

**In this Issue:**

- Is Consignia failing to deliver?
- PostComm announces plans to liberalise the postal services market
- Who are the likely entrants into the market
- Risks and opportunities with market liberalisation

**FAILING TO DELIVER**

*“The current postal monopoly is clearly not providing its customers with the service they want and is failing to contain its costs.*

*We believe the most effective way to change this is for the company to face real competition.*

*Competition will produce the changes in Consignia that will secure its own future, and the universal service.*

**Graham Corbett,  
Chief Executive of  
PostComm**

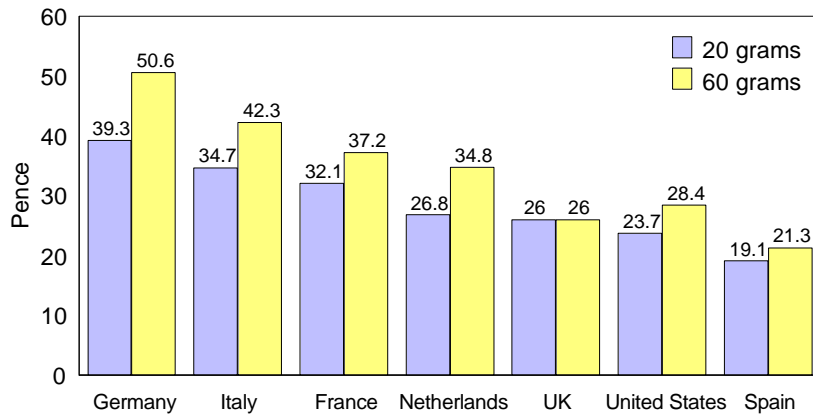
**LIBERALISING THE MARKET FOR POSTAL SERVICES**

Postcomm, the market regulator, has established a Competition Working Group to provide Postcomm with “informal” advice on the opening up of the UK postal market from Consignia’s major competitors.

All of these competitors are members of The Association of International Couriers and Express Services (“AICES”). The major members of AICES who are likely to provide new competition to Consignia as the postal market is liberalised are listed below: (click on the hyperlink to learn more about the existing services that these businesses provide to a mainly corporate client base)

*(Continued on page 2)*

**INTERNATIONAL POSTAL CHARGES**



Source: PostComm Data for 1999

**The Economics of Postal Service Liberalisation**

Consignia’s **statutory monopoly** in postal deliveries is now under serious short term and medium term threat following a review of the UK market and proposals for **greater competition** released by the postal industry regulator. PostComm have announced that they plan to **liberalise the market** for postal services with the aim of achieving full competition in postal services by 2006. The decision comes at an already difficult time for Consignia. It is suffering heavy losses faces significant competitive pressures from other forms of communication such as email.

PostComm requires Consignia to meet prescribed **standards of service**, including delivering 92.5 per cent of first class mail the next day– but it has failed to achieve this level of service, with its national performance only achieving 89 per cent of first class mail next day in 2000-01. In some postal areas, especially in London where transport congestion is a permanent problem and where there have been persistent industrial relations problems, Consignia’s performance has been much worse. The current dire state of Britain’s railways has also damaged their record in delivering mail on time.

*(Continued on page 3)*

*(Continued from page 1)***CONSIGNIA PROFIT AND LOSS**

*Consignia's operating costs have also been rising faster than its turnover, resulting in a year-on-year decline from an operating profit from £528 million in 1998 to a loss of £3 million in 20017.*

*The operating loss increased to £100 million in the six months to 23 September 2001, while the post-tax loss after exceptional items was £281 million.*

**POTENTIAL COMPETITORS IN THE UK POSTAL INDUSTRY**

TNT	<a href="http://www.tnt.co.uk">www.tnt.co.uk</a>
UPS	<a href="http://www.ups.com/europe/gb/engindex.html">www.ups.com/europe/gb/engindex.html</a>
DHL	<a href="http://www.dhl.co.uk">www.dhl.co.uk</a>
Hays	<a href="http://www.hays.co.uk">www.hays.co.uk</a>
Business Post	<a href="http://www.business-post.com">www.business-post.com</a>

Competitor expectations of the degree to which Postcomm would open up the UK postal market have been high for some time. However, most have stated that a "stepped" approach to market opening is the best way, provided that the initial market opening step is a significant one.

In particular, major competitors have lobbied for the announcement of an end date for full market liberalisation. Such an announcement is thought likely to finally convince Consignia that liberalisation will really take place and encourage it to take "difficult decisions" to prepare for real competition.

The provision of access to Consignia's postal facilities has been cited by several competitors as an important part of their **market entry strategy**. This will enable operators to build up a viable business without significant investment in infrastructure. With this arrangement, Consignia would be responsible for sorting and/or delivering mail, with competing operators responsible for the collection and consolidation of customer mail. An important issue (yet to be resolved) if Consignia is to share postal facilities is the "access pricing" that it will be allowed to charge competing operators.

**Consignia's Response**

What is Consignia's response to the challenges thrown down by the PostComm announcement. Chief Executive Allan Leighton was swift to condemn the speed with which PostComm plans to introduce competition in business mail services.

*"Markets should be opened up at a pace and in a way that enables customers to have more choice, whilst at the same time gives us a realistic chance to compete effectively and maintain a universal service at a uniform price.*

The Postcomm proposal to open up 30% of the market in just a few weeks time threatens the universal service. Competitors can now cherry-pick the profitable parts of our business, which substantially pay for the "one-price-anywhere-in-the-country" promise of universal service.

For Consignia, the regulator's approach represents death by a thousand cuts."

Allan Leighton, Chief Executive of Consignia

**MORE USEFUL WEB LINKS**

Useful web links

National Audit Office: <http://www.nao.gov.uk>

PostComm: [www.postcomm.gov.uk](http://www.postcomm.gov.uk)

PostWatch: [www.postwatch.co.uk](http://www.postwatch.co.uk)

**DELIVERY**

*"Service is more important than price for most customers"*

(National Audit Office Report, January 2001)

**THE ROLE OF POST-COMM**

*Postcomm's duties are to:*

*Ensure the continued provision of a UK-wide universal postal service at a uniform tariff,*

*Promote effective competition for the Royal Mail,*

*Control Royal Mail prices and service standards*

*Advise on how to maintain the network of rural and deprived urban post offices.*

**THE NEW FRAMEWORK**

*In March 2001, Postcomm became responsible for the independent regulation of the postal services market in the UK.*

*At the same time, the Post Office changed into a public limited company wholly owned by the Government, under the new name of Consignia Holdings plc (Consignia), but with no change to its brands such as Royal Mail.*

**PHASE ONE**

In a staged **deregulation** of the market, new entrants can apply for **licences** to handle high-volume batches of mail from business users containing more than 4,000 items. Operators can deliver this mail themselves or pass it to Royal Mail for delivery. This second option is known as a **consolidation service**. Taken together, this reform would open up around 30% of Consignia's current market.

**PHASE TWO**

Phase Two is scheduled to occur from 1 April 2004 – 31 March 2006: This will be the major liberalisation of the market – and will involve reducing the bulk mail threshold – to 500 and 1000 items per mailing. By March 2006, PostComm hopes all restrictions on household and business mail will have been lifted.

**FROM PROFIT TO LOSS**

Consignia's operating costs have been rising faster than its turnover, resulting in a year-on-year decline from an operating profit from £528 million in 1998 to a loss of £3 million in 2001. The operating loss increased to £100 million in the six months to 23 September 2001, while the post-tax loss after exceptional items was £281 million. Consignia is a public limited company, but it is wholly owned by the Government. So, although Consignia is supposed to raise extra capital using the same sources of capital finance as privately owned firms, it is still constrained in how much it can borrow to invest in postal services

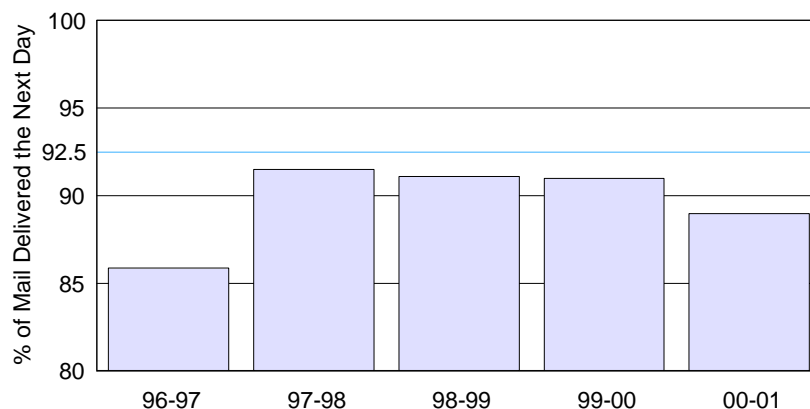
**POTENTIAL WINNERS AND LOSERS FROM MARKET DEREGULATION**

The decision to liberalise postal services poses **risks** and **opportunities** for consumers and businesses alike. Will the entrance of new suppliers lead to an improvement in efficiency and welfare? What might be the social consequences if Consignia or any other leading market participant is unable to maintain the current level of service to rural areas?

**Advantages**

The experience of liberalisation in telecommunications and gas & electricity supply suggests that competition encourages suppliers to become more efficient and reduce prices for consumers. Private sector companies have the pressure of shareholder-discipline, whereas Consignia is accountable to the Department for Trade and Industry. New entrants increases total fixed investment in the industry. The greater contestability of the market should also bring more dynamic efficiency (for example an improvements service quality)

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**MISSING DELIVERY TARGETS FOR 1ST CLASS MAIL**

Source: Postwatch (August 2001) Target = 92.5%

## The Risks

### Will new firms actually come in?

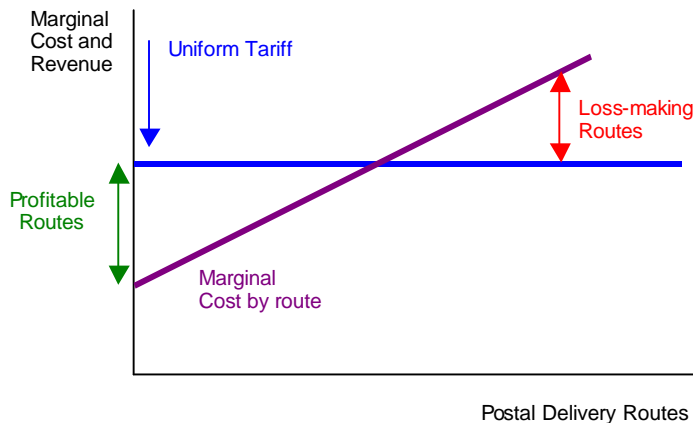
Potential entrants may be deterred if PostComm grants only short-term licences. Consignia has a fifteen year **licence** and the **strength of its brand** might act as an entry barrier. The market needs to be sufficiently contestable to affect Consignia's behaviour and performance.

There are other **barriers to entry** – not least the investment in capital that entrants must make. Some of these costs are non-recoverable **sunk costs**. Consignia estimates that 40% of its operating costs are fixed and it is unlikely that new suppliers would have a different cost structure. They would need a sufficiently large market share in order to bring down their **overhead costs per unit** to make their business viable. Some firms may engage in "**cream-skimming**" i.e. focusing on market segments that are most profitable.

### Can Consignia continue to deliver a universal service?

Consignia has a statutory duty to ensure a **universal service** at a uniform price. If it were to lose market share to new competitors, Consignia might find it hard to maintain a universal service at current price and service levels. Delivery to remote areas involves a higher marginal cost. The opportunities for **cross-subsidisation of services** to outlying areas will be reduced. The social benefits of continuing to operate loss making services might be lost if Consignia can no longer meet its universal service commitment.

### Will Consignia react by engaging in predatory pricing?



Consignia may by reducing its prices for types of service that are attractive to entrants or refusing entrants access on reasonable terms to services that are difficult to duplicate, such as final delivery of mail. This market behaviour might come under the scrutiny of the Office for Fair Trading and the Competition Commission, but making out a conclusive case that a business is engaged in **predatory pricing** designed to drive a new competitor out of the market is hard to do.

### The VAT advantage

Consignia is not required to charge VAT for its postal services – this potentially gives Consignia a competitive advantage in the market, unless other operators are granted the same exemption.

Postal services have been deregulated in several other countries over recent years—a summary is shown in the table below. The existing firms have kept the majority of their market share—competition has had the greatest impact in business direct-mail deliveries and in parcels.

DEREGULATION OF POSTAL SERVICES IN OTHER COUNTRIES			
Country	Form of Liberalization	Year of Liberalization	Market Share currently held by the incumbent
Sweden	Full	1993	95%
Finland	Full	1994	100% of letter market
New Zealand	Full	1998	98%
Germany	Competition above 200 grams for single letters and 50 grams for direct mail	1998	92%
Netherlands	Competition above 100 grams – direct mail has full competition	2000	100% of <100 gram market; 80-90% of direct mail