MAIN DEVELOPMENTS IN THE POSTAL SECTOR 2013-2016

Preliminary findings

Prepared for the European Commission
7 March 2018
Brussels

Summary info on our background

Copenhagen Economics

- Offices in Brussels, Copenhagen and Stockholm
- 70+ economists

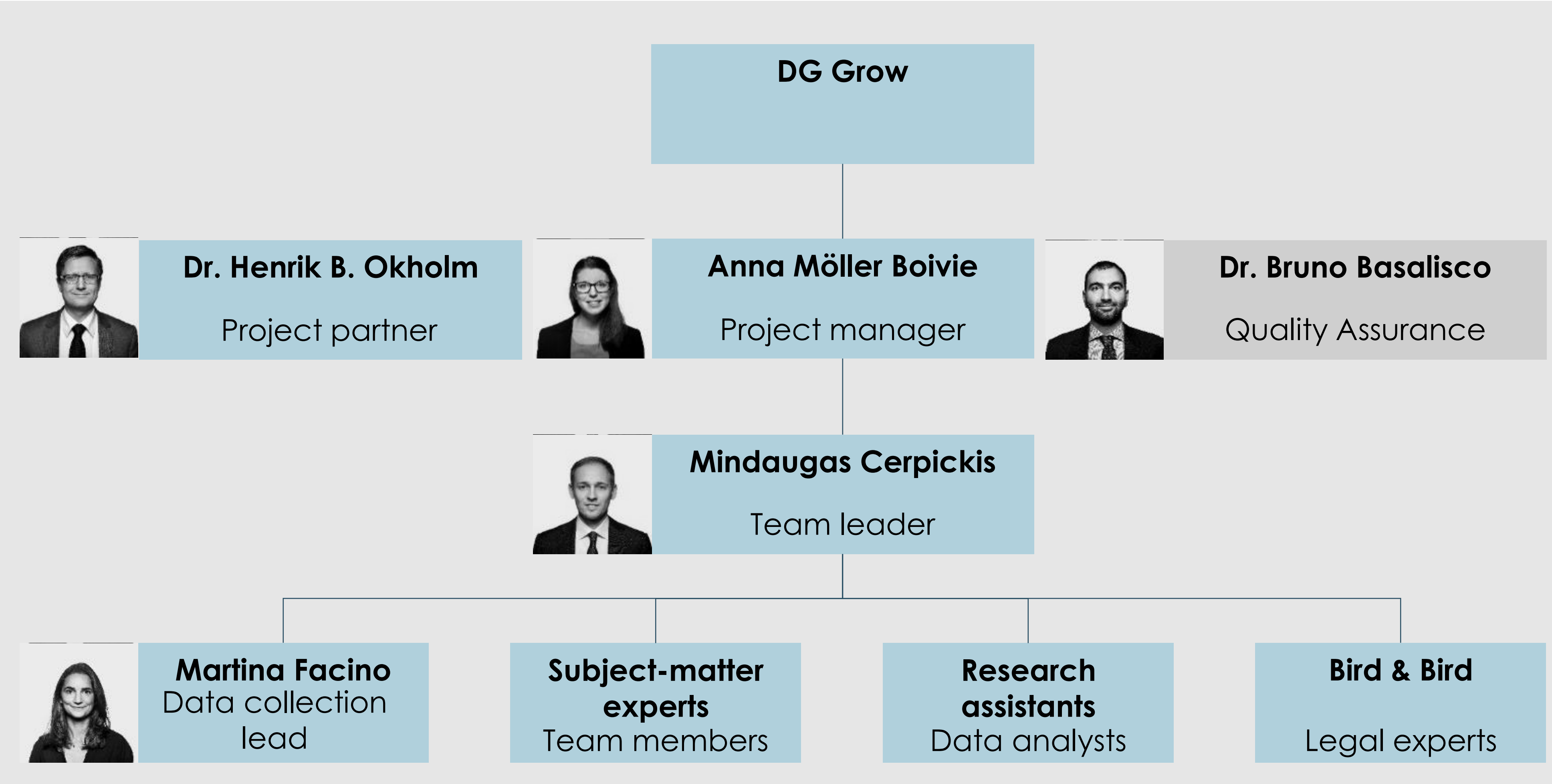
Postal sector experience

- 3 studies for the European Commission
- Calculation of USO net costs
- Terminal dues
- Tariff regulation
- Cost allocation and pricing
- Scope of USO
- Access regulation
- Antitrust and regulatory cases in multiple countries

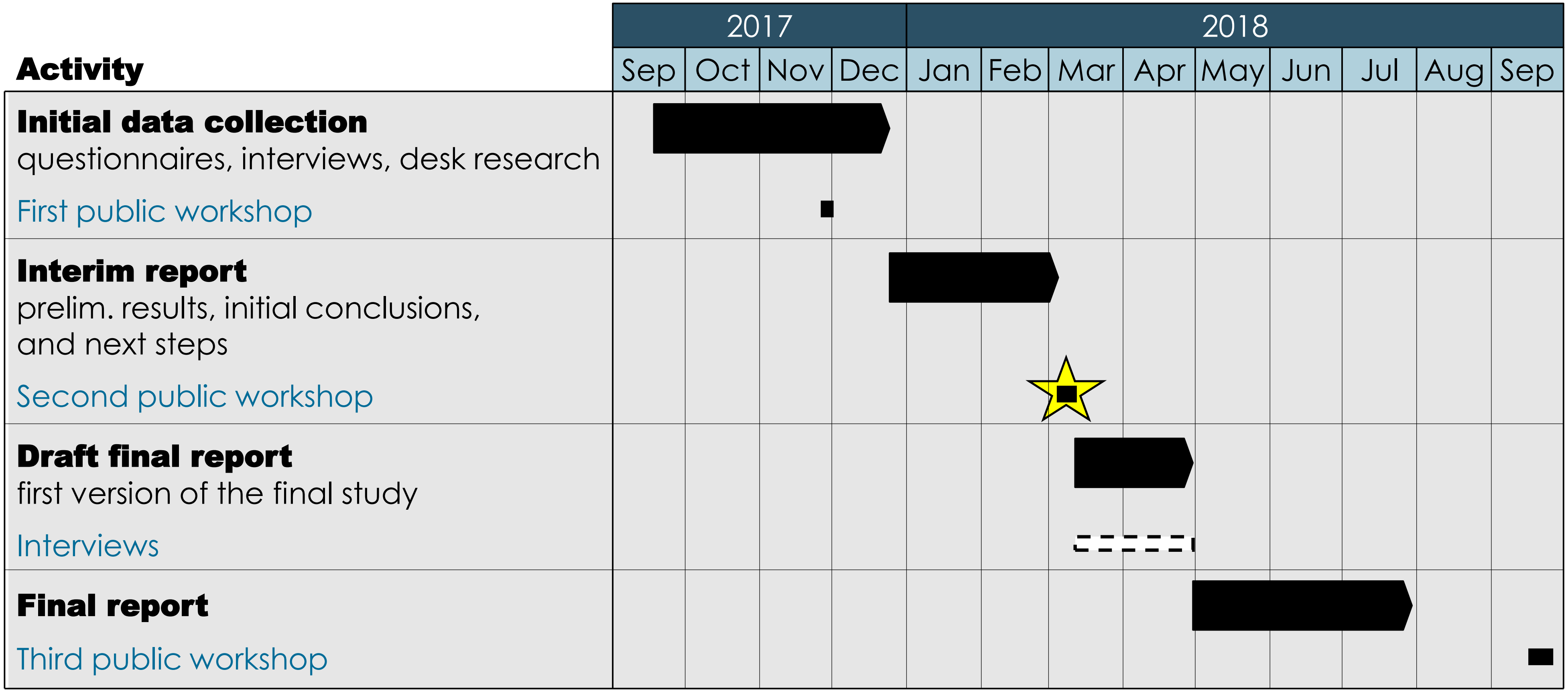
Data-intensive projects

- E-commerce and Delivery (2012)
- Pricing behaviour of postal operators (2011)
- Terminal dues study for the US PRC (2014-15) and other studies

The project team



Project timeline



PART 1

Structural letter volume decline

10:30-11:20

Q&A

11:20-11:40

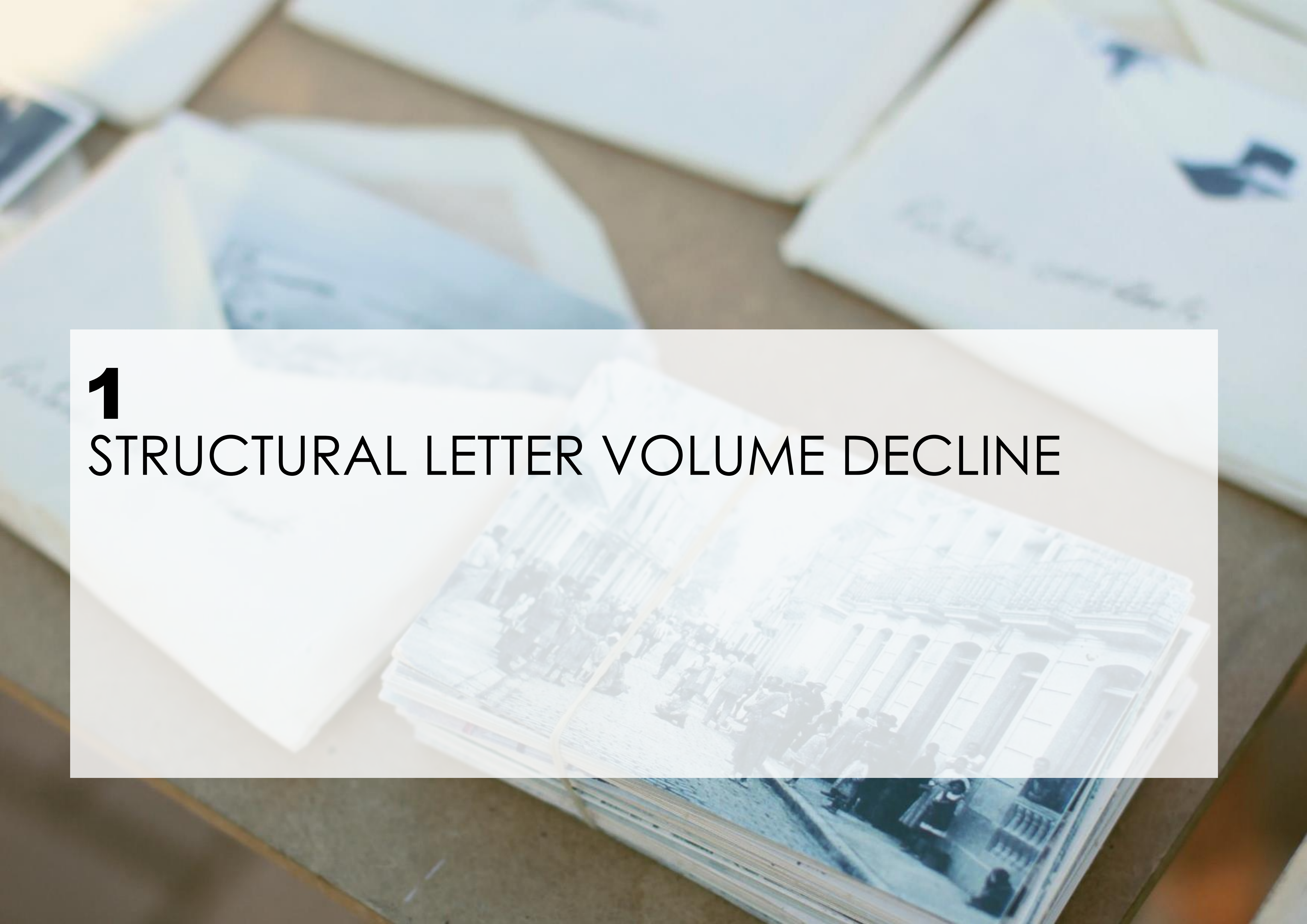
PART 2

Growing volumes of e-commerce packets and parcels

11:40-12:10

Q&A

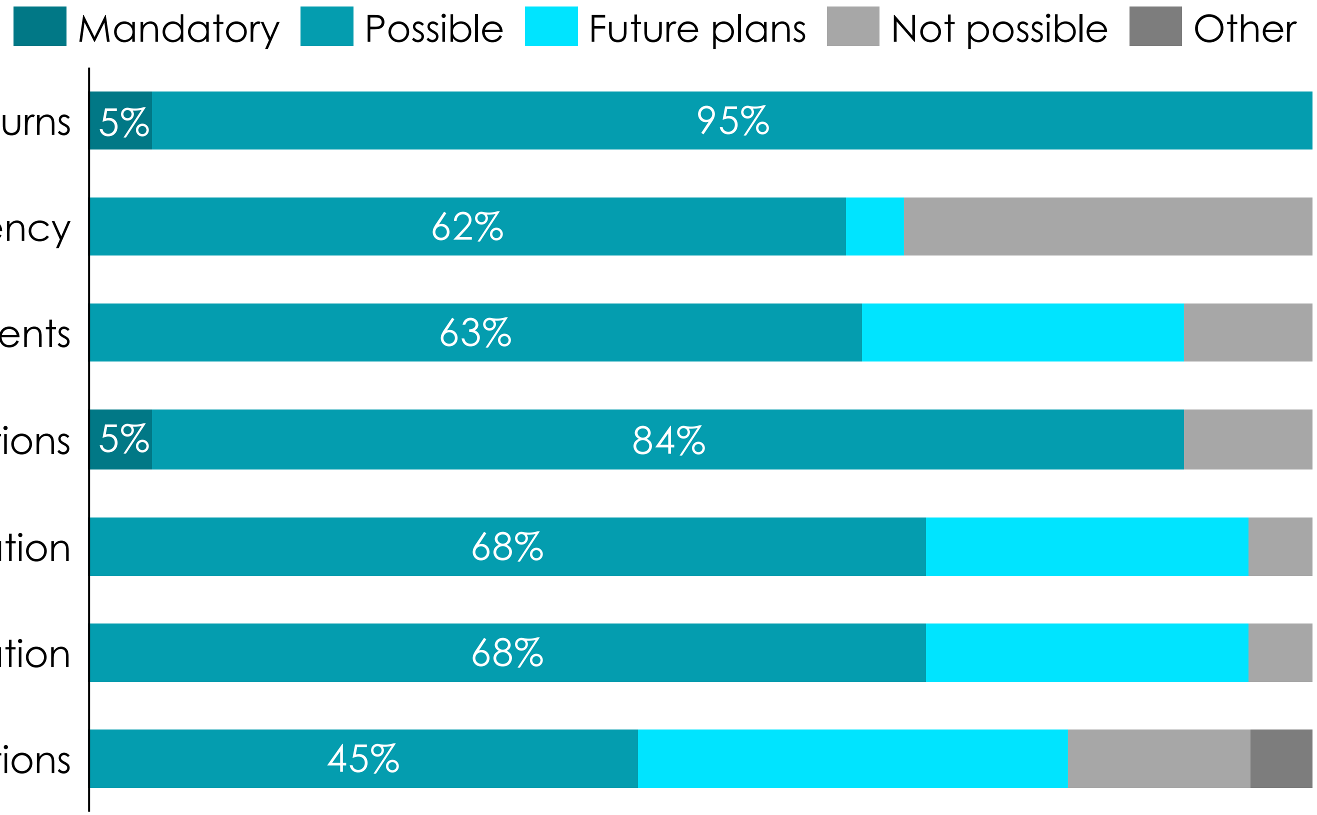
12:10-12:30



1
STRUCTURAL LETTER VOLUME DECLINE

Many types of communication that were traditionally based on letter post have been digitalised

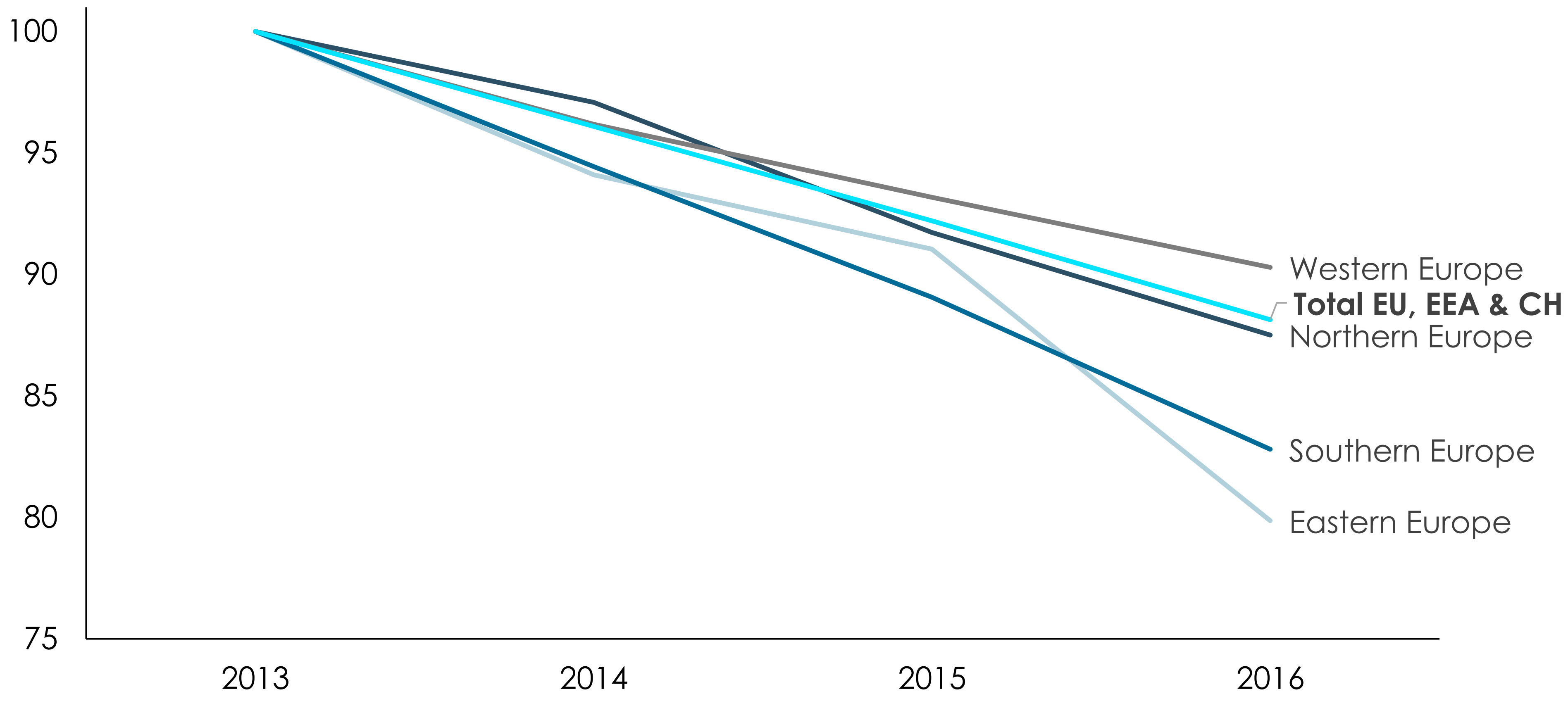
Electronic communication with public institutions, 2016
Share of countries (21 countries)



Source: Questionnaire to USPs.

As a result, domestic letter volumes dropped by more than 10% since 2013

Development of domestic letter post volume
Index, 2013 = 100 (29 countries)

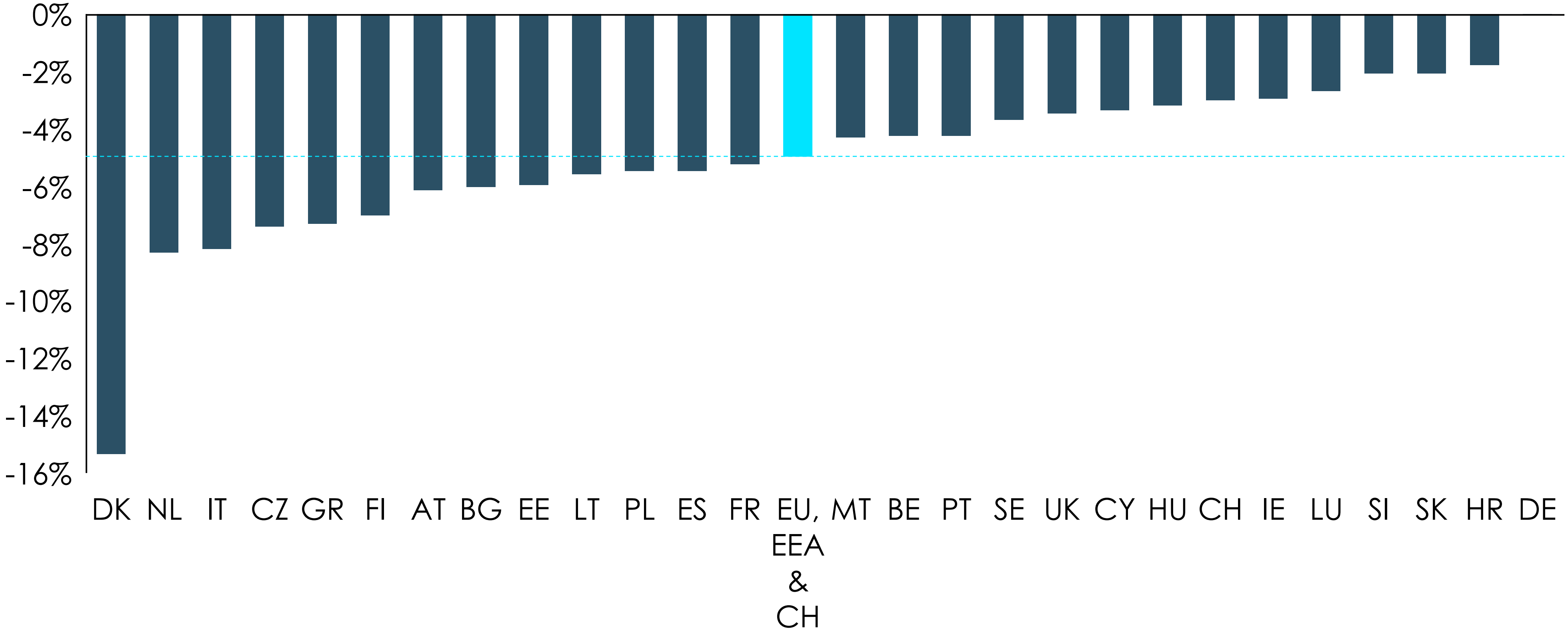


Source: Questionnaire to NRAs.

Denmark, Netherlands and Italy have experienced the highest rate of letter volume decline

Development of domestic letter post volume by country

Annual change in the 2013-2016 period

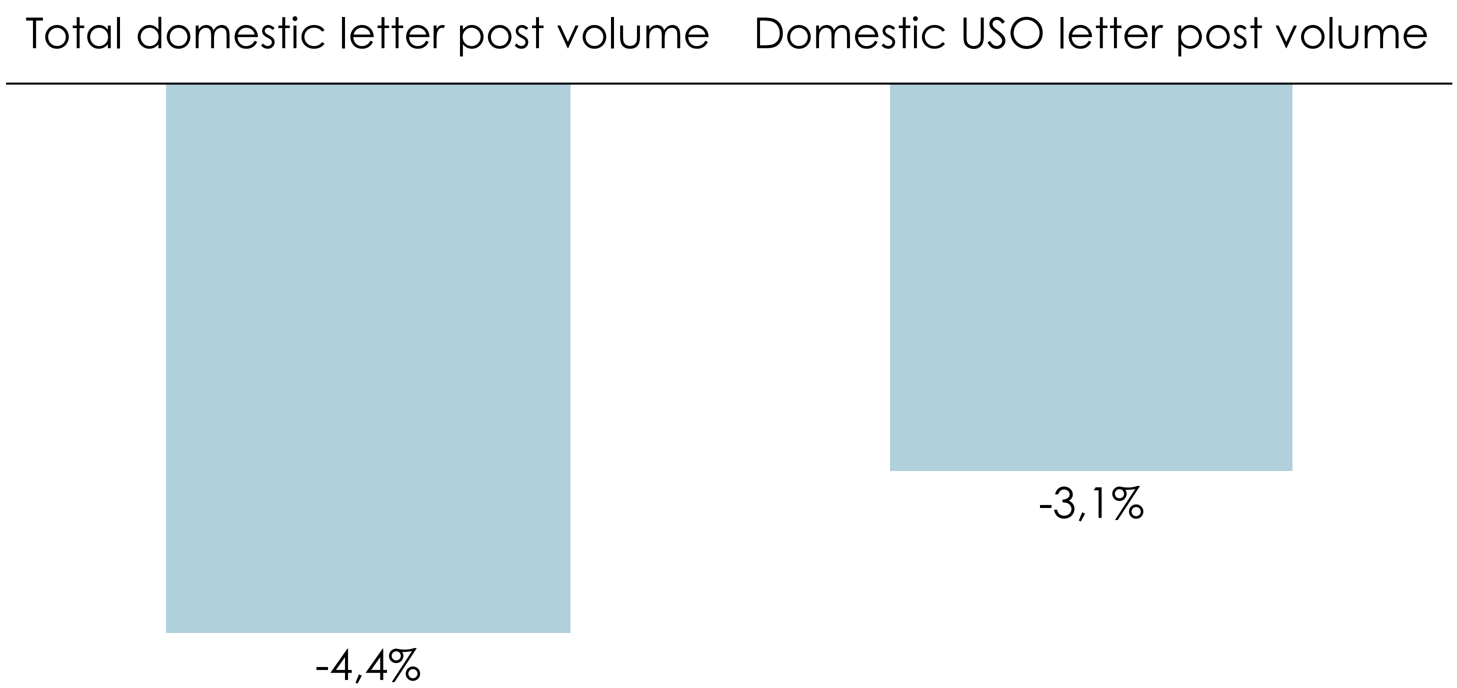


Source: Questionnaire to NRAs, USPs annual reports

Letter post volumes are declining faster for non-USO letter services

Development of domestic letter post volumes in EU, EEA & CH

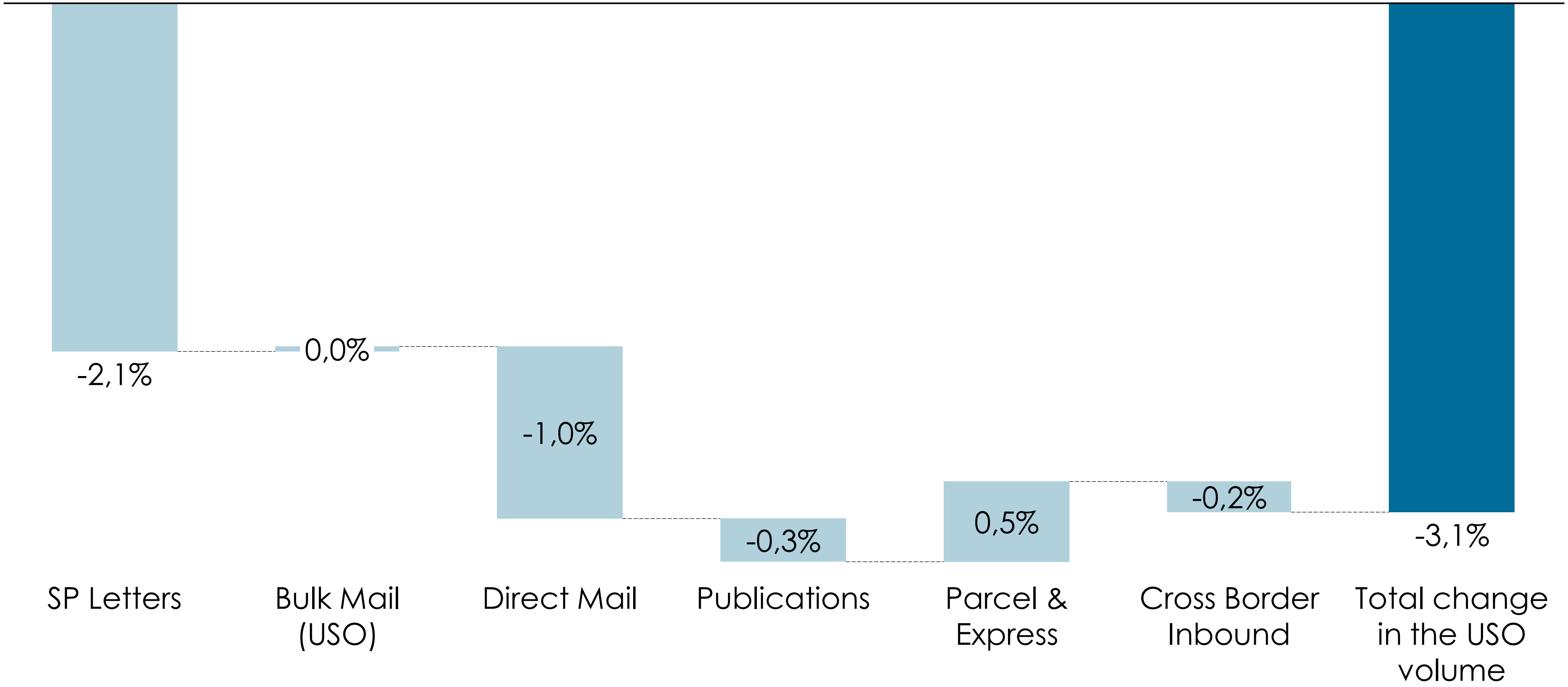
Percent change in volumes 2015-2016



Source: Questionnaire to USPs and NRAs.

In 2015-2016, the decline in universal services was primarily driven by declining single piece letter volumes

Development of universal service volumes, 2015-2016
Percent change in volumes 2015-2016

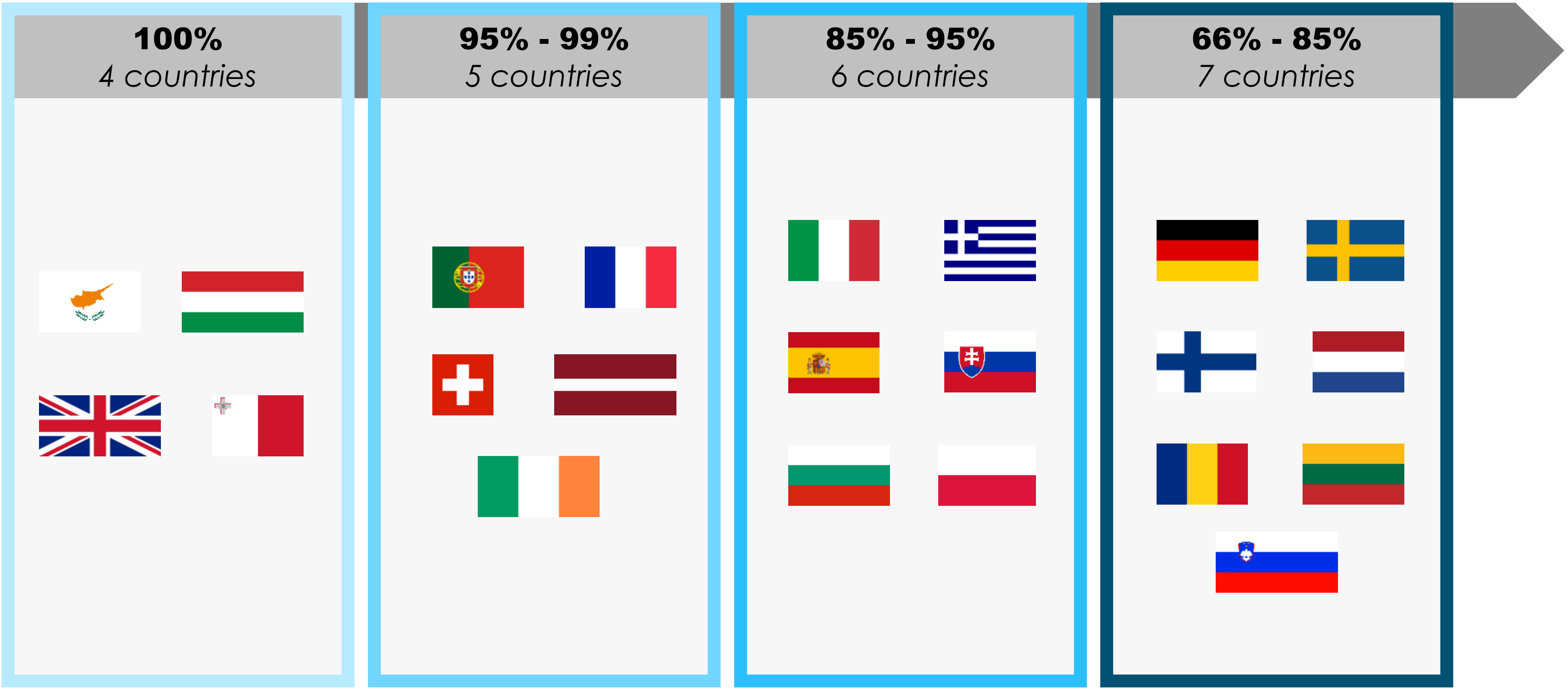


Source: Questionnaire to USPs and NRAs.

In the declining letter post market, competition is still highly concentrated…

Market share of the incumbent in the addressed letter market

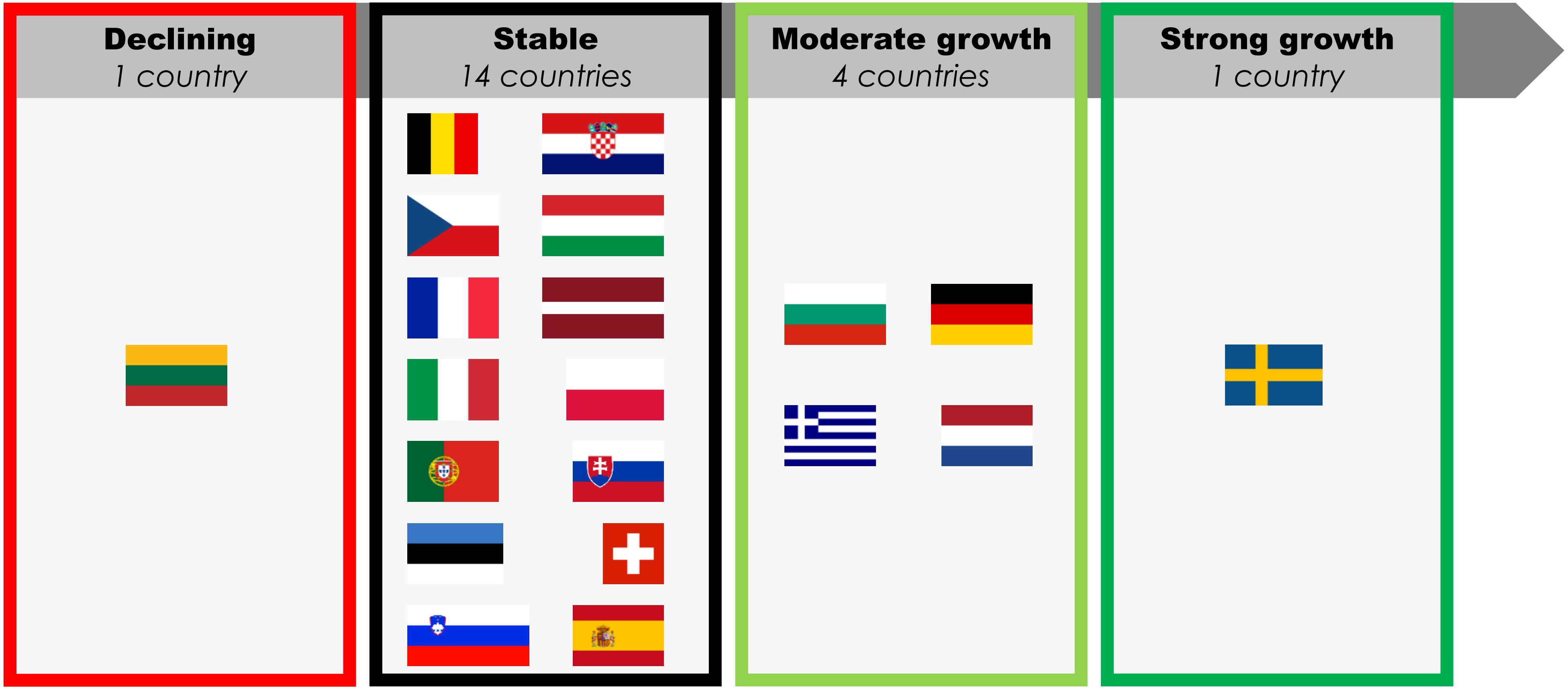
Market share based on volumes, 2016



Source: Questionnaire to NRAs, public sources.

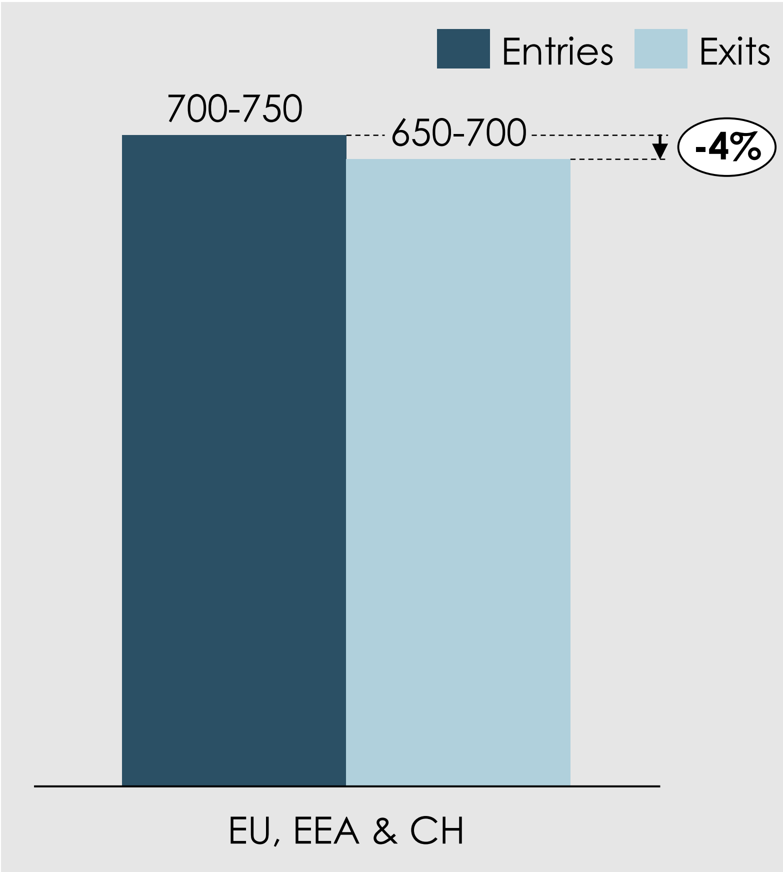
...and competition is not developing

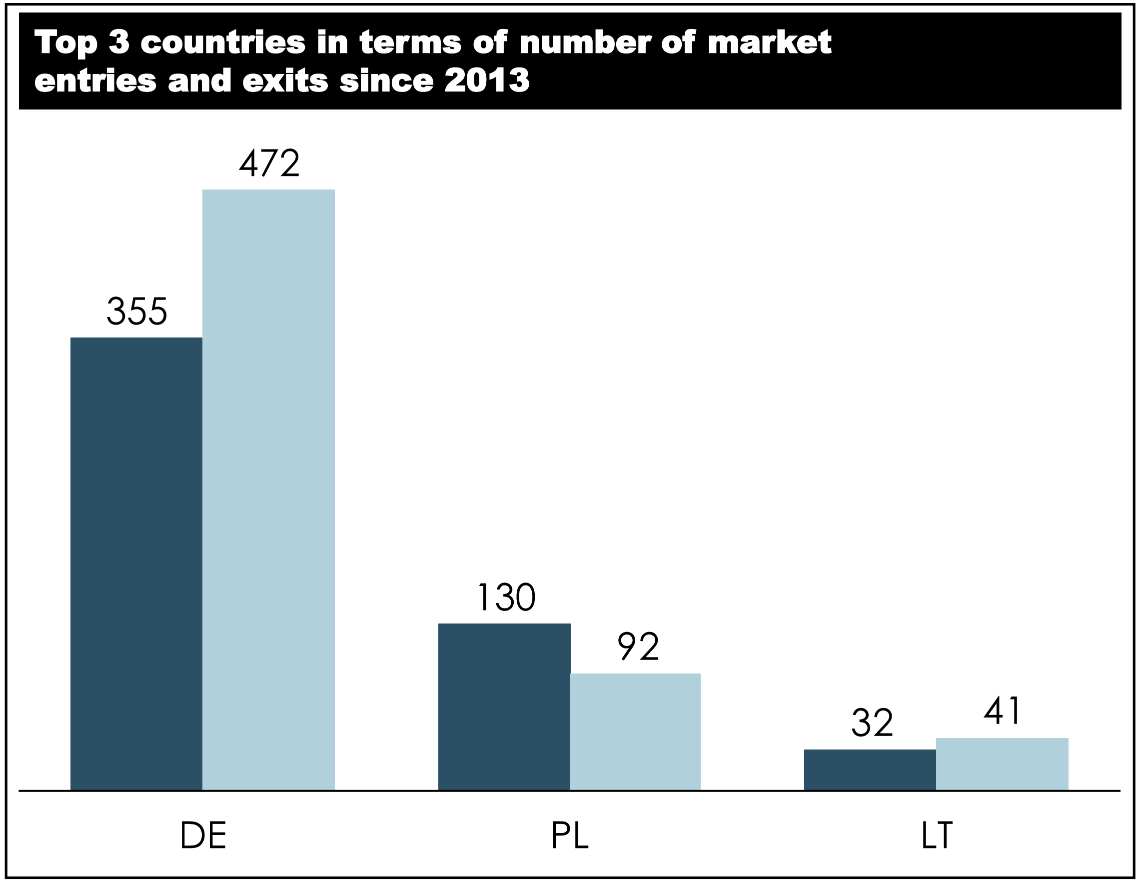
Evolution of the 3 main competitors' market share in the letter segment



On the other hand, barriers to entry appear to be low

Market entries and exits in the letter segment since 2013
Number of entries and exits





Source: Questionnaire to NRAs.

USPs and policymakers are searching for the appropriate reaction to market developments

Increased revenues

- USPs diversify revenue streams
- Governments financially compensate the designated operator for the increasing net cost of the USO
- Governments procure services of general economic interest

Reduced costs

- USPs reduce their operational costs
- Ministries and NRAs adapt regulations and USO

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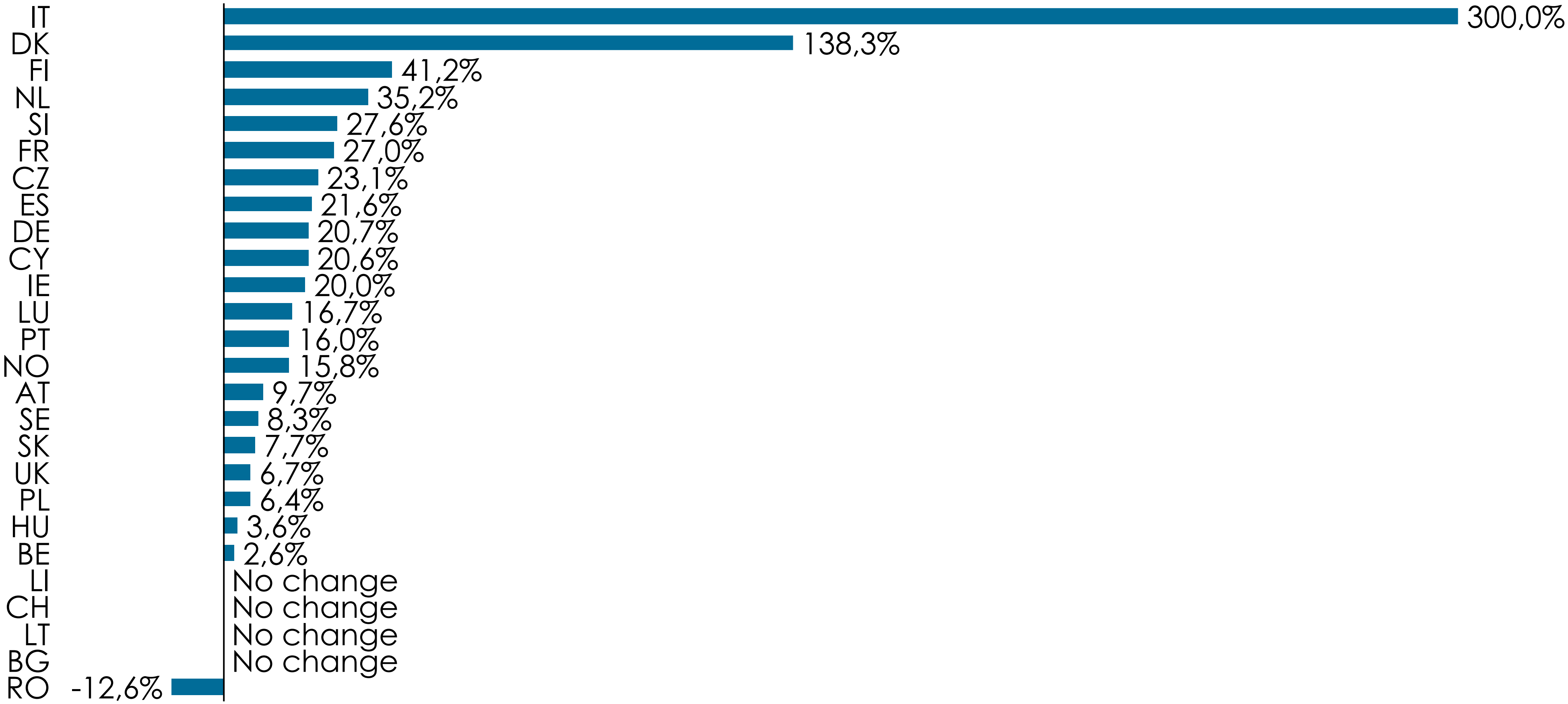
Single piece letter post prices have increased by up to 300%

Price change for 20g single piece FSC domestic letter, 2013-2016

% change 2013-2016

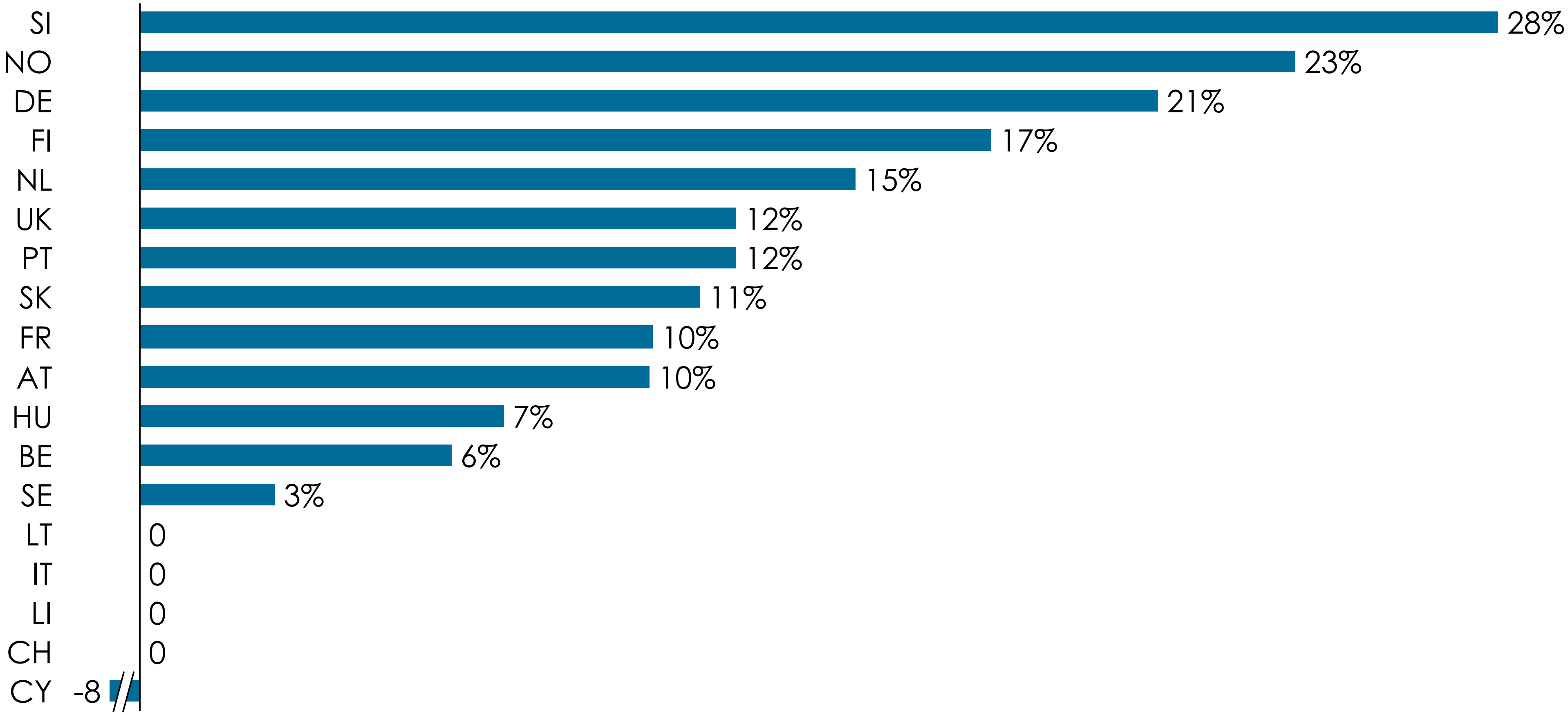


Source: Questionnaire to USPs.

Bulk mail prices have increased by up to 28%

Price change for 20g bulk mail letter, 2013-2016

% change 2013-2016

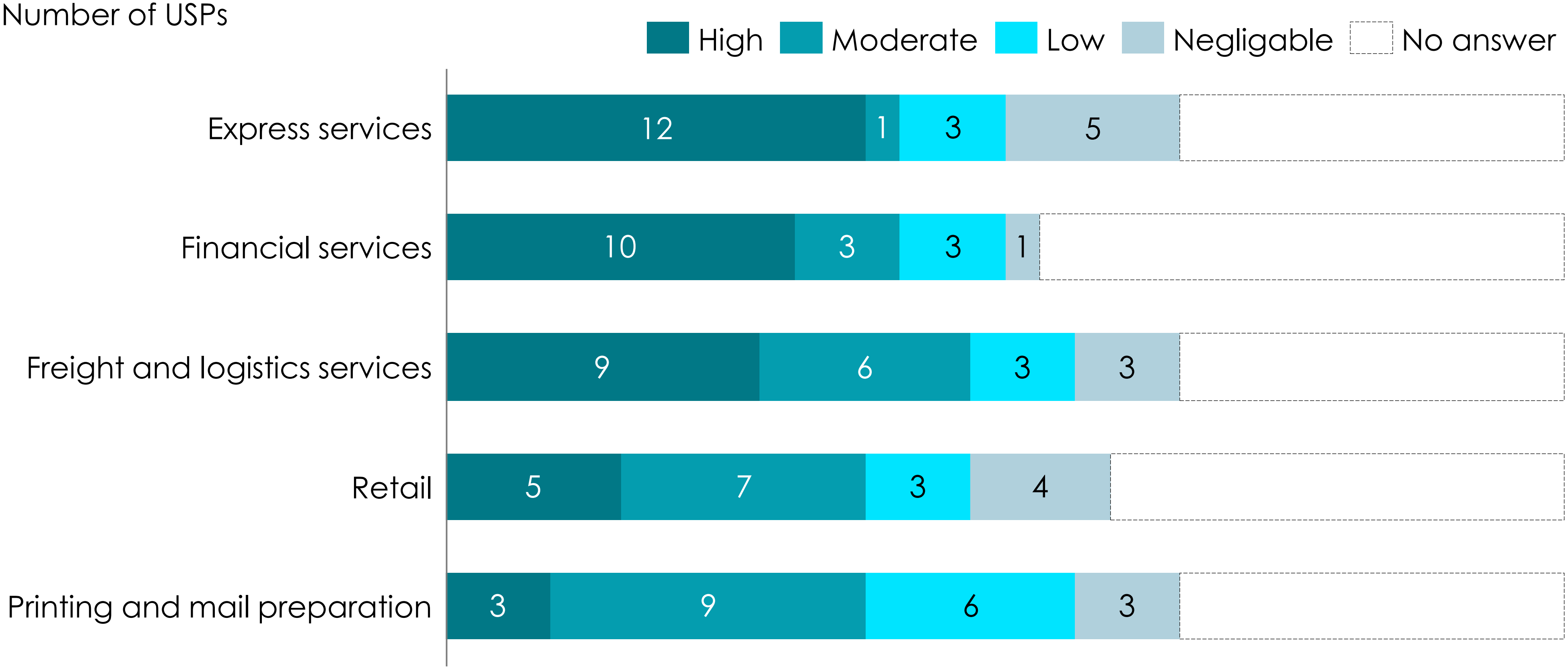


Source: Questionnaire to USPs.

Express, financial, and freight & logistics services are key to the future sustain-ability of the USO

Number of USPs identifying an adjacent service important to the future sustainability of the USO

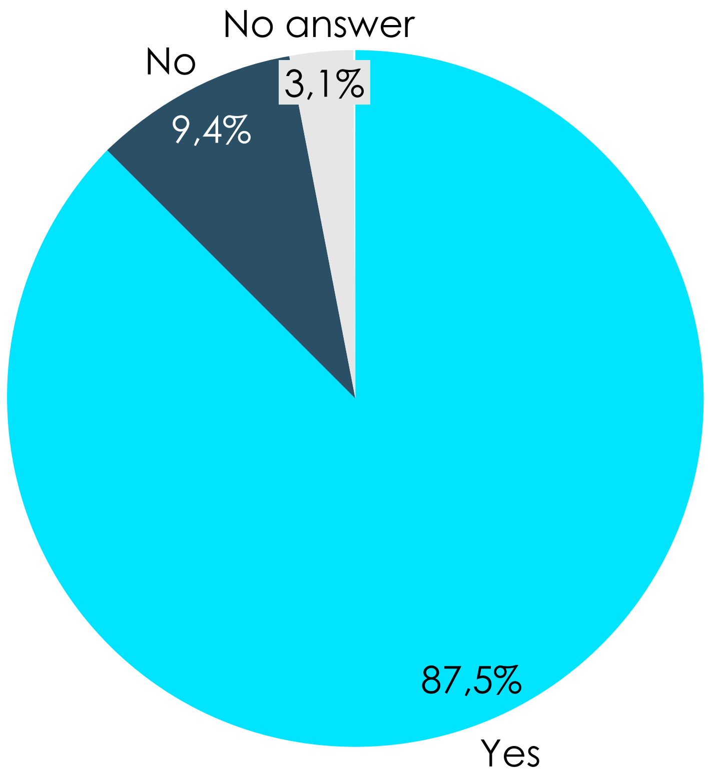
Number of USPs



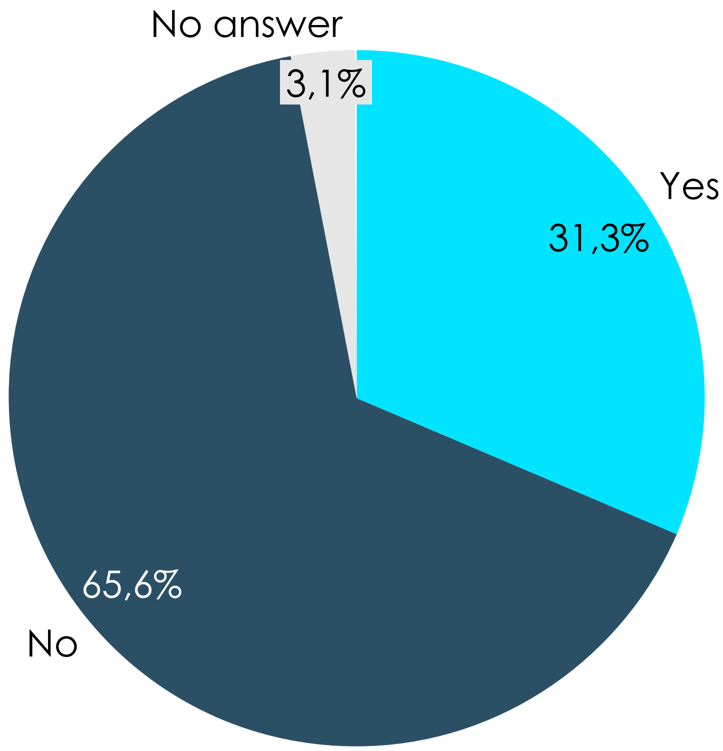
Source: Questionnaire to USPs.

Many countries authorize different forms of compensation by law, but rarely establish them in practice

Is some type of compensation authorized by law?



Is that type of compensation established in practice?



Source: Questionnaire to NRAs.

Services of general economic interest are an important source of funding/ economies of scope for some USPs

- Distribution of press
- Retail banking services
- Social services
- Electoral services
- Other services, e.g. energy renovation, recycling

USPs and policymakers are searching for the appropriate reaction to market developments

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- Governments procure services of general economic interest

Reduced costs

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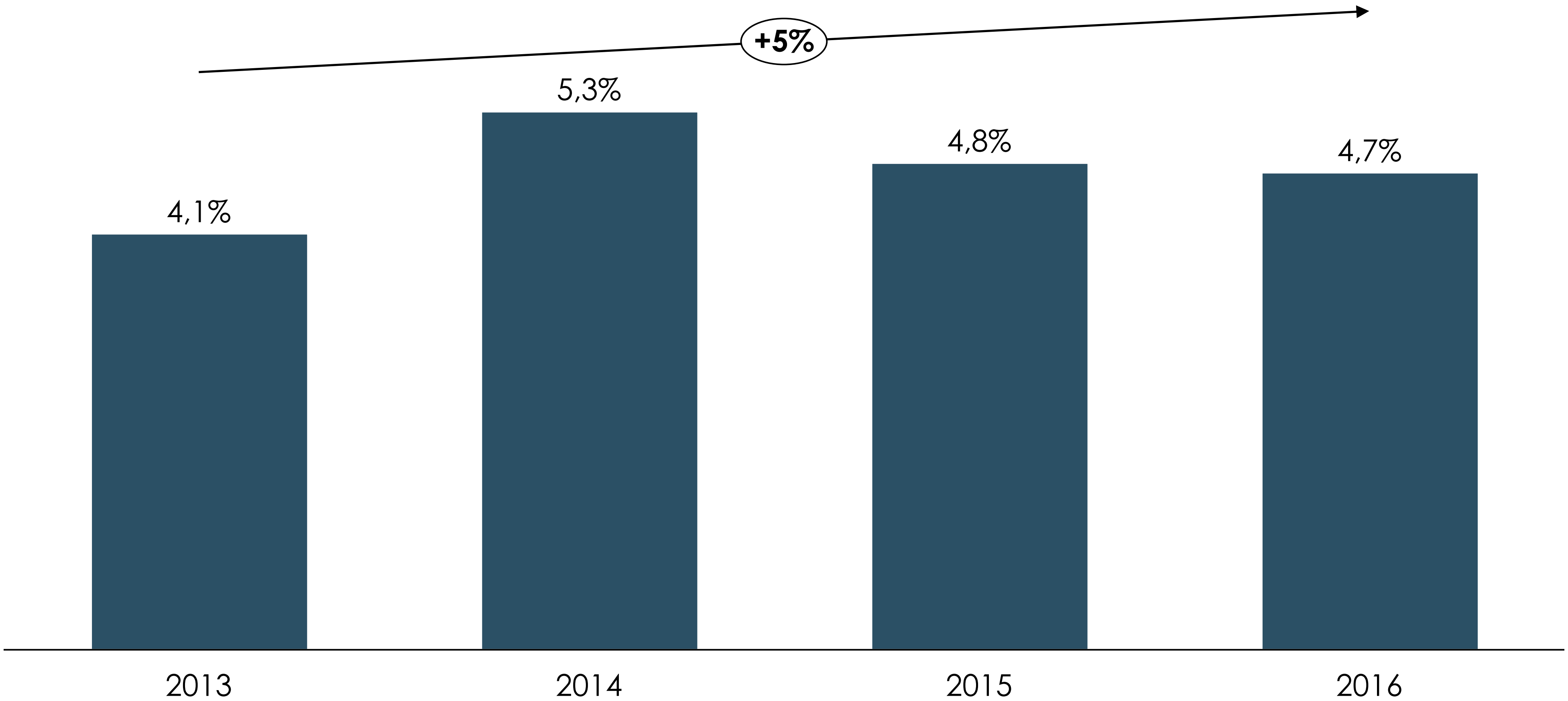
- Ministries and NRAs adapt regulations and USO

Despite falling revenues in the letter post segment, USPs maintained profitability relatively stable at 4-5%

Development of USPs' profitability in the EU, EEA & CH area, 2013-2016

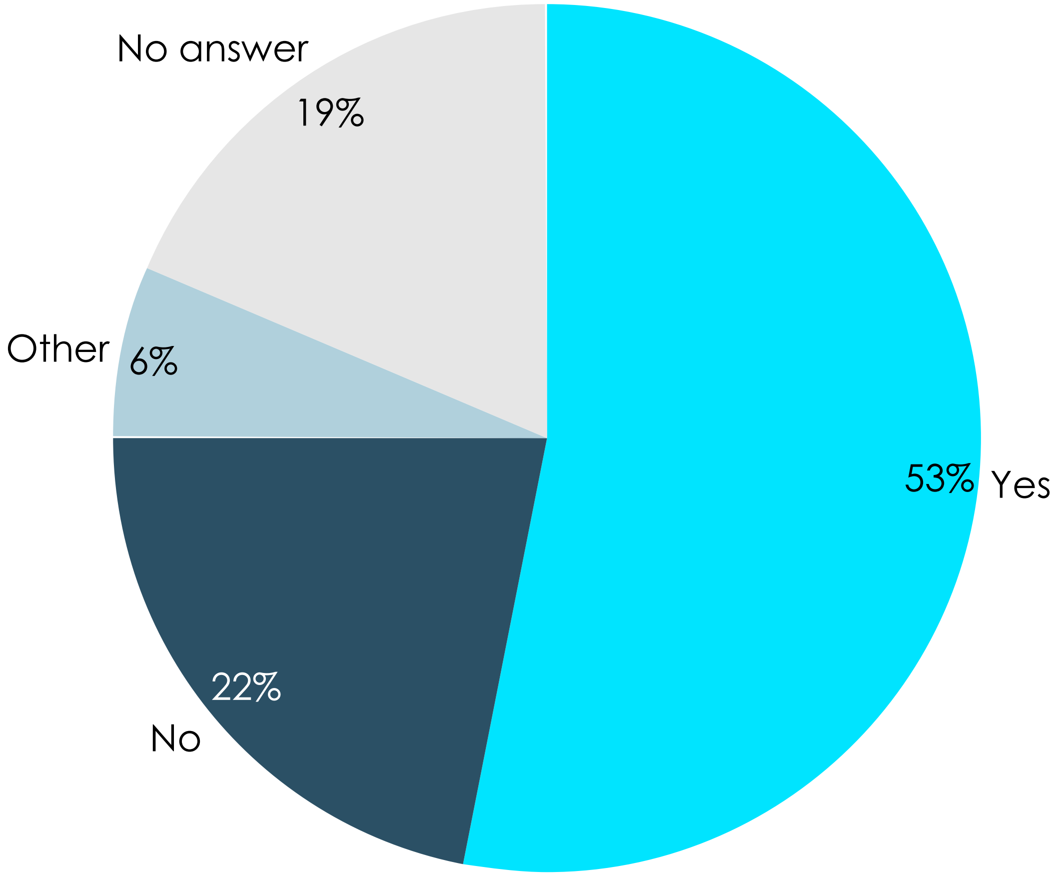
Average EBIT %



Source: UPU database, USPs' annual reports.

As a response to rising delivery costs, postal operators employ new operational models

Have you carried out a major reorganization of your logistics network?

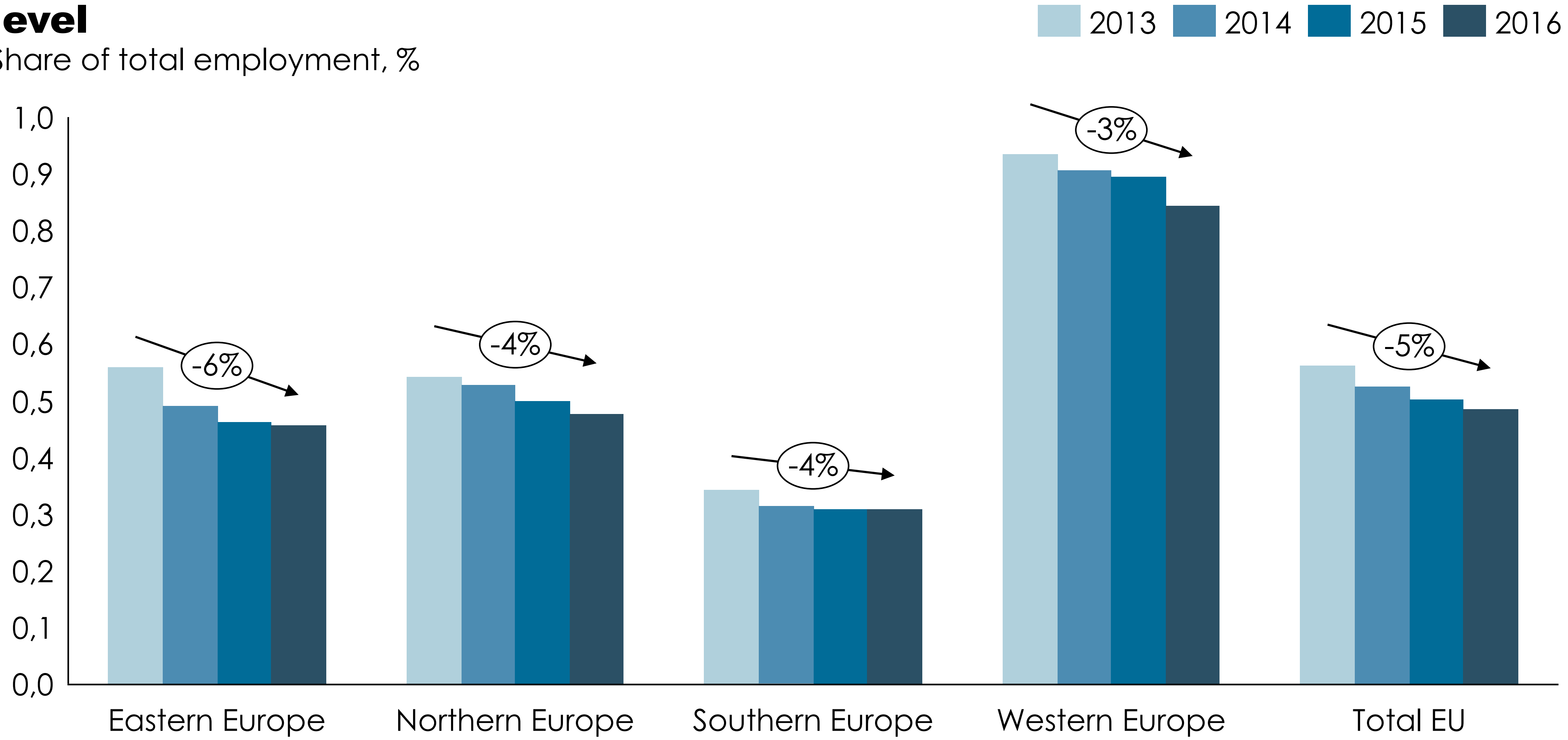


Source: Questionnaire to USPs.

USPs’ share of total employment has declined across all European regions

Contribution of USP employment to the overall employment at European-level

Share of total employment, %



Source: Eurostat

USPs are outsourcing the outlet part of their business to cut costs

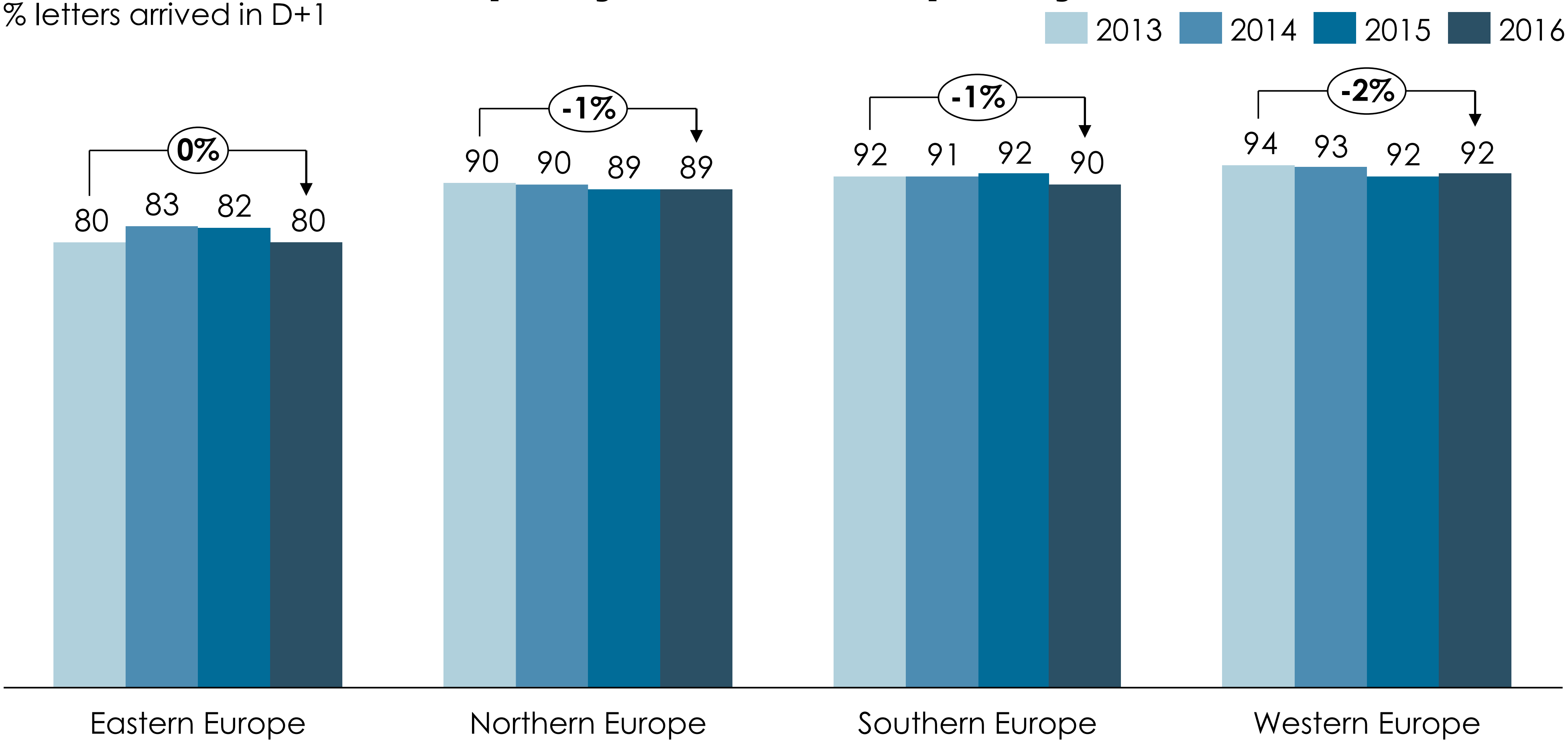
Share of USPs' outsourced post offices, 2016

Share of a total number of post offices

Sources: Questionnaire to NRAs.

However, cost reductions did not impact the overall service quality of letter post

Evolution of domestic quality of service for priority letter
% letters arrived in D+1

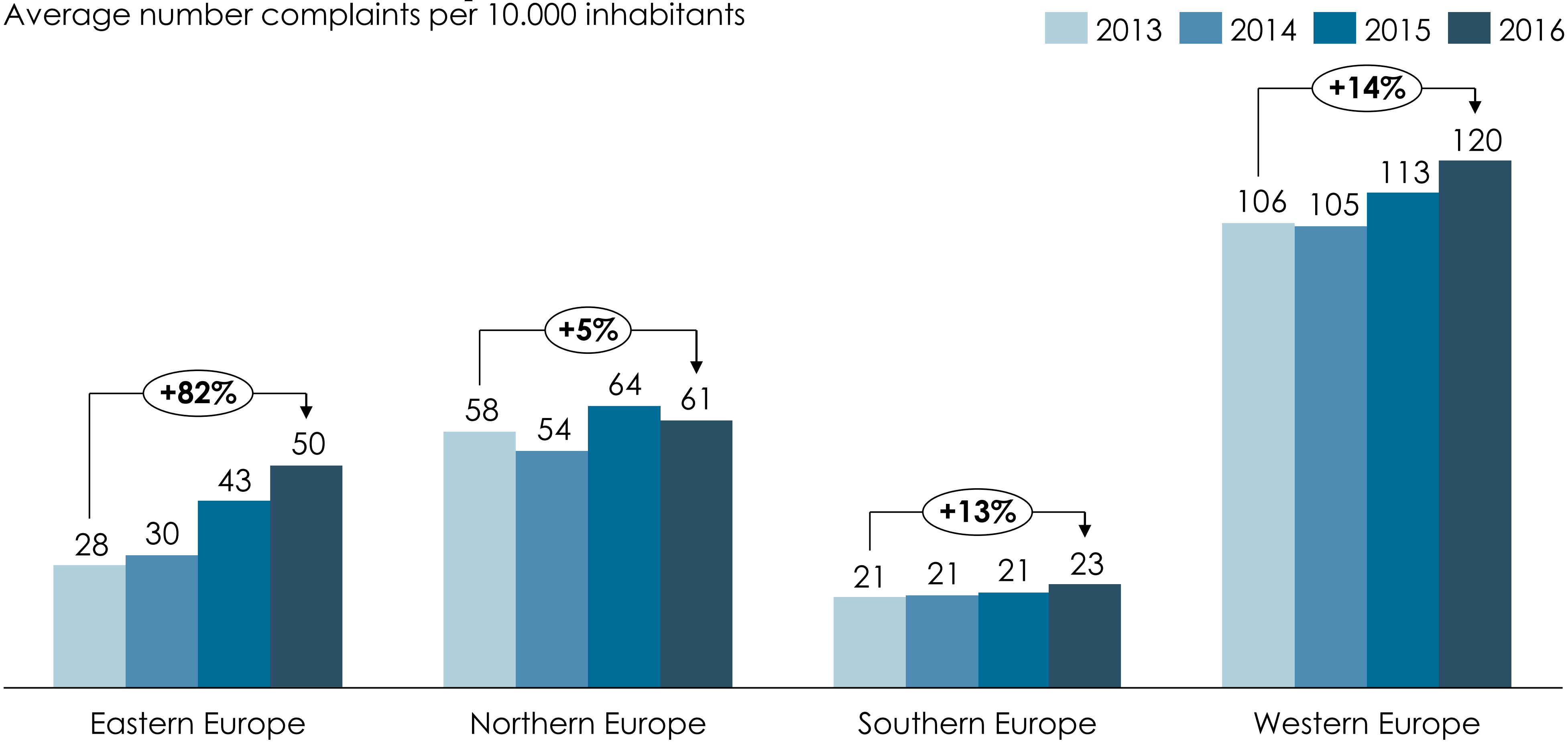


Source: Questionnaires to NRAs.

... although most countries have seen an increase in user complaints

Evolution of user complaints sent to NRA and USP

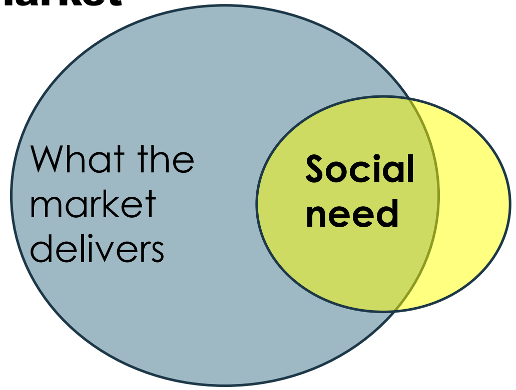
Average number complaints per 10.000 inhabitants



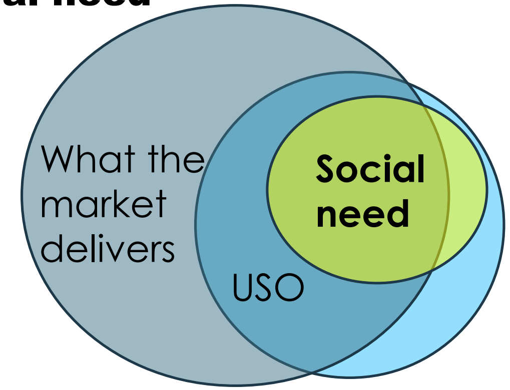
Source: Questionnaire to NRAs.

We have seen cases where postal regulations were adapted to changes in demand and supply conditions

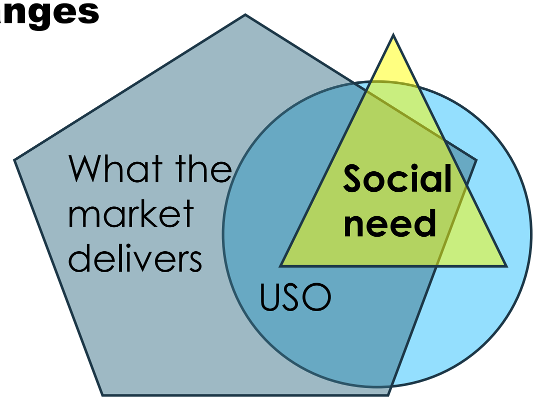
1. Social need not delivered by the market



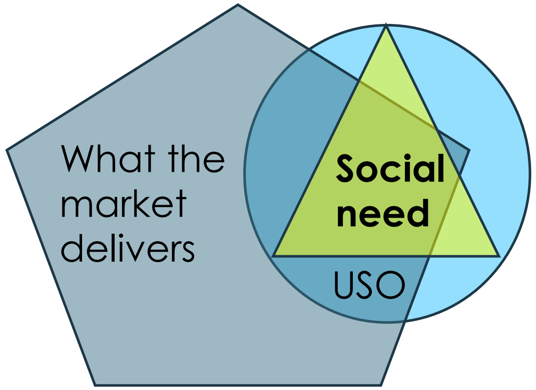
2. USO put in place to cover the social need



3. Market and social need changes



4. USO adapted



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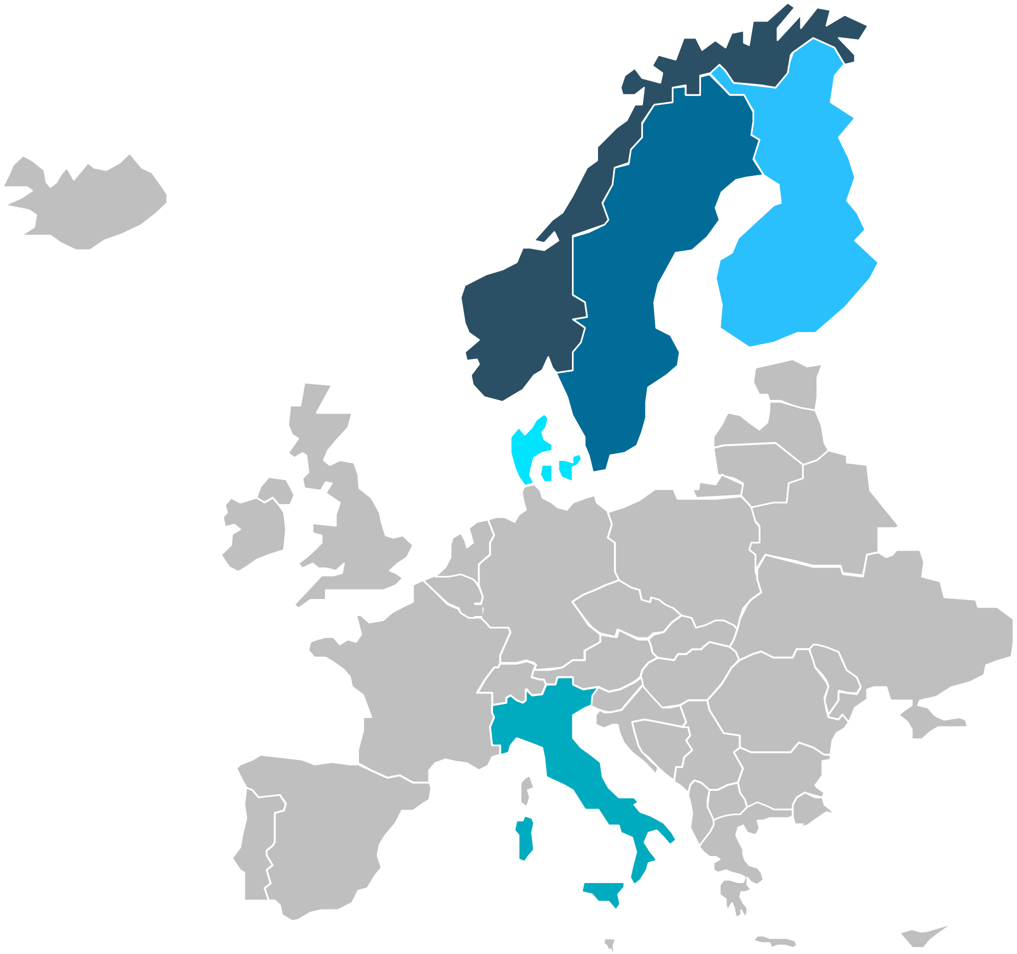
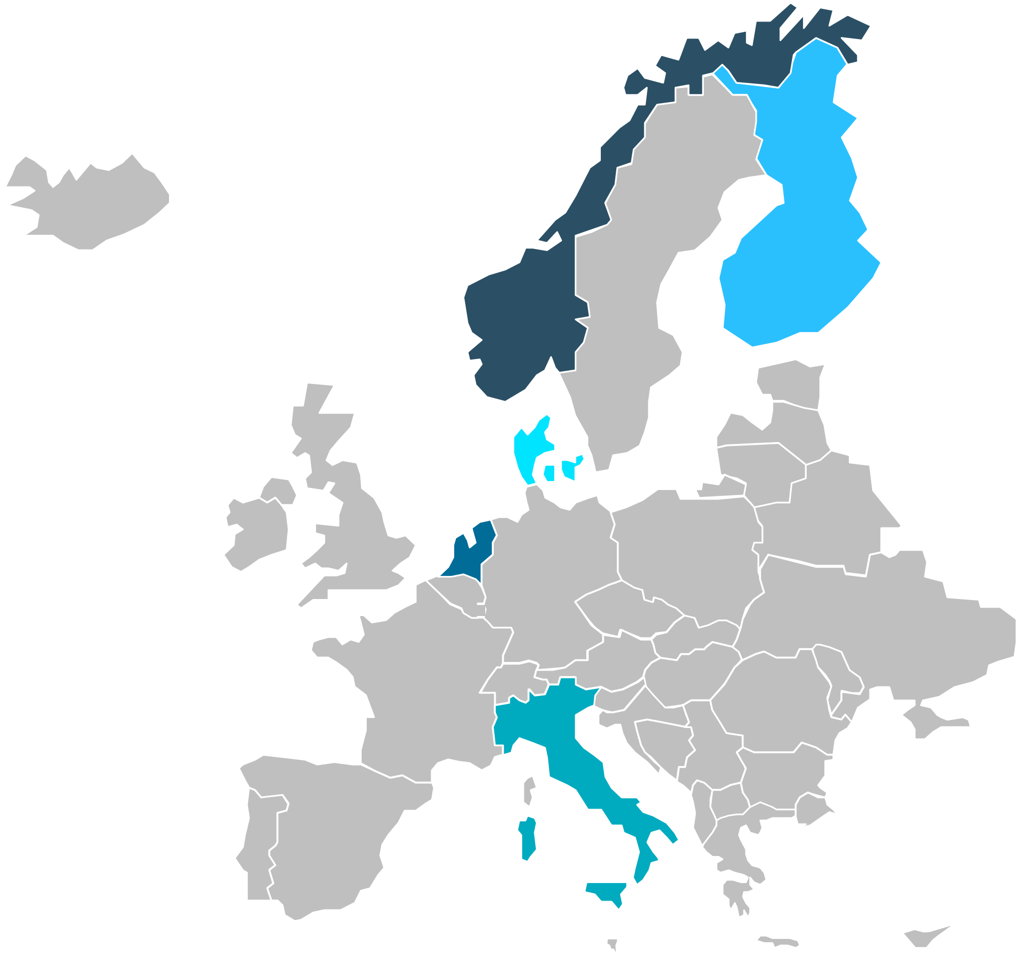
Letter delivery speed (requirement) was reduced in several cases…



- **NO** – Merging of A and B letters, creating a D+2 standard service (2018)
- **SE** – D+2 replacing D+1 as standard product (2018)
- **FI** – Merging of A and B letters , creating a D+2 standard service (2017)
- **DK** – Elimination of first class letters from the USO and decreased delivery speed for B-letters (2016)
- **IT** – Introduction of slow letter mail product, D+4 (2015)

...together with the reduction in mail delivery frequency (requirement)



NO Mail delivery on Saturdays discontinued (2016)

FI Introduction of 3-day delivery in urban areas (2017)

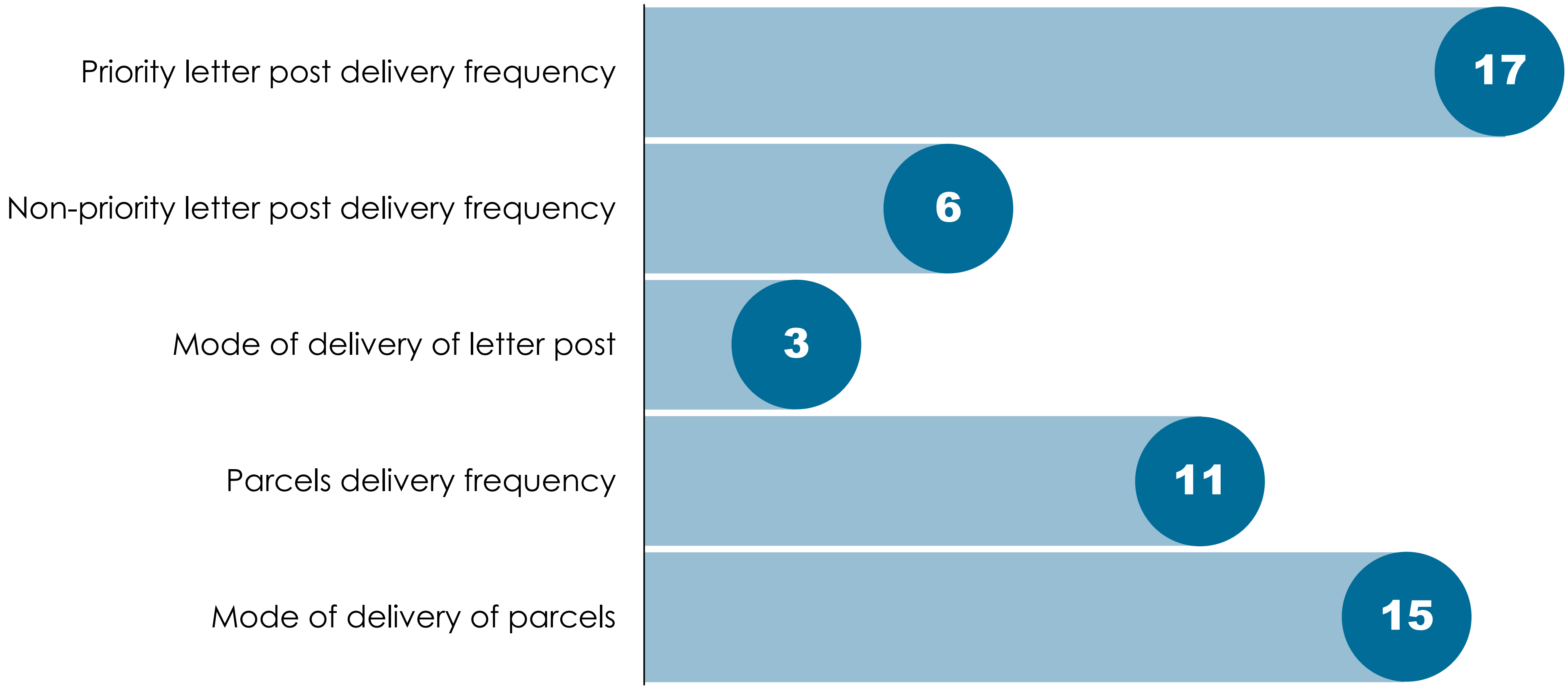
DK Introduction of XY-delivery (2009)

NL Reduced delivery frequency (2014)

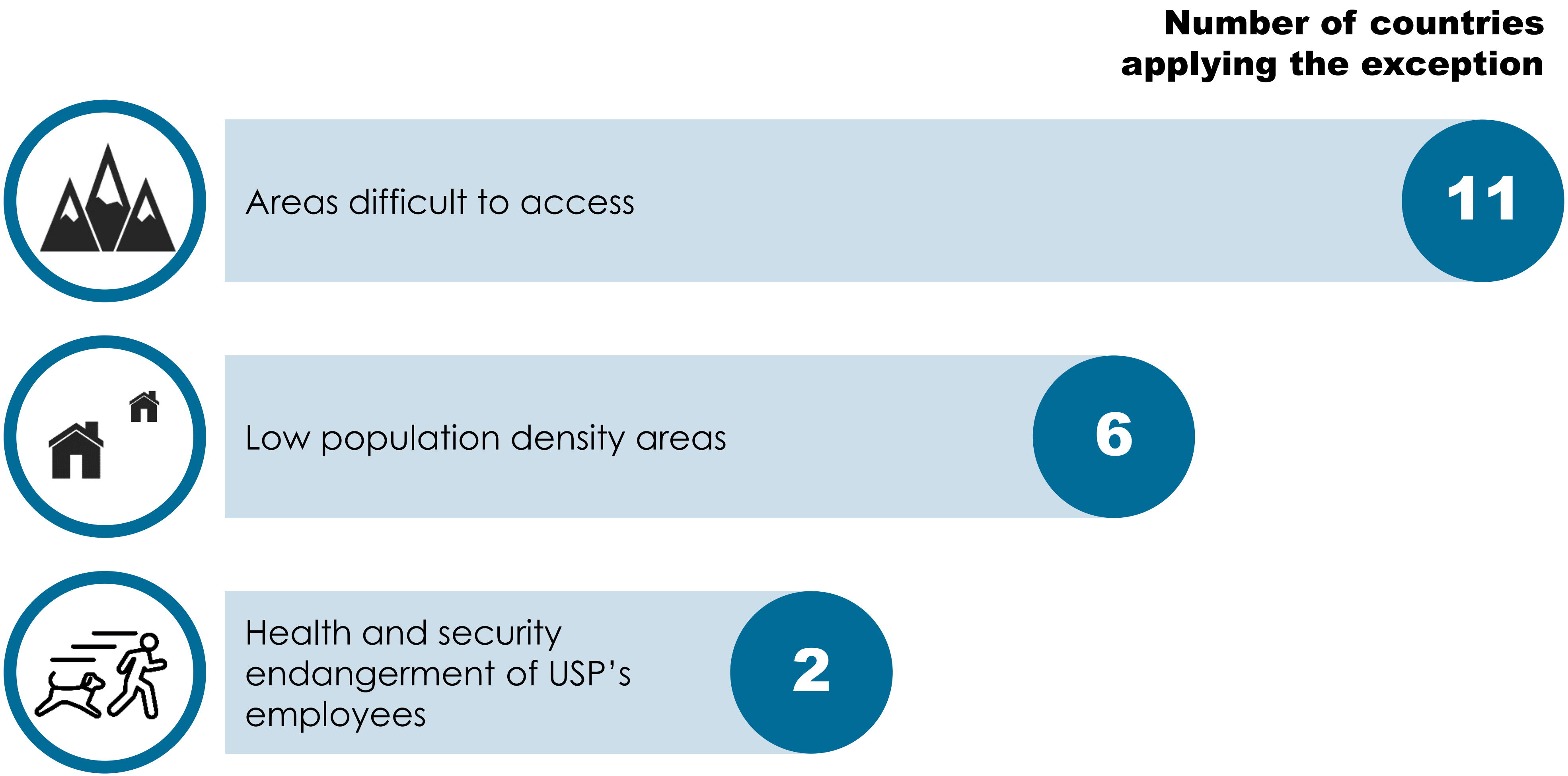
IT Introduction to XY delivery in rural areas (2014)

Countries apply a number of different exceptions to the minimum requirements of the USO set out in the Postal Directive

Number of countries applying exceptions to the USO minimum requirements

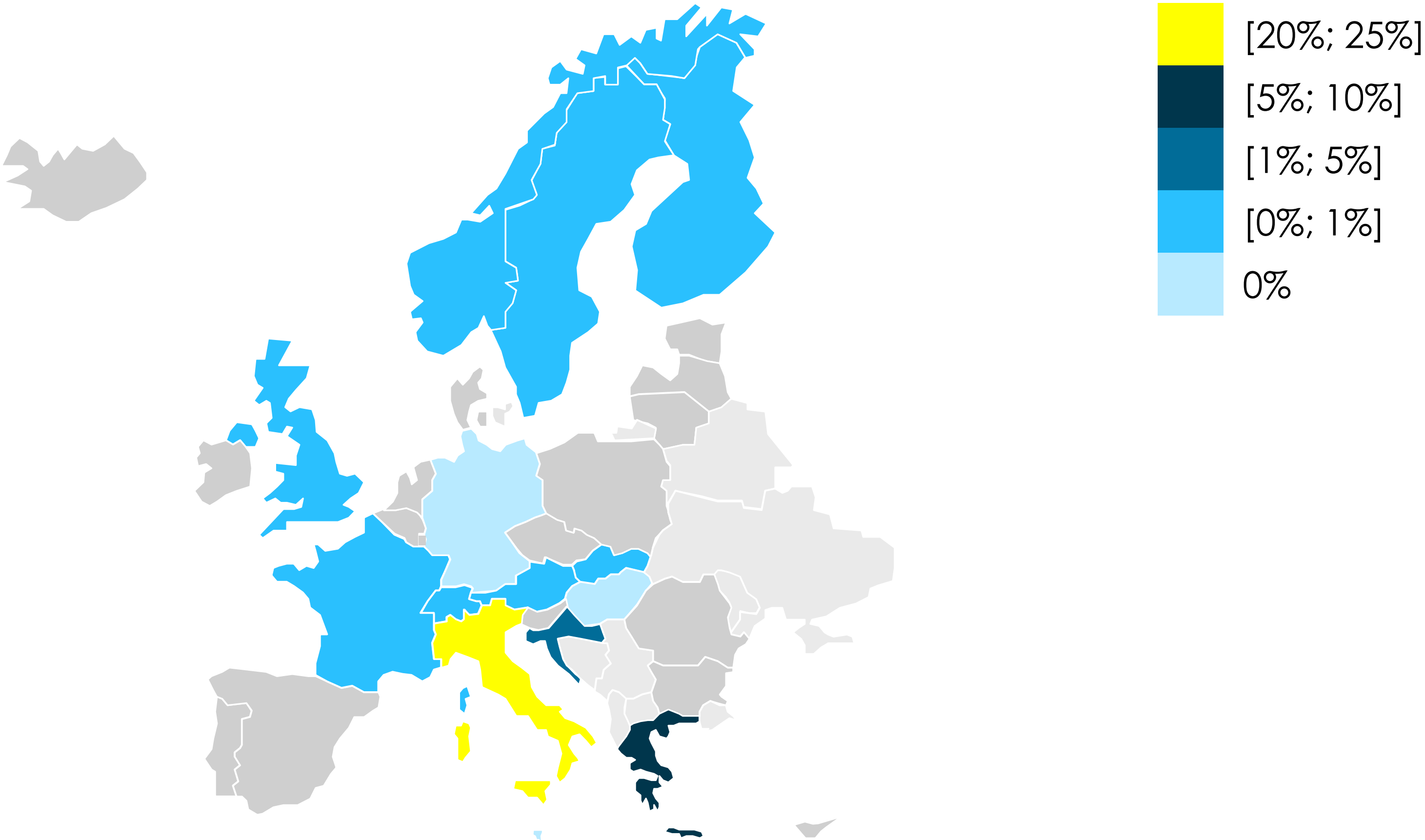


The most common reasons for exceptions are related to accessibility, safety and efficiency



The impact of these exceptions is generally limited to 1% of the population

Approximate share of the population not receiving priority letters at standard frequency



Source: Questionnaire to NRAs.

Looking ahead, we find that market stakeholders are considering several policy scenarios for the USO

1	Status quo	• Maintain the current scope and minimum requirements of the USO
2	Reduce delivery frequency	• From 6 to 5 days nationwide • From 5 to 2.5 days nationwide • From 5 days nationwide to 3 days in rural areas, 5 days in urban areas • From 5 days nationwide to 3 days in urban areas, 5 days in rural areas
3	Reduce speed of delivery	• From D+1 to D+2 • From D+2 to D+5
4	Allow different forms of delivery	• From delivery to the door, delivery to the street • From delivery to the street, delivery to the post office • From delivery to the street, delivery to the communal centre
5	Remove uniform prices requirement	• Remove the price uniformity requirement, i.e. allow geographic price differentiation for SP and bulk letters
6	Relax ubiquity (ace-ssibility) requirement	• Reduce the required number of post offices in rural areas by 25% to 50% • Reduce the required number of post offices in urban areas by 25% to 50% • Allow alternative models, e.g. mobile post offices, franchise model

Besides providing financial sustain-ability, changes to the USO may also have a negative impact on certain users

Impact on users from reduced delivery frequency and speed

	Vulnerable user	Affected service (need)	Alternatives?
Slower delivery service, from D+1 to D+3	Elderly and disabled citizens	Urgent delivery of medicine	• Pick up at the pharmacy • Local delivery companies • Delivery with homecare
	Laboratories and SMEs	Delivery of fresh samples or food	• Express service
		Delivery of components and spare parts	• Express service
	E-commerce consumers and online retailers	Delivery of small packets	• Parcel delivery • Competing networks
	Private households and businesses	Daily newspapers	• Digital newspapers • Retail stores • Competing network

Source: Desk research, Interviews with e-retailers and consumer association.

The potential negative impact on employment should also be considered

Impact on employment from reduced delivery frequency and speed

Activity in production chain	Potential cost effects	Economic rationale
Collection	• No impact	
Sorting	• Small impact (-)	• The need for overnight sorting is reduced. • The extra time will allow for efficiencies in production. • The extra time may allow for a less dense network of sorting centers.
Transport	• No significant impact	• Ambiguous whether different mode of transportation requires less labour.
Local sorting	• Small impact (-)	• The need for overnight sorting is reduced. • The extra time will allow for efficiencies in production.
Delivery	• Large impact (-)	• When going from five day delivery to for e.g. delivery every other day, the daily route cover only 50 percent of the households requiring fewer man hours. This, in turn means a lower need for labour.

Source: Desk research.

Conclusions

- Structural decline in the letter post segment triggered by digitalisation is driving multiple changes in the European postal markets:
  - USPs are responding through price increases, diversification and cost reductions.
  - Governments are responding by authorizing and establishing compensation mechanisms, procuring public services, and optimizing regulations.
- In the future, we expect to see more initiatives to optimize the USO to changing user needs and contemporary market conditions.
- A special care must be taken with regards to potential impact on vulnerable users and employment.

Q&A

20 MIN BREAK

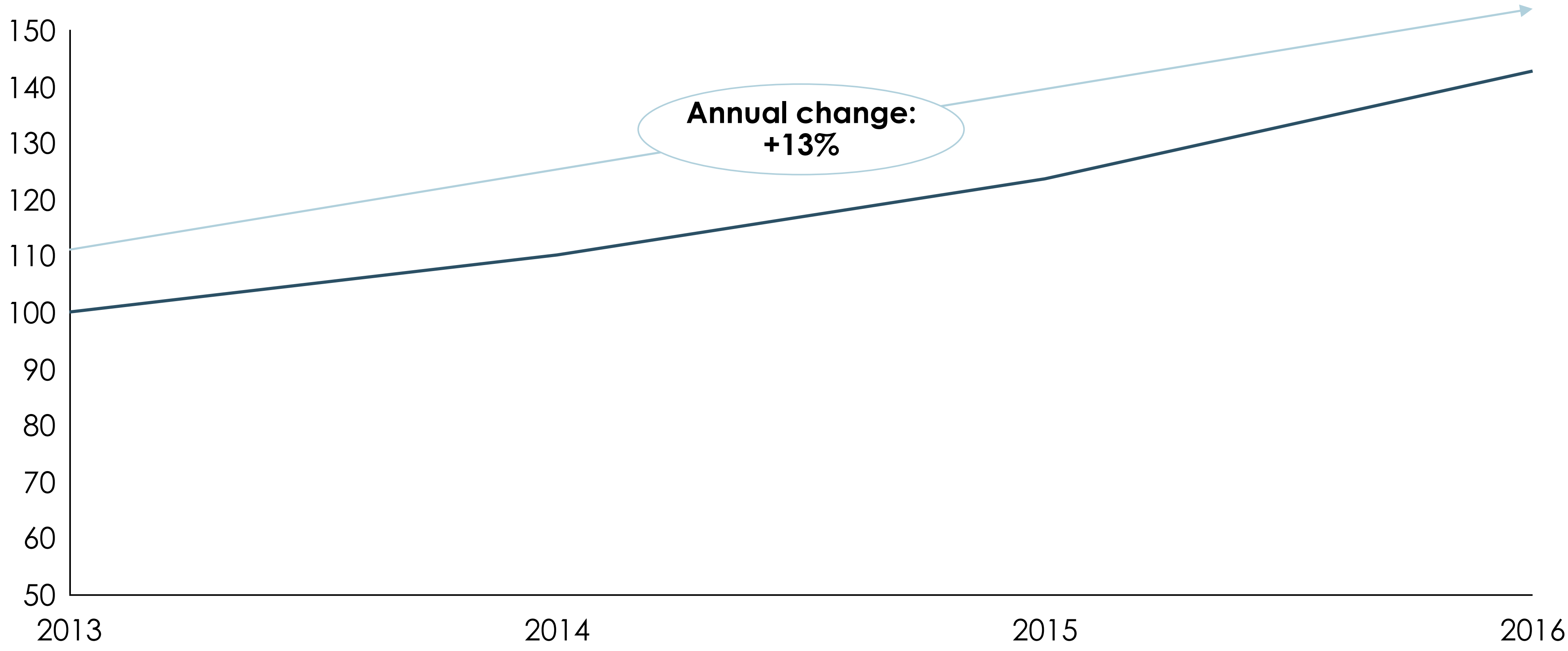
PLEASE RETURN AT 11:40

2
GROWING VOLUMES OF E-COMMERCE PACKETS AND PARCELS

In contrast to the declining letter post, parcel & express volumes grew on average 13% annually

Evolution of parcel & express services volumes, domestic, 2013-2016

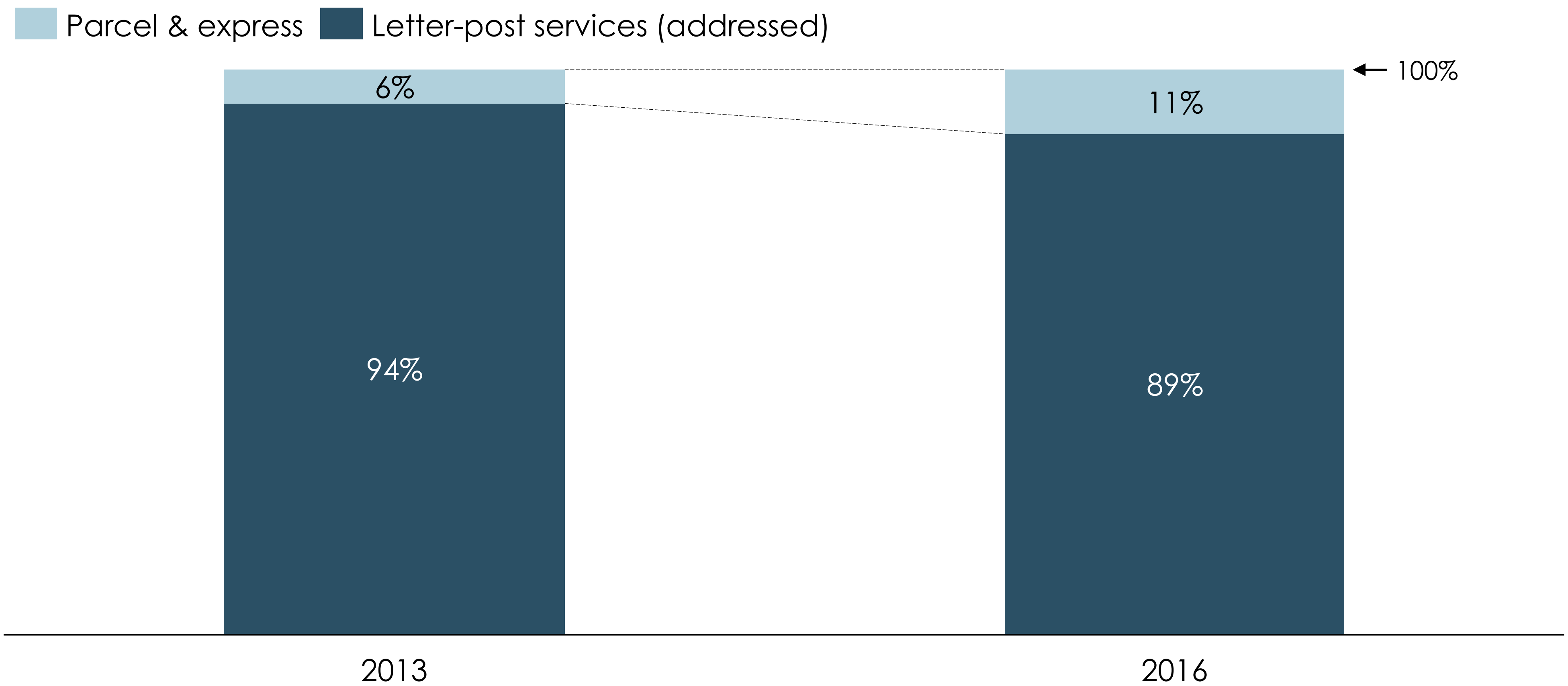
Index (2013=100)



Source: Questionnaire to NRAs.

The product mix of postal operators is changing: less letters, more parcels

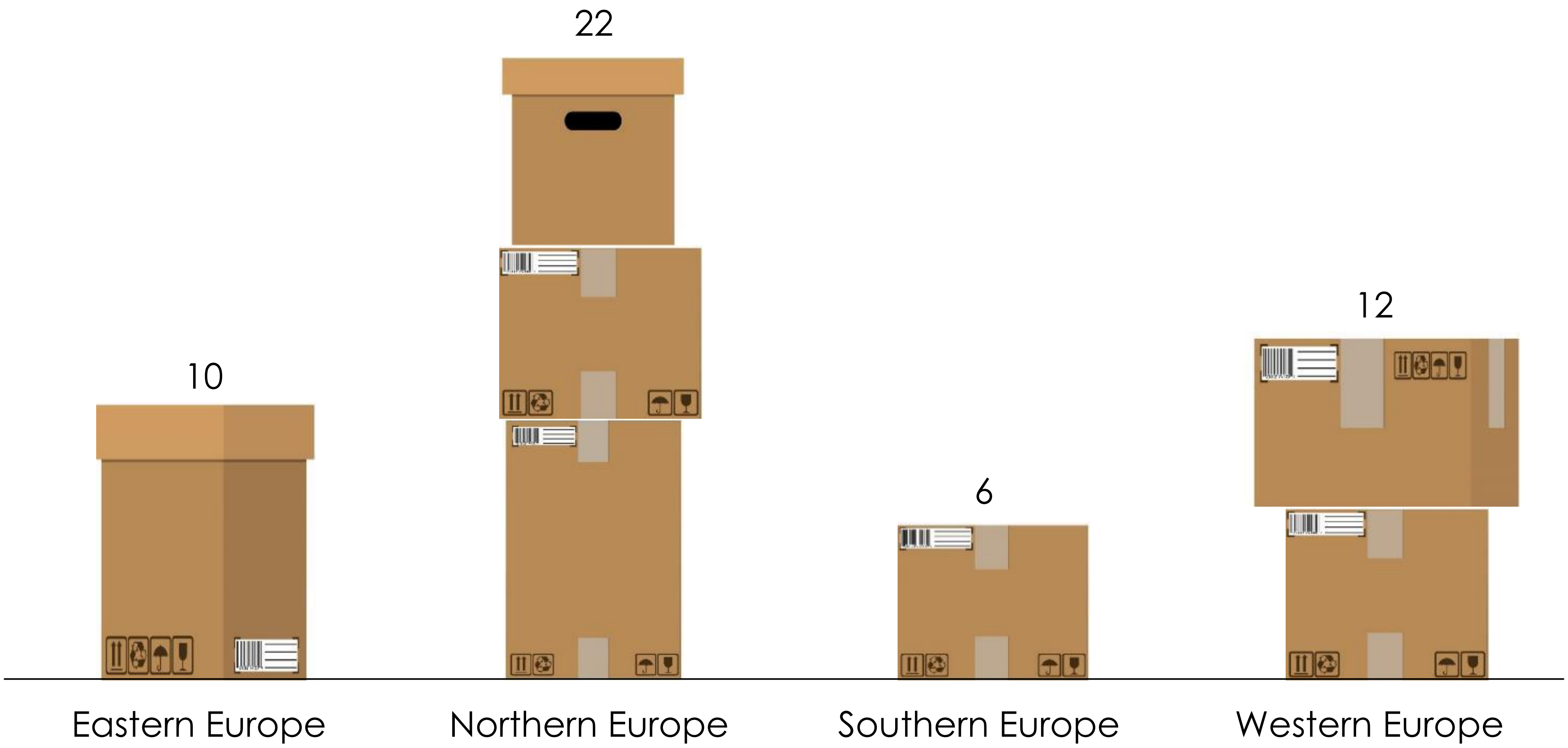
Composition of domestic mail volume %, 2013 vs 2016
Share of domestic volume



Source: Questionnaire to NRAs.

Demand for parcel and express services per capita varies more than five times across the European regions

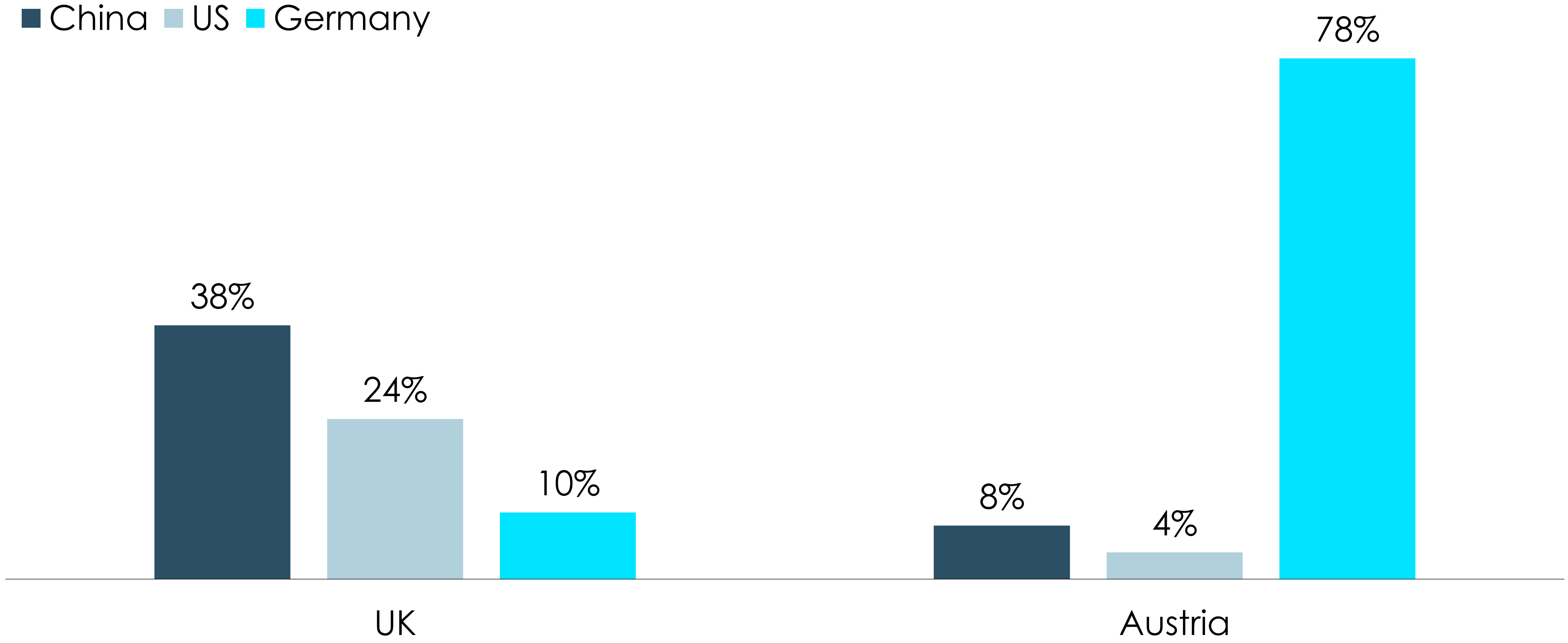
Domestic parcels & express items per capita, 2016
Items per capita per year



Source: Questionnaire to NRAs; Eurostat

The landscape of cross-border e-commerce flows and origins vary substantially across countries

The most common countries of origin of inbound cross-border e-commerce (2016)



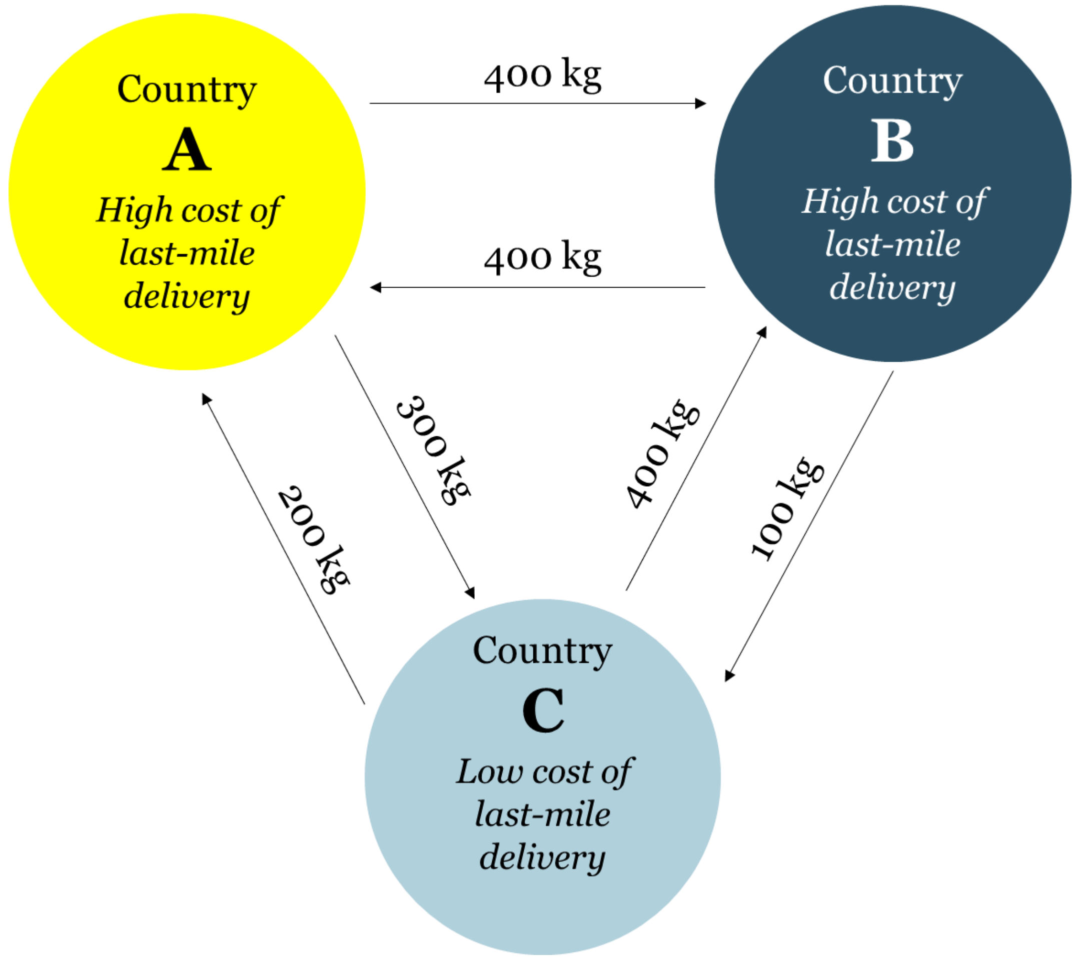
Source: IPC (2016) Cross-border e-commerce shopper survey, p. 15.

The UPU terminal dues system creates financial transfers between national operators worldwide

Designated postal operators will face a financial burden, if:

1) In the domestic market, **costs for last-mile handling** of mail, and postal prices are high; and

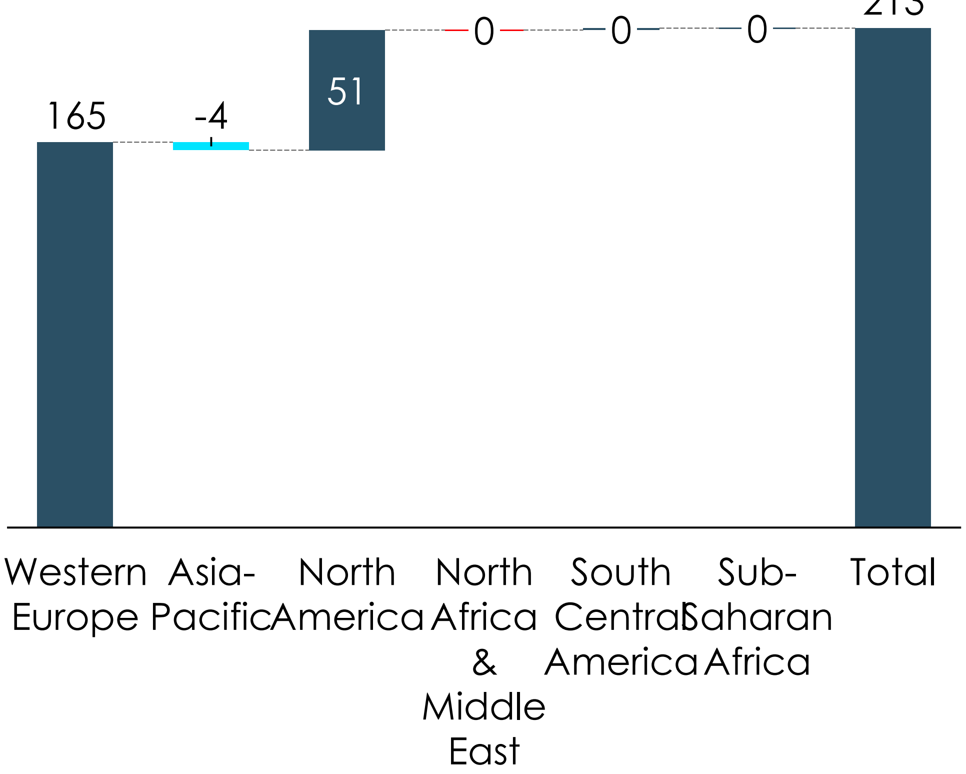
2) The country is a **net importer or net exporter** of international letters.



Eastern European regions receive positive transfers, while Western Europe experiences the largest negative net transfer overall

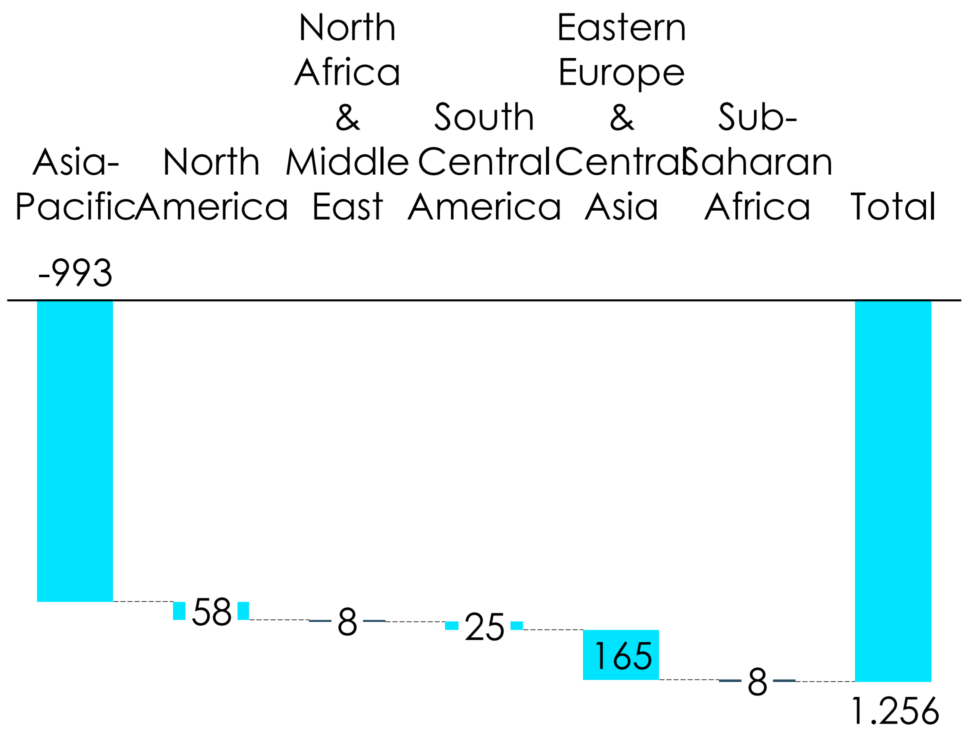
Eastern Europe & Central Asia net financial transfer

Million euros



Western Europe net financial transfer

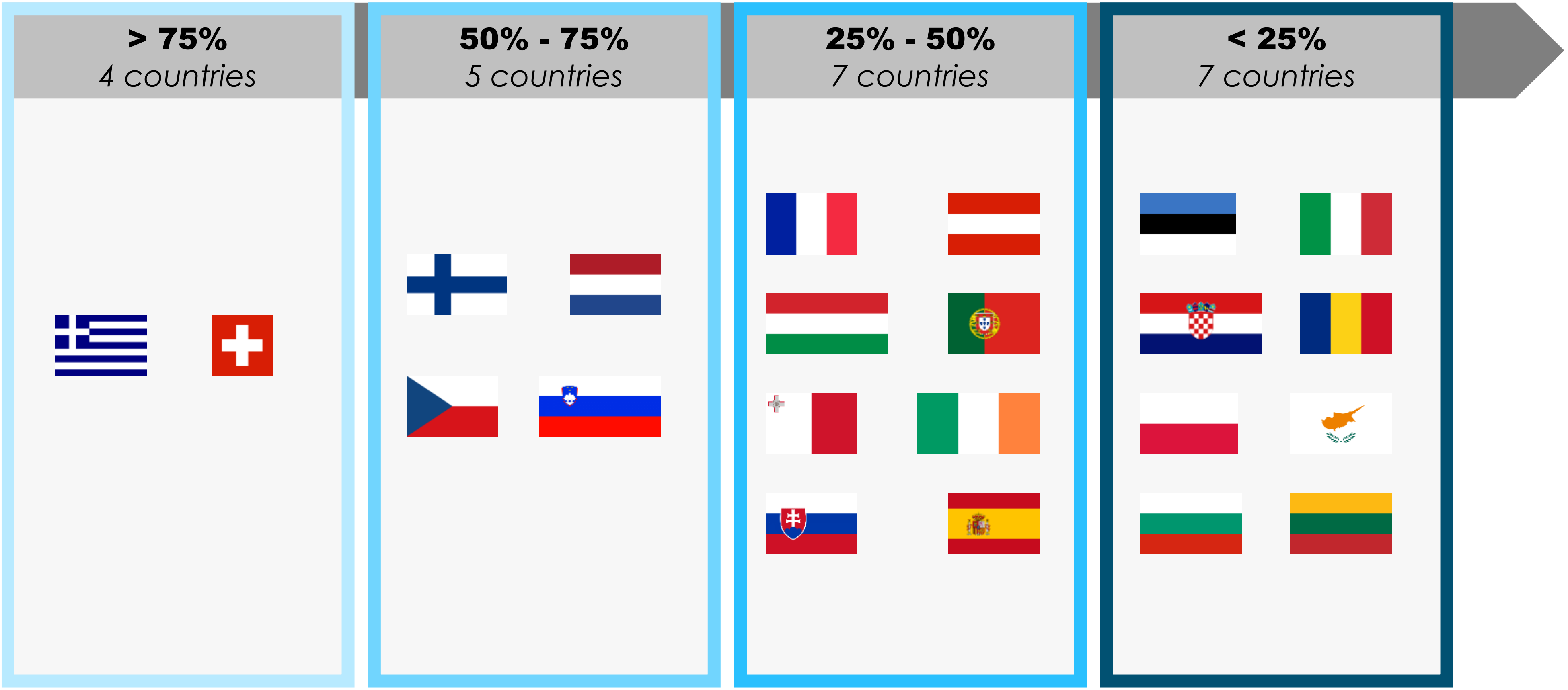
Million euros



In contrast to the letter post segment, competition in the parcel & express segment is fierce

Market share of the USP in the domestic parcels market

Market share based on volumes in 2016

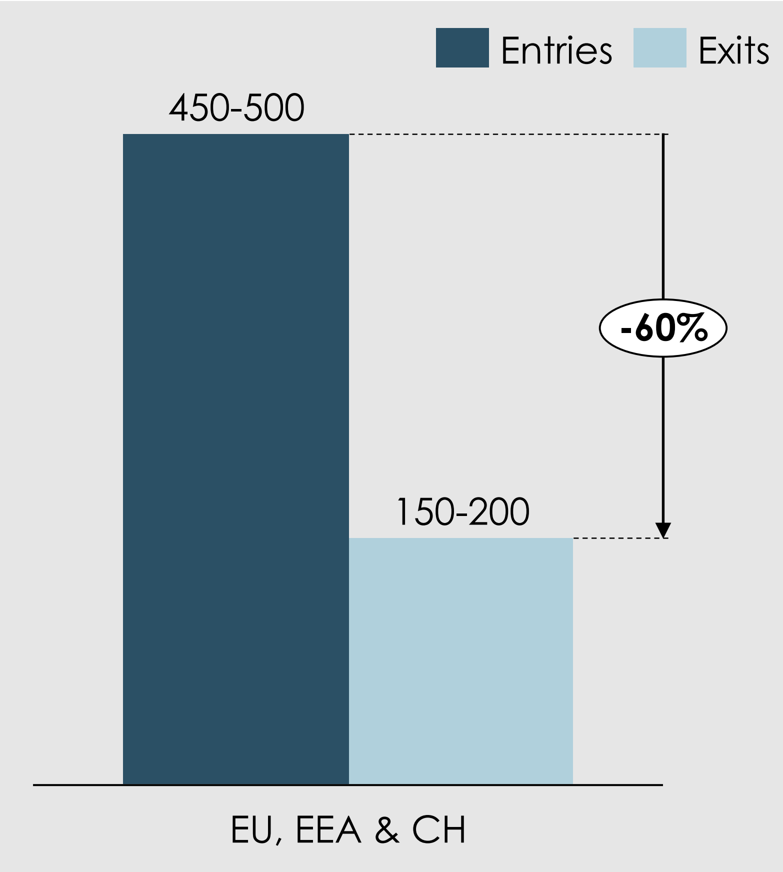


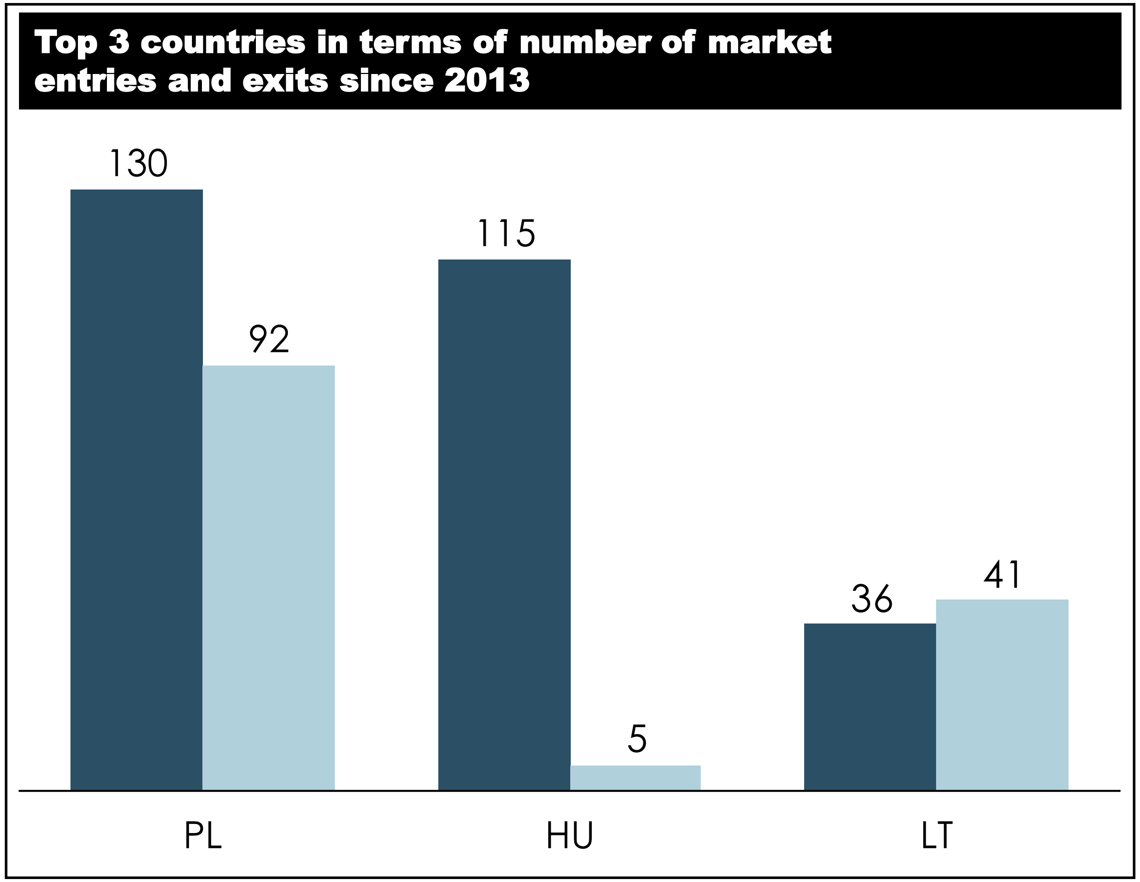
Source: Questionnaire to NRAs, public sources.

And overall, there were more entries than exits in the parcel segment

Market entries and exits in the parcel segment since 2013

Number of entries and exits

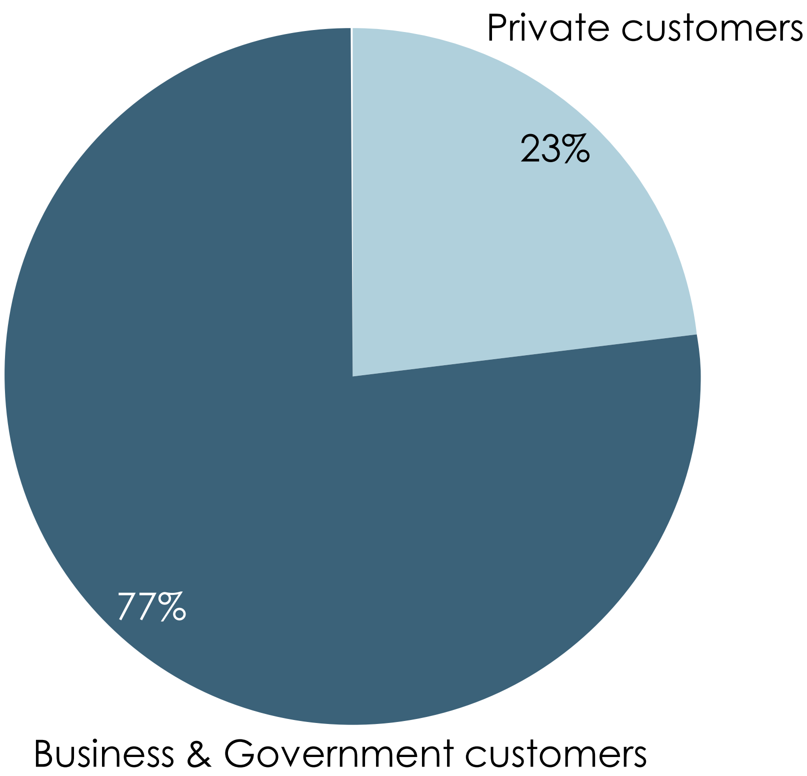




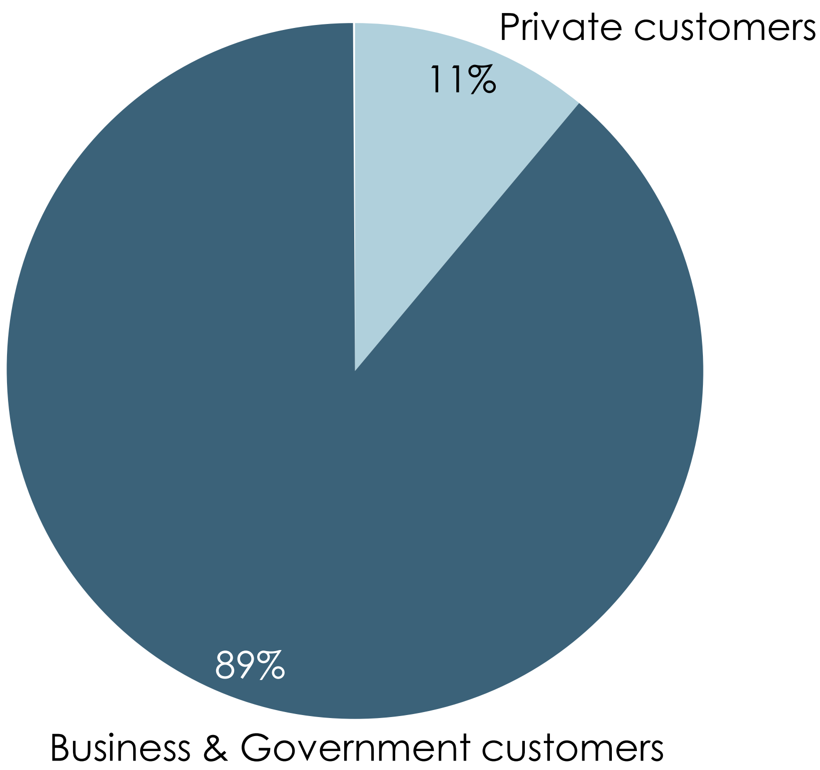
Source: Questionnaire to NRAs.

Competition in the parcel segment is centred around core business clients

Parcel and express <u>revenues</u> of the USP in 2016



Parcel and express <u>volumes</u> of the USP in 2016

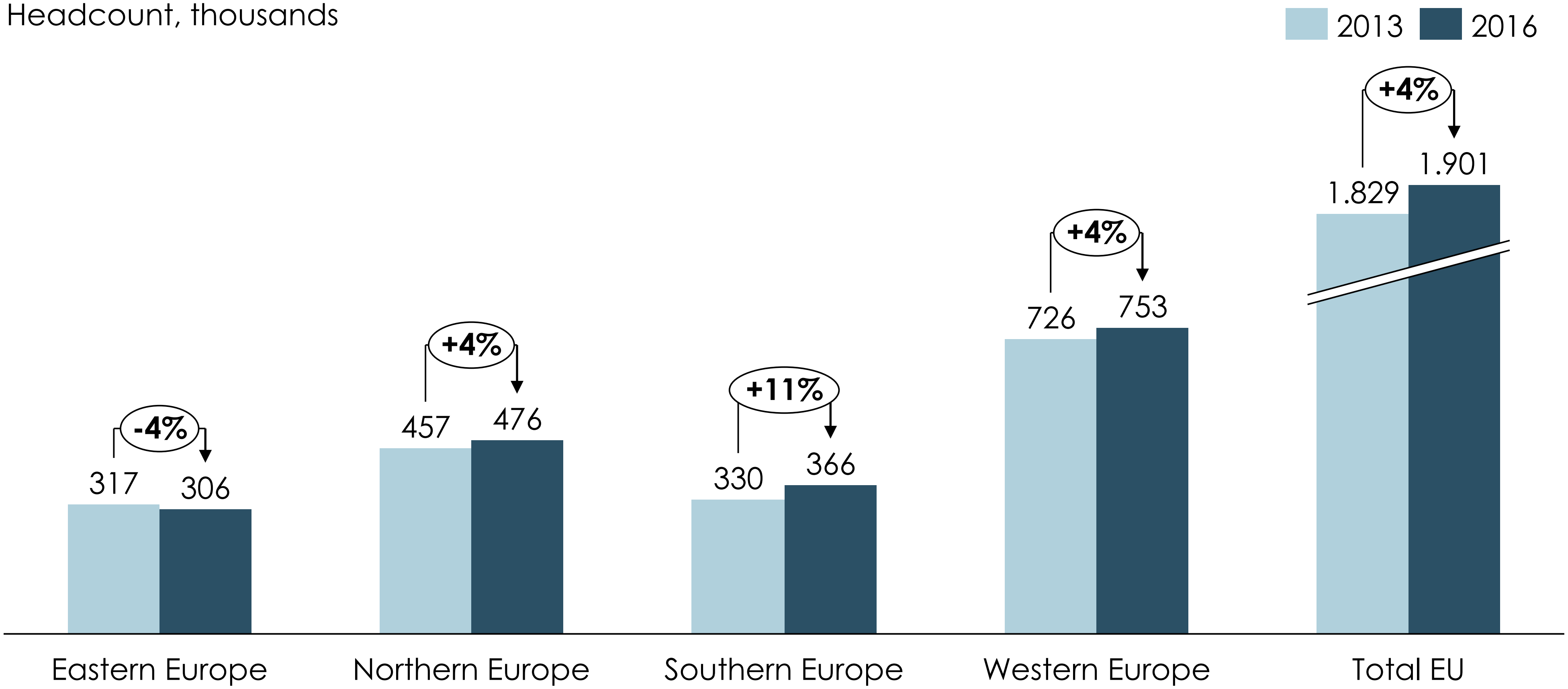


Source: Questionnaire to USPs.

Due to growing ecommerce, the total employment in the postal and courier sector has increased by 4% overall...

Evolution of postal and courier sector employment

Headcount, thousands

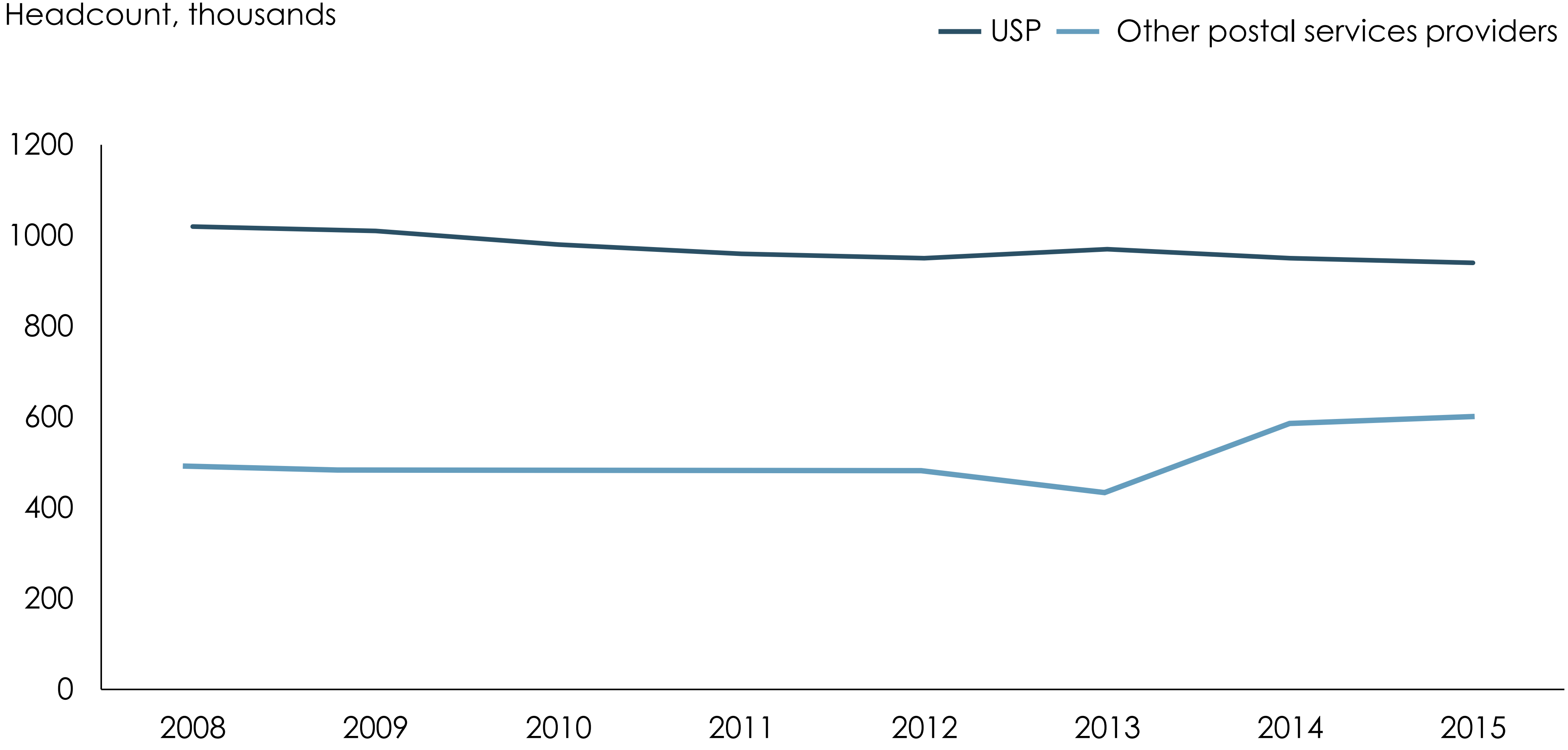


Source: Eurostat

... driven solely by employment at non-USO postal service providers

Total employment by USP and other postal providers, 2008-2015

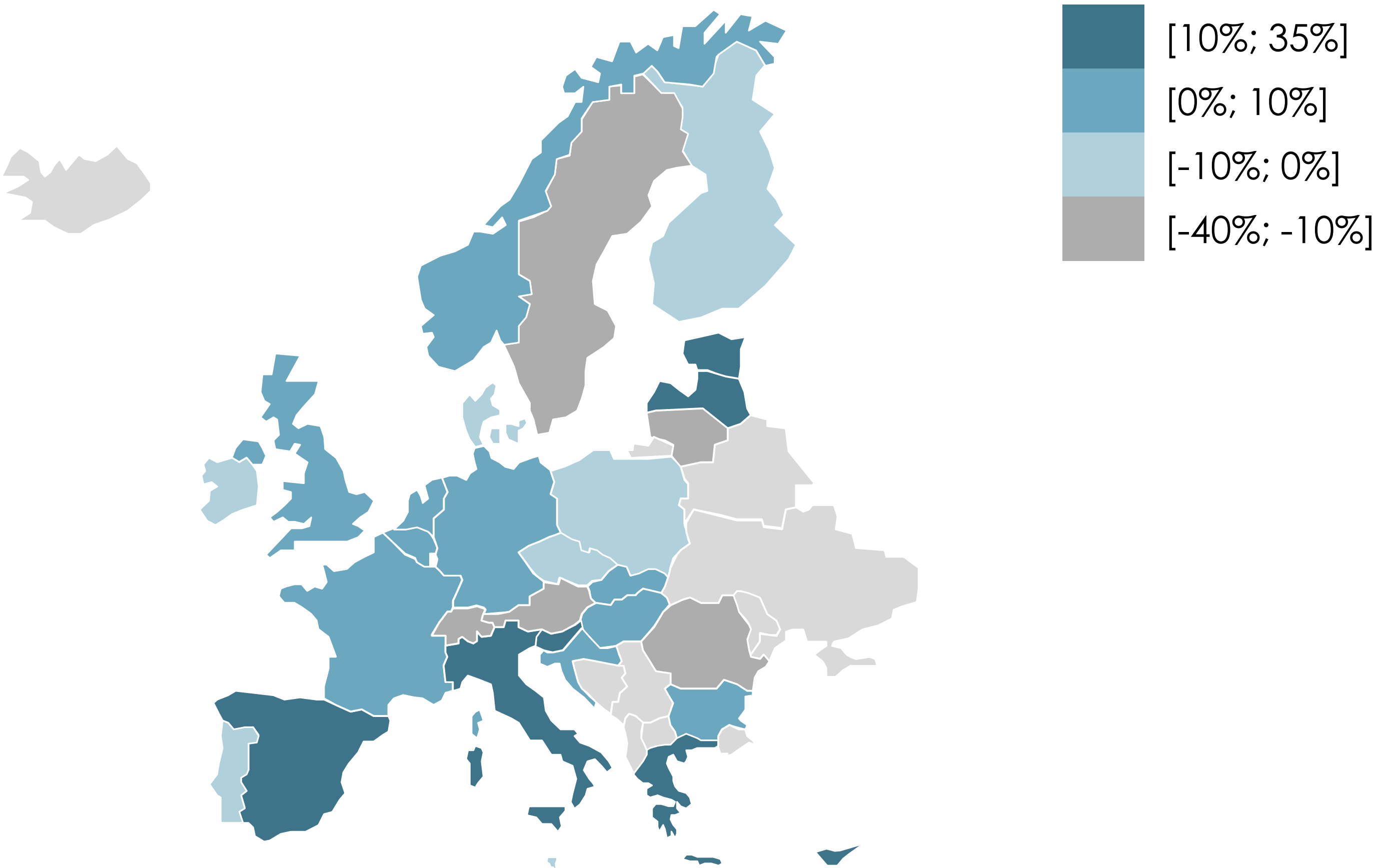
Headcount, thousands



Source: ERGP (16) 38 Report on core indicators for monitoring the European postal market

The level of increases and declines in the postal & courier sector's employment varies across investigated countries

Overall percentage change of the postal and courier sector's total employment, 2013-2016



Source: Eurostat

However, there are particular challenges to maintain the social standards in employment

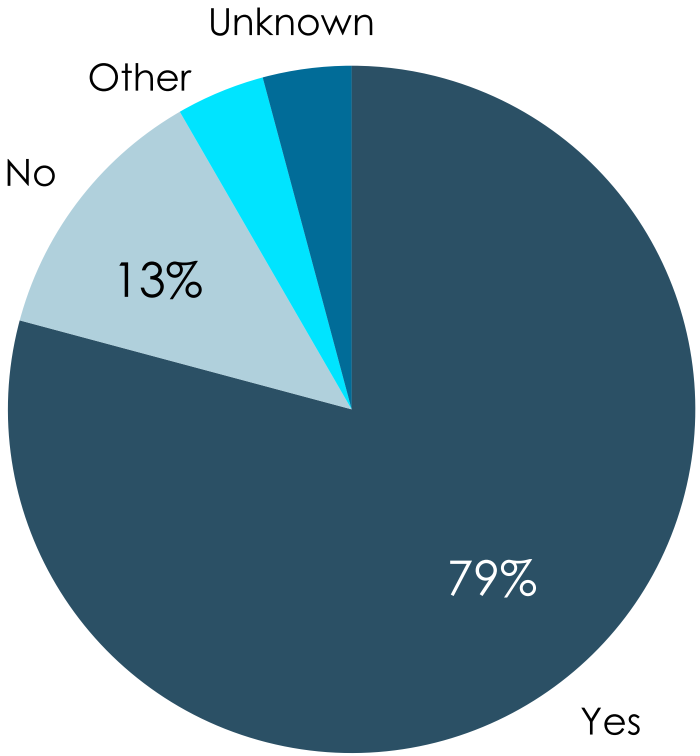
Use of different employment models by USPs

Employment model	Number of countries	Change in the share of contracts 2016 vs 2013
Temporary employment	19	+ 15-20%
Subcontracted workers	18	+ 55-60%
Flexible employment	10	- 5-10%
Performance-related pay contracts	7	+ 1-5%
Self-employment	5	+ 80-85%
Part-time employment	23	- 5-10%

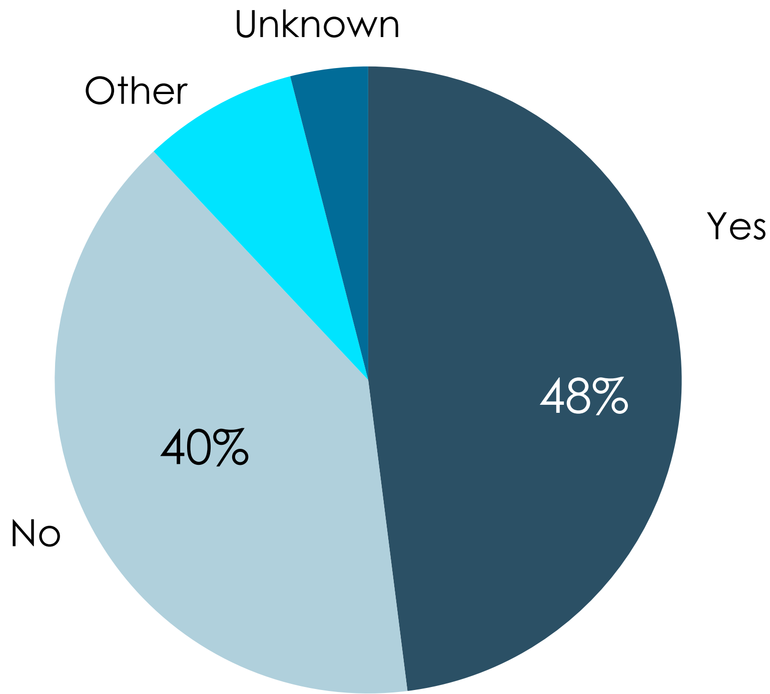
Source: Questionnaire to USPs.

USPs are setting environmental targets on own and subcontractors' operations

Share of USPs setting environmental targets on their operations



Share of USPs setting environmental targets to subcontractors

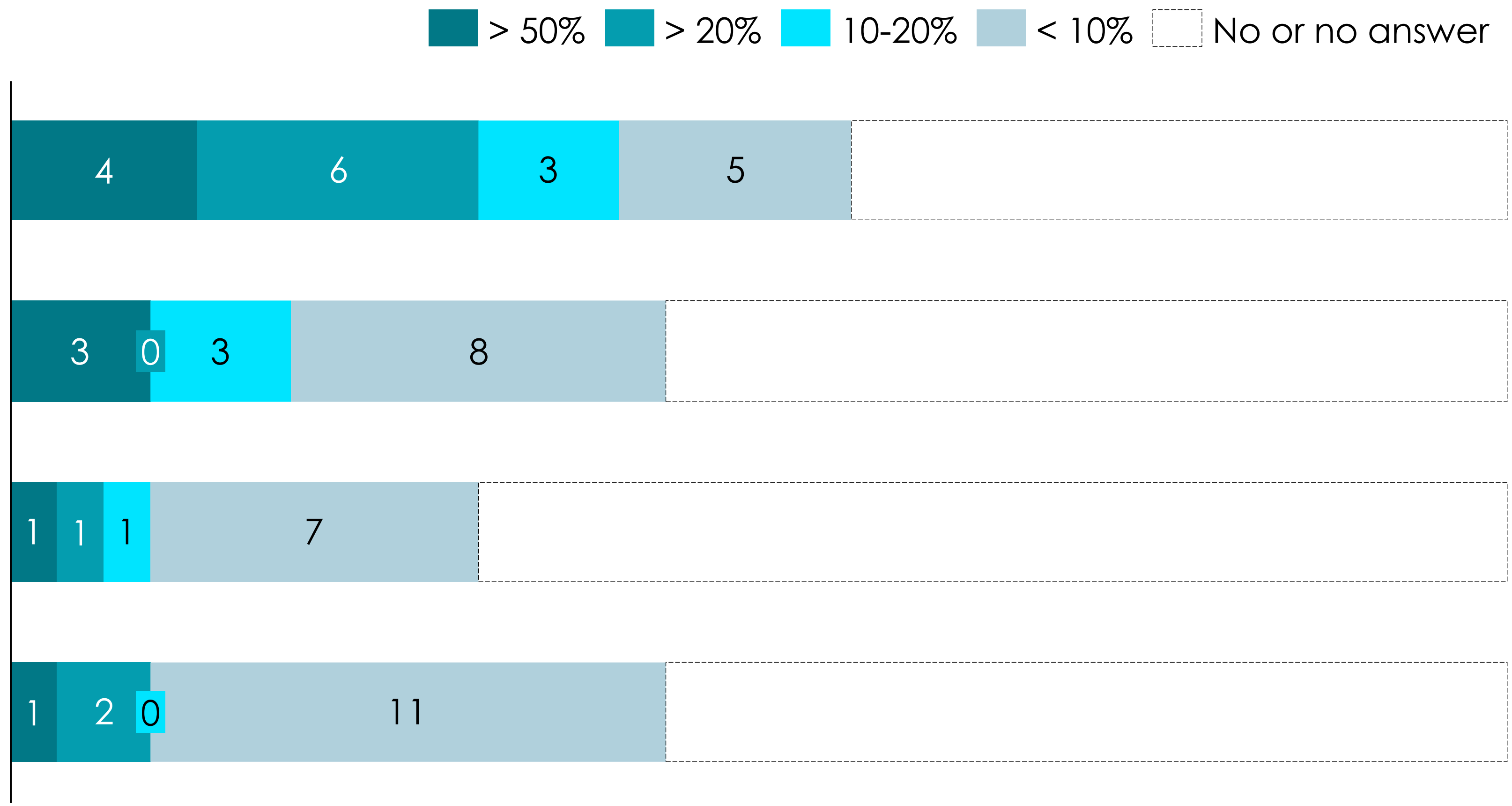


Source: Questionnaire to USPs.

USPs are investing in new cost-efficient and environmentally friendly modes of delivery

Cost-efficient and environmentally friendly modes for the last-mile delivery

Number of USPs



Source: Questionnaire to USPs.

Looking ahead, changes (if any) in the USO may have direct and indirect effects on parcels segment

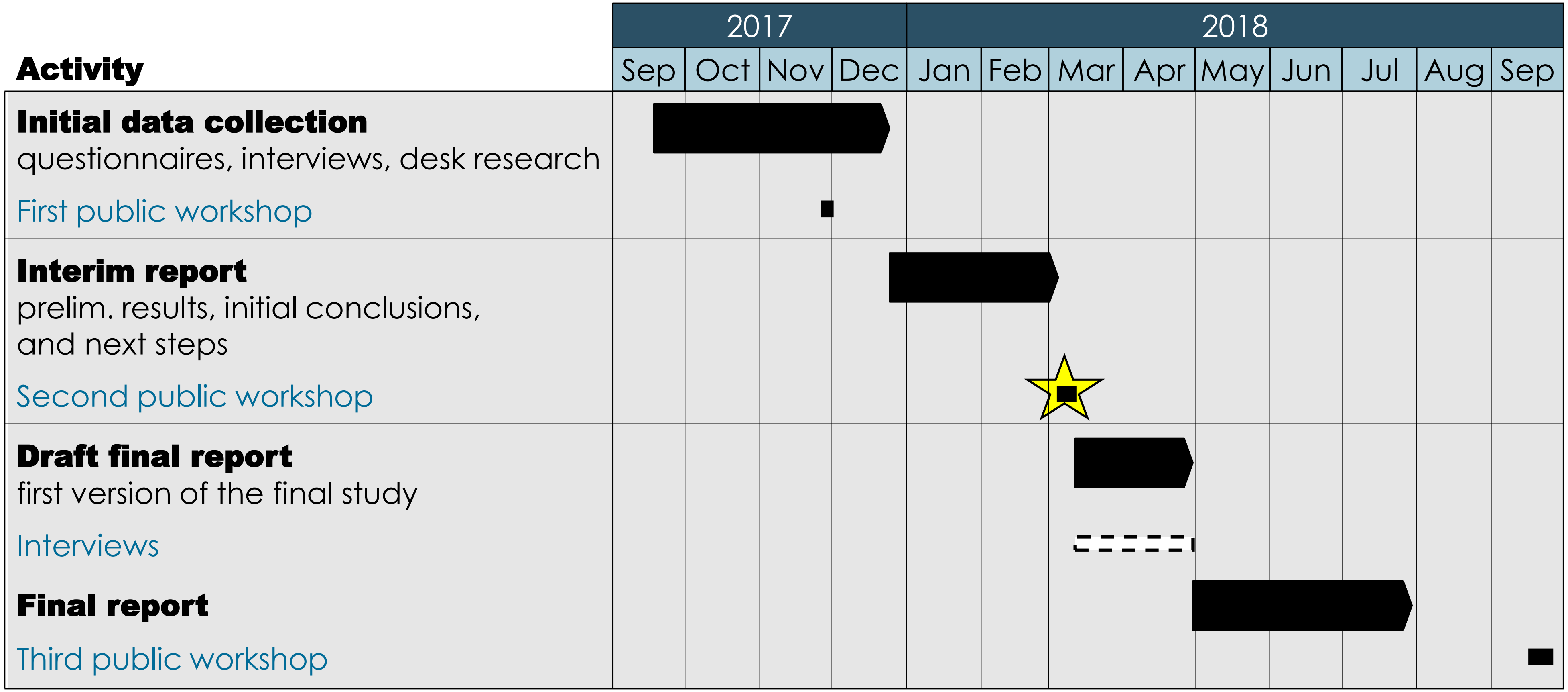
Revenue effect from reduced **delivery frequency** and **speed** for the standard service

Revenue effect from introducing **delivery to post offices in rural areas**

Motivation

- **Packets may arrive later**. Some mailers are able and willing to pay more. If not they may turn to other distributors.
- Some users of the USP's small packet service might **switch to parcels** as the price for express packet service is higher than for the standard service (up-trading).
- Some senders of packets may **switch to other delivery solutions** that can deliver to the door.

Project timeline



Thank you!

We look forward to seeing you in interviews.

We will meet again **in September** to present and discuss the final results.

Q&A

MAIN DEVELOPMENTS IN THE POSTAL SECTOR 2013-2016