



Australian Government

Department of Finance

**SUBMISSION TO THE
SENATE STANDING COMMITTEE ON ENVIRONMENT
AND COMMUNICATIONS**

**INQUIRY INTO THE PERFORMANCE OF
AUSTRALIA POST AND LICENSED POST OFFICES**

November 2013

TERMS OF REFERENCE

That the following matters be referred to the Environment and Communications Legislation Committee for inquiry and report by 11 December 2013:

- a) the overall performance, importance and role of Australia Post in Australian communities, and the challenges it faces in the immediate and longer term;
- b) the operations of Australia Post in relation to Licensed Post Offices (LPOs), with particular reference to:
 - i) the importance and role of the LPO network in the Australian postal system, with particular reference to regional and remote areas;
 - ii) the licensing and trading conditions applicable to LPOs, including the Community Service Obligations, and any effects these may have on operating an LPO business; and
 - iii) marketing, retail and trading arrangements between Australia Post and LPOs and other entities; and
- c) any related matters.

INTRODUCTION

1. In response to the invitation of the Senate Committee on Environment and Communications, the Department of Finance provides this submission on the *Inquiry into the performance of Australia Post and Licensed Post Offices*. This submission outlines Australia Post's financial performance and some of the challenges facing the business in the immediate and longer term. It also briefly notes some of the issues facing Licensed Post Offices, which are linked to broader issues facing Australia Post's business. We understand that the Department of Communications will also be putting forward a submission addressing Australia Post's operational performance, including in relation to Licensed Post Offices. This submission does not seek to replicate those matters.
2. Australia Post is a prescribed Government Business Enterprise (GBE), subject to:
 - a. the *Australian Postal Corporation Act 1989* (APC Act)¹;
 - b. the *Public Governance, Performance and Accountability Act 2013*²;
 - c. the *Commonwealth Authorities and Companies Act 1997*³; and
 - d. the *Commonwealth Government Business Enterprise Governance and Oversight Guidelines 2011*.⁴
3. Under the APC Act, the principal function of Australia Post is to supply postal services within Australia and between Australia and places outside Australia. Australia Post is also able to conduct other functions that are ancillary and incidental to its principal function.⁵
4. Australia Post's dual purpose is to provide a universal letter service that is reasonably accessible by all Australians in a manner consistent with sound commercial practice to provide a commercial return to its shareholder.⁶ Its performance standards are set out in section 27 of the APC Act and its subordinate legislation (Community Service Obligations (CSOs)). The CSOs require Australia Post to adhere to the following prescribed performance standards:
 - a. *universal letter service* – Australia Post must deliver daily to 98% of all delivery points and at least two days each week to 99.7% of all delivery points;
 - b. *uniform price* – the Basic Postage Rate (BPR) is currently 60 cents and was last increased in June 2010, applies to all items under 250g (currently 99% of total letter volumes).
 - c. *reasonably accessible to all Australians* – Post must maintain at least 4,000 retail outlets (including, no fewer than 2,500 in regional and rural locations) and 10,000 street posting boxes, and located so that:
 - in metropolitan areas at least 90% of residences are within 2.5km of an outlet; and

¹ http://www.austlii.edu.au/au/legis/cth/consol_act/apca1989337/

² http://www.austlii.edu.au/au/legis/cth/num_act/pgpaaa2013432/

³ http://www.austlii.edu.au/au/legis/cth/consol_act/caaca1997387/

⁴ http://www.finance.gov.au/publications/governance-arrangements/docs/GBE_Guidelines.pdf

⁵ s14-16 of the *Australian Postal Corporation Act 1989*

⁶ s26-27 of the *Australian Postal Corporation Act 1989 and Commonwealth Government Business Enterprise Governance and Oversight Guidelines 2011*

- in non-metropolitan areas at least 85% of residences are within 7.5km of an outlet.
- d. *performs to a standard that meets the social, industrial and commercial needs of the Australian community* – Post must deliver at least 94% of all mail within specific timeframes.
5. Australia Post also provides parcel delivery, and retail services including acting as an agent for a range of financial institutions and identity verification services including passports. Australia Post has recently diversified into digital communications services, through the launch of the Australia Post Digital Mailbox (APDM).
 6. Australia Post operates at arm's length from the Government and is overseen by an independent Board of up to eight non-executive directors and the Managing Director. Australia Post has two Shareholder Ministers: the Minister for Finance; and the Minister for Communications, who also has portfolio responsibility.

AUSTRALIA POST – FINANCIAL PERFORMANCE AND LETTER VOLUMES

7. Australia Post's business is at a critical point where its letters service is in serious decline, with an increasing reliance on its ancillary business for cross-subsidisation. To date, Australia Post's profit from its commercial activities has been sufficient to meet the financial losses from its letters services. However, the cost of servicing its CSOs (estimated by Australia Post at \$177.5 million in 2012-13) is becoming increasingly unaffordable.
8. Changes in technology and consumer behaviour are driving a sharp decline in demand for letter services as consumers substitute electronic communications for physical mail.⁷ Australia Post's CSOs represent a rising fixed cost as the number of delivery points increases in line with population and commercial growth.
9. Mail volumes have declined by more than 18% since 2007-08 or approximately one billion items over five years.⁸ At the same time, Australia Post's costs have risen due to, among other things, the requirement that it deliver to, on average, 130,000 new delivery points each year.
10. The majority of letter volumes originate from businesses or government, as detailed in Chart 1 and Table 1 below. Both groups are encouraging customers to receive correspondence online to reduce distribution costs. With the growing availability of affordable high speed broadband, it is expected that this will further accelerate the decline in mail volumes sent by both business and government.

⁷ Communication trends and the role of mail: Report for the International Post Corporation, Copenhagen Institute for Futures Studies. http://www.ipc.be/~media/Documents/PUBLIC/CIFS_Communications.PDF

⁸ Australia Post Annual Reports 2007-08 to 2012-13

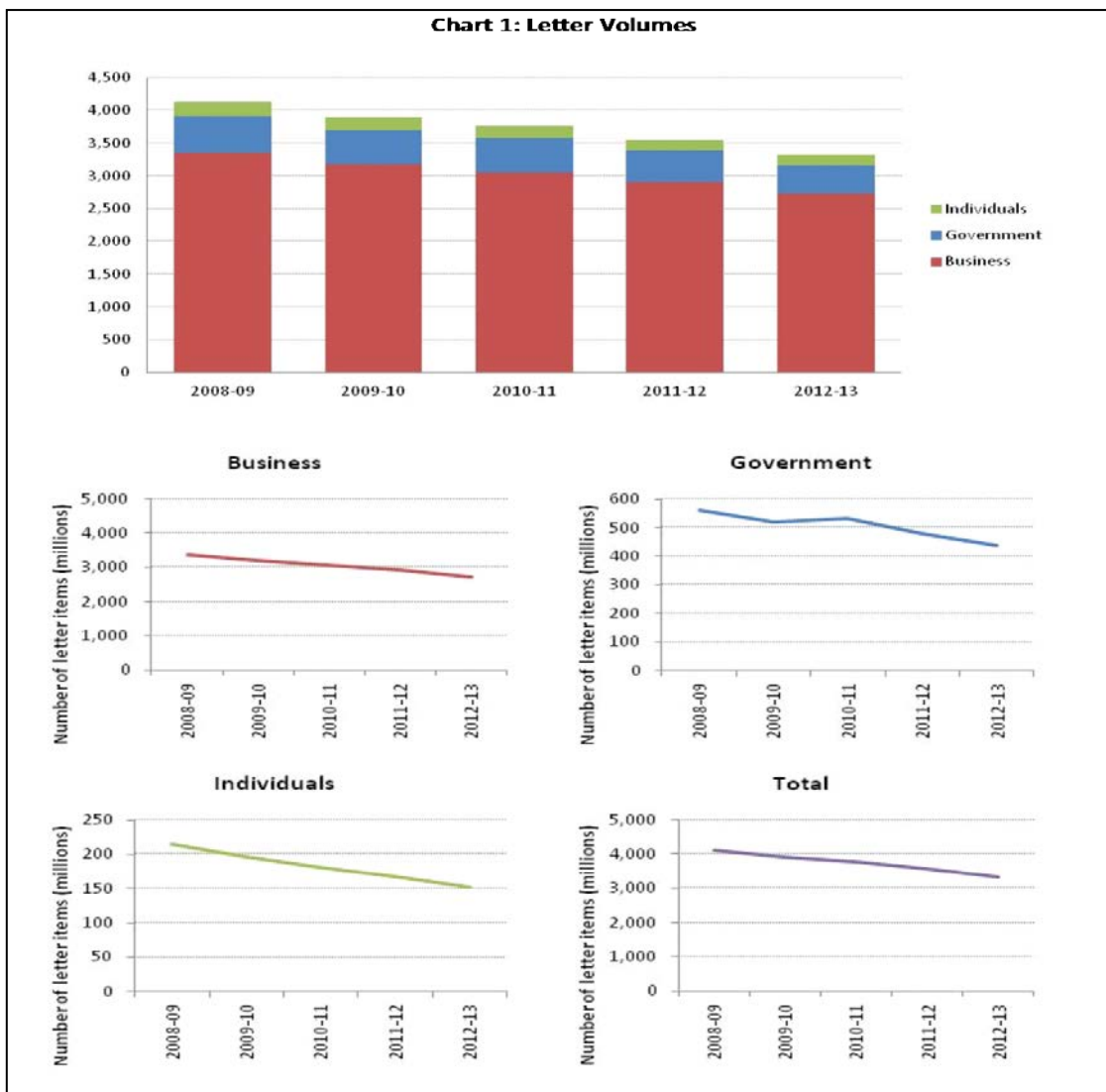


Table 1: Letter Volumes (million)	2008-09	2009-10	2010-11	2011-12	2012-13
Government	561.8	518.7	533.8	479.9	438.7
Business	3,353.2	3,184.4	3,045.1	2,909.5	2,733.0
Individuals	215.2	196.5	181.7	167.6	152.2
Total	4,130.2	3,899.6	3,760.7	3,557.1	3,323.9

Source: Australia Post

11. Letter volumes continued their steep declines in 2012-13, with addressed letter volume declines of 6.4%⁹, resulting in the monopoly letters business incurring a trading loss of \$147.4 million in 2012-13.¹⁰ Inclusion of regulated international mail increases this loss to \$218.4 million¹¹. Due to the strong performance of its parcels business, Australia Post

⁹ Australia Post Annual Report 2012-13, p. 5

¹⁰ Australia Post Annual Report 2012-13, p. 11

¹¹ Australia Post Annual Report 2012-13, p. 11

recorded an overall profit after tax in 2012-13 of \$311.9 million.¹² Australia Post’s profit after tax in 2007-08, prior to the GFC, change in policy to provide high speed broadband, and technological step change in mobile devices was \$432.2 million.¹³

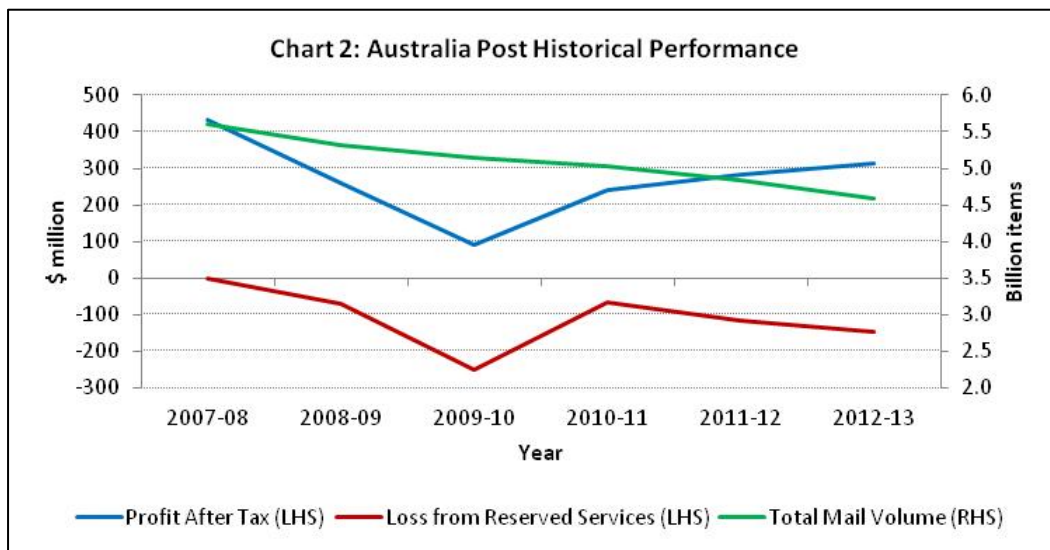
12. The revenue and profit contributions of Australia Post’s monopoly letter service and competitive businesses are detailed in Table 2 below.

Table 2 (\$million)	Reserved (Monopoly)	Unreserved (Competitive)
Revenue	1,716.5	4,158.3
Trading Profit/(Loss)	(147.4)	563.6

Source: Australia Post Annual Report 2012-13, p. 122

13. The majority of Australia Post’s revenue and all of its profits are generated by the parts of the business operating in competitive markets. However, given the increasing losses in the letters business are forecast by Post to overwhelm any profits generated by the competitive business in the next few years, this cross subsidisation is not sustainable in the medium to longer term. Total Government equity in Australia Post at 30 June 2013 was approximately \$1.7 billion, down from \$2.8 billion at 30 June 2008.¹⁴ Further significant declines are anticipated for the outyears.

14. The trends in financial performance and letter volumes are summarised in Chart 2 below.



Source: Australia Post Annual Reports 2007-08 to 2012-13.¹⁵

15. Australia Post has advised that it will experience significant pressure on its profitability due to ongoing decline in letter volumes and it expects to make losses from 2015-16 onwards, with dividends to the Commonwealth being reduced to zero.¹⁶ It is possible

¹² Australia Post Annual Report 2012-13, p. 11

¹³ Australia Post Annual Report 2007-08

¹⁴ Balance Sheet Equity from Australia Post Annual Reports 2007-08 and 2012-13

¹⁵ The decrease in profit in 2009-10 (and improvement thereafter) is a result of \$150.2 million in restructuring costs being incurred in 2009-10. In the absence of these restructuring costs, the underlying negative trend in profitability within the letters business is in line with the negative trend in letter volumes. Total Mail Volumes were sourced from Australia Post Annual Reports (2007-08 to 2012-13) and include letters, parcels as well as other products such as Express Post, Print Post and international mail.

¹⁶ Based on financial forecasts provided by Australia Post, which have experienced some volatility in the past, reflecting the changing business environment.

that budget or equity support may be required to continue providing the same community service whose use by citizens is in significant decline – see paragraph 10.

AUSTRALIA POST'S RESPONSE

16. Australia Post's Future Ready¹⁷ program was initiated in 2010 in response to the challenges in its business environment. Under this program, Australia Post has undertaken a number of initiatives, including:
 - a. extracting costs from the letters business and modernising its network;
 - b. diversification of revenue streams, including into digital mail (including APDM) and financial and identity verification services; and
 - c. investment to capitalise on opportunities in its parcels business stemming from growth in eCommerce. Australia Post's acquisition of SecurePay¹⁸ in December 2011 and Qantas's 50% stake in Star Track¹⁹ in November 2012 formed part of this strategy.
17. These initiatives have assisted in ensuring Australia Post has been able to subsidise its declining letters business and maintain its financial position to date. However, the underlying deterioration of the letters business continues.
18. A significant level of capital for investment by Australia Post (and by default the Commonwealth Government) to acquire assets in fully contestable markets, would likely be required to generate sufficient revenue and profits to cross subsidise increasing losses in the letters business. Further, there are constraints in the *Australian Postal Corporation Act 1989* in relation to the scope of its incidental and ancillary functions which may limit further diversification initiatives in the absence of legislative reform. Accordingly, the scope for continuing to manage the decline of the letters business and Australia Post's longer term sustainability, without significant reform or policy intervention is limited. This gives rise to a number of public policy issues regarding the requirements of the CSO and the means by which it is delivered.

POLICY RESPONSES IN INTERNATIONAL JURISDICTIONS

19. Australia Post's experience of declining letter volumes is not unique in the international context. It is a global trend and a structural challenge facing many postal services (eg. Europe, the United Kingdom and North America). Driving the decline is technological change, with both businesses and consumers increasingly substituting digital communications for physical mail.
20. Policy responses employed by international jurisdictions to address challenges facing postal operators have generally comprised a combination of the following:
 - a. **Pricing flexibility** – in March 2012, a new regulatory regime for pricing was introduced for the Royal Mail in the United Kingdom.²⁰ Price control for first class stamps was removed and Royal Mail is able to flexibly set pricing for second class mail within a cap indexed at CPI. Finance considers that pricing reform alone would

¹⁷ <http://auspost.com.au/about-us/future-ready-business-renewal.html>

¹⁸ <http://auspost.com.au/about-us/australia-post-strengthens-ecommerce-presence.html>

¹⁹ <http://auspost.com.au/about-us/australia-post-finalises-startrack-acquisition.html>

²⁰ <http://www.royalmailgroup.com/regulation/regulatory-reform>

be insufficient to put Australia Post on a sustainable footing given the inevitability of letter volume declines.

- b. **Product diversification** – the majority of international postal operators, including Deutsche Post, Royal Mail and New Zealand Post, have pursued diversification agendas, including into financial services, parcels, logistics and retail businesses. As noted earlier, Australia Post is already well diversified into these market sectors, and its ability to further diversify is constrained by legislative impediments and would require significant additional capital funding.
- c. **Network changes** – a number of international postal operators have pursued modernisation of postal networks in order to support growth in parcel volumes and decreasing letter volumes. Canada Post is implementing a range of modernisation initiatives including a new delivery model involving integration of its parcel and letter delivery network.²¹ In October 2012, Australia Post announced a \$2 billion investment in its infrastructure, products and services with the aim of expanding the capacity of its parcels network²². We note that Australia Post’s letters and parcels networks are largely separate. Continued reform to drive network efficiencies does provide potential to reduce Australia Post’s cost base and assist in ensuring the business is more sustainable.
- d. **CSO changes** – overseas examples to amend service obligations are limited. However, in 2013 New Zealand Post announced changes to its services standards to apply after 30 June 2015.²³ Changes include: the introduction of a minimum three-day delivery to urban areas while maintaining five-day delivery in rural delivery areas; and permitting minimum points of presence to include self-service kiosks. Finance notes, in other contexts, reforms to community services have generally provided protections for special needs groups. For example, recent Australian reforms in relation to telecommunications universal service obligations associated with retiring legacy infrastructure (Telstra’s copper network) included provisions to ensure the most vulnerable members of the community retained access to basic telephone services.
- e. **Ownership** – Full or partial privatisation of postal services has occurred in Germany, Austria, the Netherlands, Belgium and most recently in the United Kingdom. Benefits of privatisation in these jurisdictions have included greater access to capital and increased flexibility to innovate, take on commercial risk and reform cost structures.

LICENSED POST OFFICES

21. Australia Post’s 2,895 licensed post offices account for two thirds of its retail network.²⁴ They may be run solely as a post office or in conjunction with another business, such as a newsagency, pharmacy or convenience store. The license to operate as a post office often brings increased foot traffic and supports the sale of other products and services offered by licensees.

²¹ <http://www.canadapost.ca/cpo/mc/aboutus/corporate/postaltransformation/news.jsf>

²² <http://auspost.com.au/about-us/australia-post-increases-profit.html>

²³ <http://www.beehive.govt.nz/release/update-new-zealand-post%E2%80%99s-deed-understanding>

²⁴ Australia Post Annual Report 2012-13, p.29. Total number of retail outlets was 4,429 across Australia.

22. Licensing arrangements include fee and commission based income for an agreed license fee. Income from commissions is variable, while the costs of maintaining their premises and infrastructure are typically largely fixed. The extent to which licensed post offices are being impacted by the overall losses stemming from letter volume declines in Australia Post's reserved business is unclear. However, noting the challenges referred to above regarding the sustainability of Australia Post's letters business, it is likely that licensed post offices are experiencing symptoms of these challenges.
23. The degree to which individual businesses have been impacted would vary and is dependent on the reliance on licensee income, the nature of each business, its cost structure, and the relative size of other revenue sources. It would also depend on the individual businesses' response to any declining revenue from declining letters. Finance has no visibility to offer a view as to the financial viability of these businesses.
24. Australia Post has, however, identified that on average ten to 15 licensed post offices are closed each year and 2.4% of its network have debt of greater than \$20,000 and are on payment plans to deal with their outstanding debt.²⁵
25. Noting that licence commissions are somewhat linked to the basic postage rate, it is Finance's view that changing these commission arrangements through increases to the basic postage rate is a short term solution given declining demand for letters. Australia Post's capacity to otherwise augment franchisee revenue streams is limited given financial pressures otherwise facing the business and would likely be inconsistent with its legislative requirement to act commercially.

²⁵ Environment and Communications Legislation Committee Senate Estimates Hearing, 19 November 2013. There are 71 licensed post offices (2.4%) that have a stock debt over \$20,000.