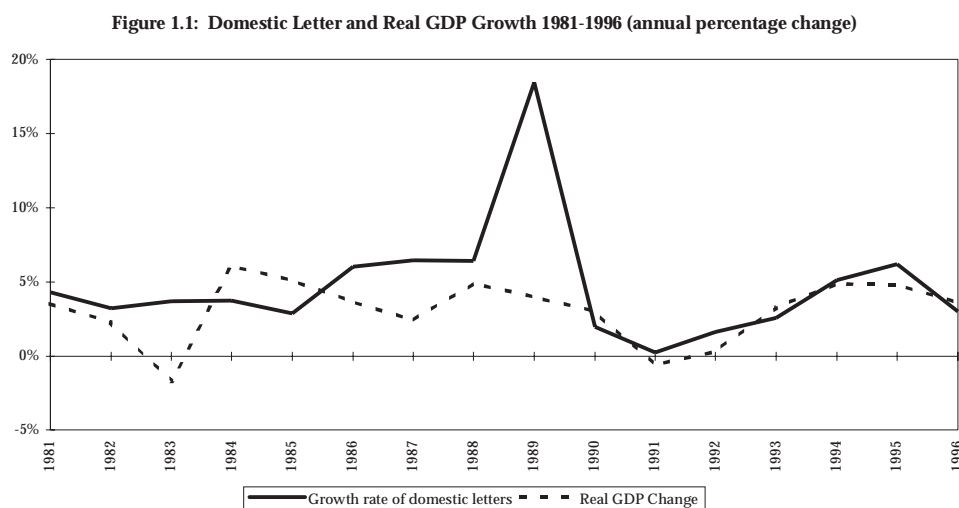
The physical letter market can be dissected in terms of destination and origination. Over the last eight years, the business to household segment has more than doubled but letter mail flowing from households, on the other hand, has almost halved. Business to business mail has grown by 23 per cent over that period, but has declined in recent years.<sup>2</sup>

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<sup>2</sup> Source: Opening Submission to the National Competition Council Inquiry into the Australian Postal Corporation Act 1989 and Associated Regulatory and Institutional Arrangements, Australia Post, August 1997.

Since 1992, the real price of a standard letter has fallen by 11.3%<sup>3</sup> and since 1992/93 service quality (as measured by the percentage of mail delivered on time) has been high and roughly constant at around 93 to 94%. Despite this favourable performance, not all types of postal traffic have shown positive growth in the 1990s.

Between 1980 and 1996, domestic letter traffic grew by 4.9 per cent p.a. Real GDP growth over the same period was 3.3 per cent p.a. *Changes* in real GDP and domestic letter traffic are shown in Fig.1.1.



Source: UPU

## Other communications services

### Telephony

Up until recently there were two licensed fixed telecommunications carriers in Australia, Telstra and Optus, and three mobile carriers, Telstra, Optus and Vodafone. This situation changed on 1 July 1997 when the Telecommunications Act 1997 removed restrictions on the number of carriers as part of a new pro-competitive regulatory framework.

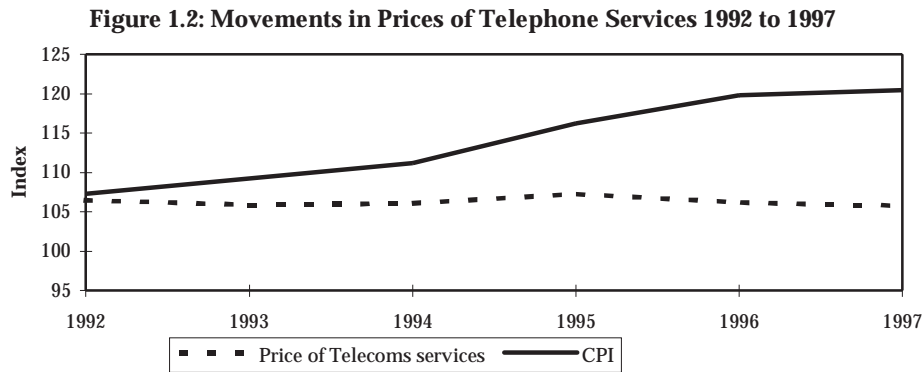
Australia has a telephone network which reaches 96 per cent of households. In 1997 there were about 9.5 million mainlines, equal to 47 mainlines per inhabitant.<sup>4</sup> The trunk network is rapidly being upgraded to digital transmission. By 1996, 74 per cent of the network was digitalised, compared to an OECD average of 83 per cent in 1995. Digitalisation is expected

<sup>3</sup> Source: Annual Report 1995-96, Australia Post.

<sup>4</sup> Source: Telecommunications Strategies Report 1997/1998, P. Budde Communications, 1997.

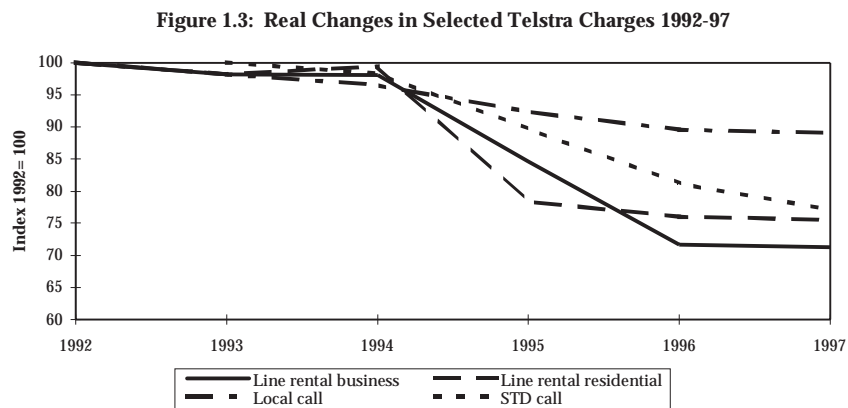
to reach 85 per cent by the end of 1997 and 100 per cent by 1999.<sup>5</sup> The main bottleneck remains the final drop which, to households at least, remains for the most part copper wire.<sup>6</sup>

Since 1992, the real price of telephone services has declined by more than 10 per cent. Figure 1.2 shows the movements in prices of telephone services compared to the CPI between 1992 and 1997.



*Source: ABS Consumer Price Index*

Figure 1.3 shows real changes in selected charges for the dominant telecommunications operator, Telstra, for the period 1992 to 1997. Line rental and trunk call charges fell by between 15 and 32 per cent, representing falls in real terms of between 24 and 40 per cent. Local calls from fixed wire telephones are charged on an untimed basis of 25 cents per call and this price has remained constant (in nominal terms) over the period.<sup>7</sup>



*Source: Communications Update, ABS Consumer Price Index*

<sup>5</sup> Ibid.

<sup>6</sup> This has implications for the speed of access to the Internet as discussed later in this report.

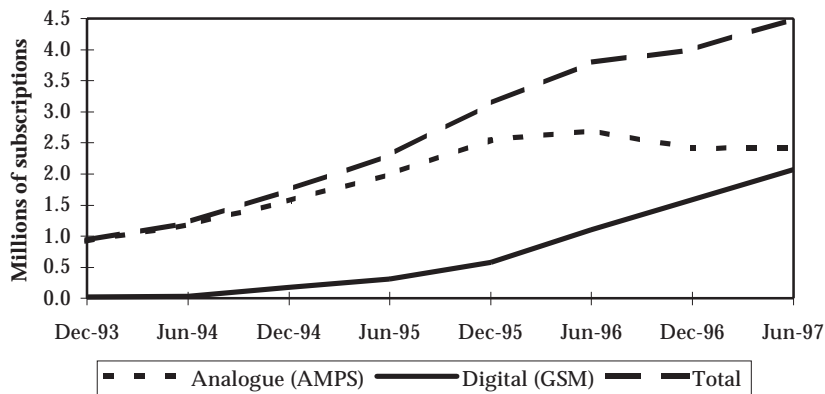
<sup>7</sup> Source: "The Communications Sector," <http://www.dot.gov.au.programs/btce/genpub/indicat2/comssec>.

On current government plans, access to broadband cable services will be available to most of Australian households in metropolitan and major regional centres, and many commercial sites by the year 2000.<sup>8</sup> Investment in a hybrid optic coaxial cable network is occurring at a rapid rate. In 1996 there were nearly 100,000 kilometres of fibre optic cable in the Telstra network.<sup>9</sup>

Digitalisation of the network will support the introduction of high speed data transfer through ISDN services. The lack of availability of ISDN has been a limiting factor in the growth of new services. In 1997, there were only 37,000 ISDN lines in Australia.<sup>10</sup> By the year 2000 Australia will have a full national ISDN capability and ISDN prices are expected to fall substantially as the network is upgraded.

Mobile phone subscriptions increased by 480 per cent between 1993 and 1997 (Figure 1.4). The number of subscribers estimated at around 4.5 million by July 1997. This represents a penetration rate of around 24 per cent, more than three times higher than the OECD average of 7.4 per cent. Under current plans, the analogue mobile phone network is to be phased out by the year 2000. For the moment, however, analogue subscribers account for more than 60 per cent of all subscribers, although the rate of growth in analogue subscriptions fell to less than 6 per cent in 1996, after recording rates of 63 per cent and 70 per cent respectively in the two previous years.<sup>11</sup> The number of digital subscribers rose more than tenfold in the two years to December 1996.

**Figure 1.4: Mobile phone subscriptions 1993-97**



Source: Asia-Pacific Telecoms Analyst

<sup>8</sup> Source: "Innovative Australia", [h://www.dca.gov.au/policy/natstrat](http://www.dca.gov.au/policy/natstrat).

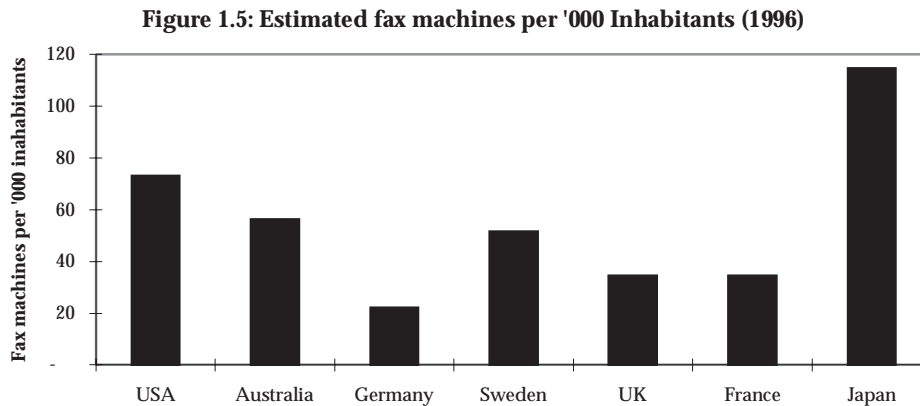
<sup>9</sup> Source: Annual Report 1996, Telstra

<sup>10</sup> Source: Telecommunications Strategies Report 1997/1998, P. Budde Communications, 1997.

<sup>11</sup> Source: Asia-Pacific Telecoms Analyst, March 1996.

### Fax services

It is estimated that in 1996 there were about 1 million fax machines in Australia.<sup>12</sup> Figure 1.5 compares fax machines per 1000 inhabitants for Australia with some other OECD countries. Fax penetration in Australia is one of the highest, at 56 fax machines per 1000 inhabitants, with only Japan and the USA being higher at 115 and 73 per 1000 inhabitants, respectively.



Source: P. Budde Communications and ITU

### PC and internet penetration

Australia also has one of the highest PC penetration rates. The ITU estimated that in 1994, 21.7 out of 100 Australians had PCs, with only the US having a higher penetration rate at 29.7.<sup>13</sup> PC penetration of households stood at 30 per cent in 1996, compared to 23 per cent in 1994. Estimates of businesses with computers for 1994 reveal that nearly 50 per cent of total businesses had computers.<sup>14</sup>

In a major new initiative, the Government will establish an integrated program called *Accessing Australia*. It will bring together initiatives costing more than A\$18 million. *Accessing Australia* is based on the concept of Alternative Access Points (AAPs). These will be provided in public places such as libraries where people will be able to get access to electronic information and services, and link up to individuals, groups and organisations through electronic mail and newsgroup facilities.

Growth in internet use in Australia has far exceeded expectations with numbers of users doubling every six months.<sup>15</sup> In July 1995, Telstra took over management of the major portion of Australia's internet services. These are divided into Telstra internet (to provide

<sup>12</sup> Ibid

<sup>13</sup> Source: *Development of the Information Society*, Department of Trade and Industry, UK, 1996.

<sup>14</sup> Source: Telecommunications Strategies Report 1997/1998, P. Budde Communications, 1997.

<sup>15</sup> Source: "Innovative Australia", [h://www.dca.gov.au/policy/natstrat](http://www.dca.gov.au/policy/natstrat).



commercial services) and services to higher education. Since 1995 Telstra has committed investment to provide a more reliable service initially to the main capital cities and to upgrade the international links (recently increased from 6Mbs to 32Mbs). Telstra has also announced a fourfold increase of the domestic internet backbone links.

In 1996, over 3m Australians accessed the internet at some time (double the previous years results), according to research based on the largest sample size to date by Roy Morgan research.<sup>16</sup> Other research shows that as many as 1.4 million Australians have regular access to the internet.<sup>17</sup> Of these, about 36 per cent were residential subscribers, 21 per cent business subscribers and the remaining 43 per cent were non-commercial subscriptions. Internet penetration in 1997 is estimated at be about 10 per cent<sup>18</sup> for all households and 32 per cent of private businesses.<sup>19</sup>

### *Others*

EFTPOS has been operating in Australia for nearly ten years. Although there are only a few service operators, the market has experienced a large increase in the number of terminals and transactions. The number of terminals increased from about 16,000 in 1988/89 to an estimated 100,000 in 1995/96.<sup>20</sup> It is estimated that there were 6,000 corporate users of EDI in 1996.<sup>21</sup>

### **Summary**

In summary, the penetration of telephone and other electronic communications media in Australia is high. Penetration of relatively new services, such as mobile telephony and the internet, is growing rapidly. The real price of using the fixed telephone network has been falling and further real price reductions can be expected now that the market has been fully liberalised. This, together with the general increase in competition in the telecoms market, should further stimulate the use of telecommunications services.

The physical letter market can be dissected in terms of destination and origination. Over the last eight years, the business to household segment has more than doubled but letter mail flowing from households, on the other hand, has almost halved. Business to business mail has grown by 23 per cent over that period, but has declined in recent years.

<sup>16</sup> Source: Financial Review, 13 October 1997.

<sup>17</sup> Source: Telecommunications Strategies Report 1997/1998, P. Budde Communications, 1997.

<sup>18</sup> Ibid.

<sup>19</sup> NERA estimate based on Telecommunications Strategies Report 1997/1998, P. Budde Communications, 1997.

<sup>20</sup> Source: "Innovative Australia", [h://www.dca.gov.au/policy/natstrat](http://www.dca.gov.au/policy/natstrat).

<sup>21</sup> Source: Telecommunications Strategies Report 1997/1998, P. Budde Communications, 1997.

## **Report Structure**

The remainder of this report is structured as follows:

- Chapter 2 provides a discussion of the current advantages of letters in Australia in terms of the service characteristics listed in Section 1.2 above;
- Chapter 3 describes potential future technological developments focusing on changes in service characteristics, and the implications for competition between postal and electronic communications services;
- Chapter 4 presents possible scenarios describing the impact of technological change on letter traffic and results of our analysis which assesses the implications of these changes on the growth in demand for postal services 5, 10 and 20 years in future.

# Appendix Six: Australia Post's Proposal

The following is an excerpt from Australia Post's proposal in the executive summary of its first submission to the National Competition Council. The excerpt should be read in the context of Australia Post's full submission, which is available from both the Council and Australia Post.

## *Australia Post's Proposal*

2.66 *Despite already operating in a highly competitive environment, Australia Post is committed to further reform and progressive reduction of the letter services reserved to us.*

2.67 *To ensure that only the protection necessary to deliver the Government's social objectives on an efficient, consistent and stable basis remains, we propose:*

- ***a further reduction of protection levels:***

*from 1 January 1999*

- *price down from 4 times the standard letter rate (\$1.80) to 2 times the standard letter rate;*
- *weight down from 250g to 125g;*

*from 1 January 2001*

- *price down from 2 times to 1 times the standard letter rate;*
- *weight retained at 125g;*

- ***followed by a further Review in 2003:***

- *to evaluate the impacts of the phased reductions in the reserved service.*

2.68 We also propose that:

- **interconnection arrangements to be maintained;**
  - *noting that access by direct competitors to postal networks is rare overseas, even among countries at the forefront of postal deregulation;*
- **the maintenance of the price “freeze” for the standard letter rate until 2002 and new discounts for barcoded mail from October 1999;**
  - *contributing to further real price falls; and*
- **a charter of postal responsibilities.**

**Public Interest**

2.69 Our proposal is based on the public interest grounds that:

- **a single national postal service with a single uniform rate for standard letters is more efficient for the nation with significantly lower transaction costs than if there were several postal services and/or multiple rates. It is also “customer friendly” and convenient for users;**
- **with full deregulation, significant “cream skimming” would occur. The social consequences of adopting a multiple rate system to resolve this problem would be unacceptable; and**
- **in any event incentive regulation through our Act will ensure continued high performance through the disciplines of the Corporate Plan,**

*quarterly and annual reporting requirements, as well as our commitment to efficiency and cost control. Our record speaks for itself - progressive reform is working and unduly accelerated liberalisation is not warranted.*

2.70 *Furthermore, weight should also be given to employment, Australian industry and industrial relations considerations ie:*

- *a steady level of corporate employment (38,690 full and part-time people, including 10,000 in regional areas) has been maintained while mail volumes have increased by 30% over the past five years; additionally;*
- *more than 90% of recurring purchases are made from Australian suppliers; and*
- *our progressive industrial relations policies and processes lead to positive working conditions and industrial harmony - with resultant consumer benefits of service reliability and high quality performance.*

### **Reform Timing Critical**

2.71 *Our proposal takes account of existing market place pressure as well as regulatory incentive for reform, both of which bring continuous pressures for improvement in postal performance.*

2.72 *Vigorous growth in electronic alternatives will continue to bring significant and effective pressures. These pressures are in addition to the Federal Government's oversight of the enterprise, both as regulator and owner. The record shows the effectiveness of these dual pressures.*

2.73 *We believe the most critical policy issue for the Review is the timing and management of change - not the direction. We have shown we can best serve the public*

*interest through continuous performance improvement, with the rate of reform measured and appropriate.*

- 2.74 *We also caution the Council about the risks of opening us to competition on too many fronts simultaneously. This would threaten the very viability of Australia Post and the stable delivery of postal services for Australians. The experience of Sweden Post AB, the only effectively full deregulated postal service, justifies some caution. Revenue losses, due in part to the increasing emergence of niche operators, has contributed to a decision to increase their basic postage rate (by 30% in March this year).*
- 2.75 *We are confident our proposal, by contrast, will deliver uninterrupted benefits over a reasonable time approximating market liberalisation (including freezing the basis rate until 2002). Fast tracking, or broadening reform across too many fronts, involves a high measure of risk.*
- 2.76 *We are already at world's best practice, with tangible measure in place to deliver substantial further improvements within a planned timetable.*
- 2.77 *While accelerated liberalisation could offer additional benefits to some segments of the market, in our view they are open to risk, conjecture and uncertainty. They have the potential to damage the hard-won gains of the progressive and managed past reform which has produced results the envy of many other major countries for all Australians, in the cities and "the bush".*

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