

POST

Cherry picking in liberalized postal markets

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New entrants in postal markets set up delivery networks by concentrating on urban areas and large business customers. They operate their network highly centralized, at least in the first phase of entry.

The postal sector is not entirely different from other network industries, except for the lack of a physically installed infrastructure while postal networks are rather virtual. The postal network is very labor intensive and not subject to high investments or sunk costs. The operating costs are rather scalable variable costs, such as labor costs, or disposable assets, for example, vehicles or immovables (knieps 2007). Therefore the labor intensive sub-process of delivery represents approximately 55 percent of the costs of mail conveyance (Nera 2004). Thus the postal monopoly is a contestable monopoly and was successfully attacked in partly liberalized postal markets notably Sweden, Finland, Germany, the UK and the Netherlands. Nevertheless, physical postal products are not only subject to competition by new entrants but also to potential substitutions through intermodal competition like electronic communication and media.

The universal service obligation in postal markets

Universal service obligations usually require firms to provide certain services that they otherwise would not supply. In general the universal service is defined from an individual consumer's perspective: It is a service or product to which a consumer is entitled no matter where he/she lives; that is, in terms of access to the service, quality and affordability. The traditional definition of the universal service in the postal sector implies ubiquitous delivery at a uniform price at least for letter mail but in many cases also parcels. Because of the characteristics of their networks, providers of postal universal services can even be obliged to provide services that go beyond postal services. These can include public missions like the nationwide delivery of daily newspapers before a specific hour or to provide financial services. Especially customers in non-densely populated and non-central areas are less attractive from a supplier's point of view, and less likely to receive attractive competing offers. Second, they are also the most vulnerable to price increases. Therefore, the provision of universal services and its financing in the future with respect to

public interests are related to two important issues: The provision of postal services to all customers / citizens and to provide the universal services at affordable prices

The universal service was originally financed by the reserved area. But, markets are nowadays expected to be more and more liberalized and to avoid monopolistic market structures. Under a reserved area the rural areas are cross subsidized by urban areas. Furthermore, in contrast to other network industries the receivers do not pay for the services they consume. Mail to rural areas is not only subsidized by urban areas, but also by large business customers with high volumes. These volumes are mostly pre-sorted and centrally collected. As a result the uniform prices of postal items for private customers do not necessarily reflect the actual cost of delivery. Price Waterhouse Coopers (2006) states that this is the source of 'obligation' in the discussion about universal services which leads to a number of problems. In liberalized markets this type of cross-subsidization as a general way of funding universal services is no longer feasible. Because there is no reserved area and bulk-mail is excluded from universal services. The customers who have large volumes of mail sent to low-cost areas will be most attractive to entrants. New competitors that are not expected to provide full universal services would penetrate on the more profitable segments in which incumbents still offer higher prices to cross-subsidize the non-profitable segments which they are obliged to serve. At worst, the funding of universal services is no longer guaranteed. Therefore the operators that fulfill the obligation must at least be compensated for the cost of the universal service otherwise they might be economically forced to set higher uniform tariffs to compensate market share losses in rural areas. Hence the centralized ex-ante regulation of postal universal services and the monitoring of its development is a means to ensure the provision to all customers at affordable prices—no matter which financing mechanism is chosen and how competition evolves (Oxera 2006).

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Market entry strategies and competition

Dietl and Waller (2002) identify several potential business models for new entrants: local mail services, networked local mail services, document exchange, mass mail provider, spot operator, consolidator, the provision and the national full service provider. Additionally, de Bas and van der Lijn describe the niche provider as a further entry model. Market entrants can be former customers of postal operators, for example like publishers or letter shops, existing local networks for unaddressed mail, incumbent postal operators from abroad or completely new players. Next, we describe different market entry strategies and the development of competition in fully or partly liberalized European postal markets (Ecorys 2008)

The Swedish postal market has been fully liberalized since 1993. In the following, the legislation rather focused on the provision of the universal service and quality matters than on the introduction of competition. Sweden consequently changed the 'paradigm' and became more supportive of competition in the postal sector in the late nineties. The competition emerged very slowly and there is only one established competitor in the Swedish postal market. The company which today is called Bring Citymail, and owned by the Norwegian Post, was founded in 1991 as Citymail. The entire business model concentrated on industrial pre-sorted sendings and bulk mail in Sweden's largest cities—like Stockholm, Malmö and Gotheburg—and its suburban areas. With this model Citymail covered approximately 40 percent of the Swedish area in 2008. The delivery staff is paid by delivered item. Citymail's business model is rather centralized. It strongly focuses on cities and excludes daily delivery. Investments through the option lens

The Dutch postal market has been fully liberalized since the spring of 2009. The competition has seen a strong increase in recent years. It intensified due to the market entrance of the two carriers Sandd and Selekt Mail after 2000; Selekt Mail being a joint venture of Deutsche Post DHL and the publishing group Wegener. The two entrants built their business model in a promising niche: in the market for low cost and low speed mail mainly targeted to B2B (Business to business) and B2C (business to customer) markets. The original business model focused on a delivery frequency of two times per week. It relied on pre-sorted volumes of the customers and the use of flexible labor force. The mailmen are predominately freelancers without a labor contract and paid per delivered item or address. In the end of 2007 the network of deliverers consisted predominately of housewives (37 percent), students (22 percent) and retired people (11 percent). An interesting finding is that at least three percent of the deliverers also work for other delivery services. Main clients are large

mailers, as for example financial service providers, telecom operators, publishers, charity organizations etc., . In the beginning both operators operated a hybrid model of delivery. During the development phase they built up their own networks and cooperated with a number of small local mail service providers. Sandd reached a full coverage of the Dutch area in 2006. The cumulated market shares of the two carriers have risen from 0.03 percent in 2000 up to 13 percent in the addressed mail segment and a 25 percent share in the liberalized segment in 2008.

The development of the competition and the duplication of postal networks at the same time is partly related to TNT's access policy. Since TNT was not offering attractive conditions to the existing postal network, the main competitors set up their own nationwide networks. An important issue concerning the completion and the emergence of three rather decentralized postal networks are the geographical characteristics of the Netherlands: a high population density in line with a high degree of urbanization. Therefore the competitors do challenge cherry picking. Instead of attacking large volume customers and deliver just in urban areas, they provide nationwide services for those large clients. Furthermore, the possibility to use part-time freelancers in combination with low-speed mail and new sorting techniques enabled them to compete against TNT on pricing as well as product differentiation. TNT reacted with similar low cost respectively low speed mail services.

The Swiss postal market is only partly liberalized and there is a reserved area for letters up to 50 grams. Nevertheless, a first competitor named Quickmail entered the letter market targeting specifically addressed mail heavier than 50 grams, catalogues and customer magazines. Business customers hand in their mail items on Mondays and Tuesdays, the volumes are sorted in a single sorting center in the east of Switzerland on Tuesday and Wednesday. The delivery is carried out on Thursday and Friday. In January 2010 Quickmail covered 6.3 percent of Swiss households. Quickmail plans to expand its network up to thirty percent of households by the end of 2010 and up to eighty five percent by the end of 2011. In the early entrance phases Quickmail centralizes its operations and delivers in three cantons only.

The concessioned area—where no free market was applied—in Germany has been gradually reduced and full market opening was realized in 2008. The dominant operator Deutsche Post is obliged to provide access to its postal infrastructure. One of the largest competitors of Deutsche Post is the Dutch incumbent TNT. In 2000, TNT and the Hermes Logistik group founded EP Europost which was lately renamed in TNT Post AG. The strategy was to proceed ten percent of addressed mail in Germany by con-

centrating on B2C and B2B mail volumes. The interesting point in TNT's entry model is that the company predominantly provides centralized services like sorting and transportation as well as support functions while two third of the collection and the delivery is mainly delegated to different local and regional postal operators. By means of the cooperation with their partner networks TNT covers 90 percent of German households without operating its own nationwide delivery network. TNT's business model in Germany is a mix of centralized and decentralized elements in a sense that TNT has its own delivery networks only in rural areas. Furthermore TNT provides the central process step sorting before handing over to their partners which provide decentralized parts of postal services.

Conclusions

An important regulatory issue concerning the development of end-to-end competition is the chosen access regime to the existing infrastructure. The possibility to have access to the established postal network facilitates market entrance for potential new competitors. From an incumbent's perspective negotiated access could bring advantages as well as drawbacks: individual parts of the infrastructure or processes could be better challenged but it could also result in higher likelihood of cherry picking by entrants.

The examples given above show that new entrants chose centralized entry models to enter postal markets. Although the new entrants chose different strategies and business models to compete against incumbents, they were similar in that they all differ from the model of the origi-

nal national postal operator. They either chose a special type of customer, a single area, densely populated region or a combination of these three conditions. Hardly a single competitor entered the postal market with full or nationwide coverage, resulting in the fact that the size of their own operated networks is substantially smaller than the network of the incumbents.

As mentioned above, new entrants in postal markets usually set up their delivery network by concentrating on the delivery in cities and urban areas and/or business customers with large sending volumes. This implies that they operate their networks highly centralized—at least in the early phases of entry into the market. ★

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