Australian Government

Department of Communications

The Australian Postal Market

Policy Background Paper

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About this paper

This paper briefly outlines the challenges faced by Australia Post in seeking to continue to supply a monopoly letter service, in the face of increased digital substitution, increasing fixed costs, and declining mail volumes. The paper is the fourth published as part of the Department of Communications' series of Policy Background Papers and also serves as an introduction to the more detailed paper, *Australian and International Postal Services Overview[1],* developed by the Boston Consulting Group (BCG). BCG's paper should not be taken to represent the views of the Government.

Challenges

Prior to the development of the Internet, commerce was highly dependent on efficient mail services. The speed of delivery and reach of the postal network was a key factor determining the economic efficiency of a nation. The postal network also served an important social function – an efficient mail network allowed geographically distinct communities to interact with each other. Consequently, there was a strong public interest in governments ensuring that an efficient postal service was in place.

This has changed. Email, social media and other internet services are increasingly considered by consumers and businesses to be more effective, timely and less costly ways to communicate. As a result, people are using the mail less. From their peak in 2008, mail volume in Australia has fallen by 25 per cent. There are similar or more severe rates of decline in other countries. For example, letter volumes in the United States have fallen by 30 per cent since their peak in 2006, and in Denmark, volumes have dropped by 54 per cent since their peak in 2001.

The decline in letter volumes is signaling that the role of postal services are changing, and that the services that Australia Post is obligated to provide may be out of step with community demands. Postal services no longer perform the same social function as they once did.

Over 90 per cent of mail in Australia is now sent by businesses (such as banks) and by government agencies, and these organisations are rapidly moving away from mail. As noted in the National Commission of Audit, e-Government transaction costs are substantially lower than traditional channels[2]. In recognising the efficiency of online channels, and that these channels are preferred by users, the Government has announced its 'Convenient Services Anytime Anywhere' policy[3], which requires that Government agencies use the Internet as the default way to interact with consumers. It

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[1] See http://www.communications.gov.au/post/policy_and_legislation
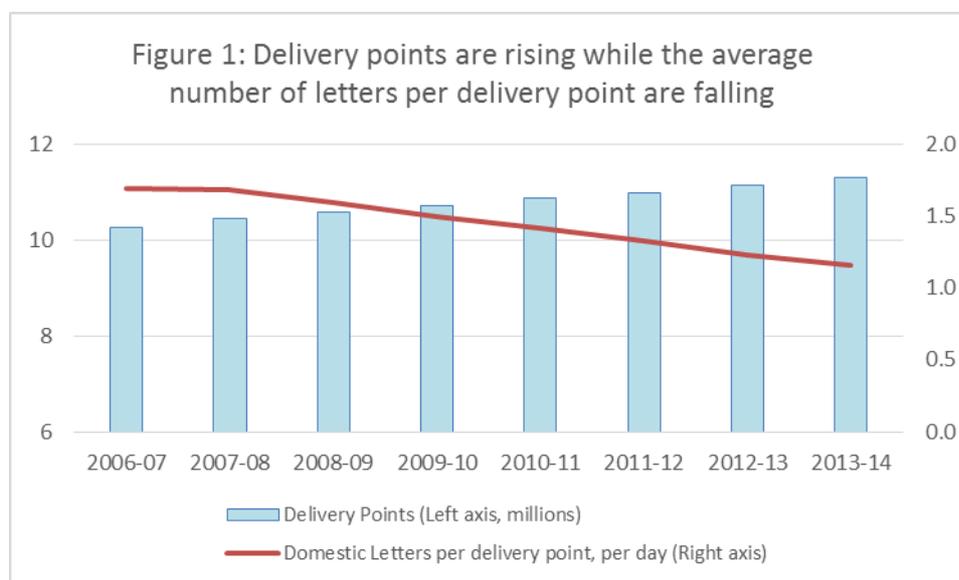
[2] National Commission of Audit, www.ncoa.gov.au/report/phase-one/part-b/10-6-e-government.html

[3] Policy for E-Government and the Digital Economy, www.malcolmturnbull.com.au/assets/Coalitions_Policy_for_E-Government_and_the_Digital_Economy_(2).pdf

is likely that there will be a residual demand from some government agencies (e.g. those who cannot use digital substitution) for traditional mail for some time.

Whilst there has been a recent push to move to more efficient communications channels, particularly in government, declining mail volumes in Australia have been apparent for some time, and these declines are accelerating. In 2007-08, the average number of domestic letters received each day per delivery point was 1.7. In 2014, the average is 1.2, and by 2020 it is projected to be 0.6[4].

At the same time, Australia Post's fixed costs continue to rise. Approximately 150,000 new delivery points are created every year as a result of population growth and the creation of new businesses. Australia Post's Community Service Obligations mean that it is obliged to deliver to these new points. Figure 1 illustrates the decline in Australia Post's letter business. Compared to 2006-07 when Australia Post delivered 4.5 billion letters[5], by 2013-14 Australia Post will be only be delivering 3.4 billion letters to a network that has grown by more than one million delivery points.

Figure 1: Delivery points are rising while the average number of letters per delivery point are falling

Delivery Points (Left axis, millions)
Domestic Letters per delivery point, per day (Right axis)

Structural changes in the postal market are threatening the financial viability of Australia Post itself. This trend has not emerged overnight—in addition to price increases, Australia Post has been considering the ways in which this problem might be addressed:

> Australia Post has sought to offset the problems in its letter business through growth in profits in other parts of its business. For example, Australia Post's parcel business has grown by about 9.3 per cent per year for the last three years[6], driven largely by online retail. However, these other parts of Australia Post's business generally

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[4] Australia Post forecasts an average decline in domestic addressed letters of 11.4 per cent per annum to 2019-20.

[5] Addressed letters, including PrintPost.

[6] Australia Post's 2013 Annual report, http://auspost.com.au/annualreport2013/products-and-services.html

operate in highly competitive markets, and ongoing cross-subsidisation of letters will not remain commercially viable.

> Australia Post has undertaken a cost reduction and network optimisation program that will continue to provide cost savings. Its "Future Ready" program has realised $1.1 billion in benefits over the last four years. These efforts have been successful in driving costs out of the business, but they are reaching their limits. It appears unlikely that further substantial efficiency gains can be made at an operational level, without reform.

These measures are insufficient to restore the letters business to profitability. In 2012-13, Australia Post made a loss of $218 million in its regulated mail business. While cross-subsidisation from other parts of Australia Post's business has been able to meet these losses until now, this is no longer sustainable. At the current rate, the losses in the letter business will begin to eclipse the profits in all other parts of the business as early as 2014-15.

Over the next ten years, Australia Post is expected to incur cumulative losses of $12.1 billion in letters, and $6.6 billion across the business as a whole. As Australia Post has been self-funding, the impact of a loss will be borne by the Government as shareholder.

Working towards a solution

The fundamental problem faced by postal administrations, including Australia Post, is that their business is constrained by regulation to offer a service that is being replaced by digital channels. As postal volumes decline, and the network grows, Australia Post remains bound by strict Community Service Obligations that are increasingly difficult for the corporation to meet while remaining commercially viable. Likewise, the network of Licensed Post Offices (LPOs) is also under pressure—visits to retail stores have declined by 30 per cent in the last 5 years. LPOs serve a particularly important role particularly in regional areas. This matter is currently being considered by the Senate Environment and Communications Legislation Committee[7] which is expected to report in August 2014.

Although the National Commission of Audit report to the Government recommended that Australia Post be privatised after 2016, the Government has no plans to do so at this time. At this stage, the Government is seeking to better understand the nature of the challenges facing Australia Post, both domestically and internationally. Australia Post has provided advice to the Government on how these fundamental problems might be addressed. In considering this advice, the Government has sought an arms-length analysis. Following a competitive tender process, the Government engaged BCG to validate the data and proposals put to the Government by Australia Post.

The *Australian and International Postal Services Overview* paper is one part of the work undertaken by BCG and is available on the Department's website. The BCG paper

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[7] Environment and Communications Legislation Committee, see
www.aph.gov.au/Parliamentary_Business/Committees/Senate/Environment_and_Communications/Australia_Post_in_Australian_communities

explains the pressures on Australia Post and postal administrations in other jurisdictions. The BCG paper notes that there have been a range of reforms that have been advanced in other jurisdictions (see chapter 5 of the paper), including moving to more flexible service standards, moving to new operating models or allowing a more flexible pricing mechanism. The Government has released the BCG paper to promote informed and constructive debate in the community.