

Public Consultation on La Poste's cost accounting rules

Observations by John Hearn, Manager Postal Liberalisation, ComReg

1 Introduction

On 29 January last ARCEP sent an English version of the text of the consultation to the relevant experts of other NRAs for the postal sector within the EU.

ComReg would not normally participate in a public consultation organised by another postal NRA as it is unlikely to have sufficiently detailed knowledge of the specific circumstances in the other country to make informed observations, for the following reasons:

- The economic characteristics of postal services vary considerably from one member state to another due to differences in geography, social characteristics and the availability and cost of other communications, advertising and distribution media.
- The importance of the Postal Sector varies significantly from country to country, for example the number of letter post items per capita per annum varied from 406 in Finland to 11 in Bulgaria according to Eurostat data for 2007.
- In some jurisdictions postal services represent a significant source of employment, but again this varies from France where according to Eurostat it represents 1.02% of total employment to Greece or Cyprus where it only represents 0.24% of total employment. (The EU27 average is 0.5%).
- In consequence, the powers and functions of NRAs notably differ from one member state to the next.

These differences are reflected in the European regulatory framework for the sector which gives member states considerable discretion when transposing the postal directives into national law. This should be contrasted with other sectors such as electronic communications and energy where the degree of harmonisation is much

greater, necessitating a more uniform implementation of the community acquis by NRAs.

In this instance however it is possible to assist ARCEP by drawing attention to a number of important papers etc that contribute to the wider debate on the issues raised and to offer some suggestions of further issues to be discussed.

2 II. A. How the weight and format of postal items affect the costs

The description of the postal (value) chain is typical of the organisational model adopted by most postal operators, but the percentage of total costs attributable to each sector is presented as a static function, which is unlikely to be the case. The following information, presented at the 10th WIK Königswinter Seminar on Postal Economics "Postal Markets between Monopoly and Competition" 12-14 February 2007, suggests that there is a considerable variation around the mean values:

Cost Splits by Activity (Letter Mail)			
	min	mean	max
Collection	5.0	12.0	22.0
Transport	2.0	7.3	14.0
Sorting	4.0	15.8	26.3
Delivery	27.5	49.6	77.0
Overheads	-	14.9	43.0

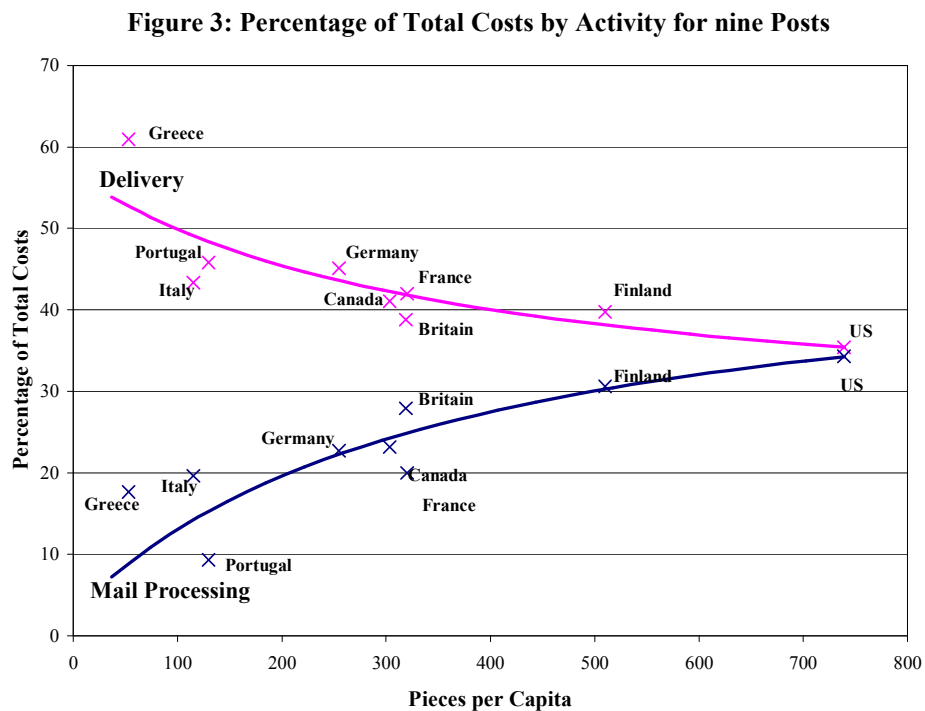
Source: NERA for EC (July 2004)

See slide 21

http://www.wik.org/fileadmin/Konferenzbeitraege/2007/10th_Koenigswinter_Seminar/04_Hearn_WIK_Koenigswinter2007.pdf

The reasons can be explained by the impact of factors such as geographical size of the country (countries such as France and Britain need considerably more complex and expensive transportation networks than smaller countries such as the Netherlands or Ireland), the urban/rural split, density of habitation, postal scale/items per capita and the business model of the operator/the extent to which upstream activities such as sorting are undertaken by the sender as part of the mail preparation process.

The following graph is illustrative in this regard:



From the point of view of economic principles in an enterprise with fixed and variable cost, the percentage of variable cost increases as the number of units produced increases. Alternatively, the percentage of fixed cost increases as the number of units produced declines. In the postal sector if volume per capita were reduced, the mail processing and transportation activity and the in-office portion of delivery would shrink basically in line with volume, while the street delivery activity would shrink only a little because it is largely fixed. Based on the above principle delivery activity is a larger share of total cost and the cost of mail processing is a smaller share of total cost as postal scale declines. These points are all explained in detail and graphically in a paper entitled "The Role of Scale Economies in the Cost Behavior of Posts" and which was presented at the 2004 WIK Koenigswinter Seminar. It has also been subsequently exhibited in a number of other papers.

This section of the paper then considers the sensitivity of the cost of certain processes to weight-format. The following observations are offered:

Process	Sensitivity to weight-formats
Collection	Only Letter format items can be deposited in what you call "yellow boxes". The packet format, registered items, etc have to be deposited at a post office or similar access point which substantially increases the cost.
Sorting (manual and mechanised)	The format-size determines the complexity (and therefore cost) of the sorting process. The extent to which weight is a factor needs further study.
Transport	Volume (i.e. cubic dimensions) is more likely to be a cost driver than weight – discussed in more detail in relation to section II.B.
Preparation	The format-size determines the complexity (and therefore cost) of the preparation process. The extent to which weight is a factor needs further study.
Delivery (load time)	This is determined by the number of delivery points where the postal operative has to call at, and the purpose of those call. Calls where delivery in person is necessary (e.g. registered items, parcels, packets) will require more time and cost than items that can be deposited in a mailbox or through an aperture in the door.
Delivery (route time)	As with transport it is more likely to be volume (i.e. cubic dimensions) that is the critical factor than weight.

3 **II. B. The link between the weight and the size of the items and II. C. The impact of weight and format in postal pricing**

It would be interesting to know in more detail the justification for the three categories of weight which is described in the opening paragraphs of this section. They appear to be a little arbitrary. Take for example an itemised telephone bill in a C5 envelope. If it consists of 7 sheets of A4 paper it is likely to weight under 50g and therefore would be process as small format (SF), but if it contains eight pages it would fall into the large format (GF). In countries that I am familiar with both items would be handled in exactly the same way, and I would advise that you ascertain whether the items are actually treated in different streams in France, and how the separation is effected.

The ARCEP paper refers to the evolution of postal tariffs from a weight based system to a format based system. This was the subject of a presentation, the "*Evolution of the Tariff Structure throughout Europe*" by Vanessa Devereux and I at the 12th Conference

on Postal and Delivery Economics in Cork, Ireland, 2-5 June 2004. Please refer to link at
→ http://www.postinsight.com/files/HearnDevereux_CRRIsides.pdf

It might briefly be observed that the concept of the standardised letter was introduced by the Tokyo Convention of the UPU (1969) and Australia was the first country (1974) to use it for pricing purposes. Ireland adopted it in 1986. In Britain the Carter Committee (1977) described the case quite succinctly;

The minimum letter post rates should in principle apply to objects which are convenient to sort as letters: that is to flat envelopes or cards within a certain size range. We note that this is how Australia defines a letter, and the British use of weight limit seems to us to be an imperfect substitute.....

It would be convenient to business if anything capable of inclusion in a 'Post Office Preferred' size of envelope went at the minimum letter rate without the trouble of weighing it.

The European Commission Green Paper on Postal services (1991) addressed this, in the context of terminal dues, in the following manner:

....any system based purely on weight will inevitably lead to differences between actual delivery costs incurred and the compensation payments made. Firstly, delivery costs are related more to the number of items delivered rather than their total weight. Secondly, the same compensation was paid regardless of the level of delivery service required. Thirdly, a single universal system ignores the reality that unit costs will vary – and mostly for reasons unrelated to efficiency.

With the adoption of the first Postal Directive and the establishment of independent NRAs such as ComReg and ARCEP this issue was crucial in terms of accounting and pricing. The ODTR's¹ Consultation Document No. 01/29 (April 2009) first raised this issue in the context of complying with the community acquis (see also the Decision Document No. 01/74). From a pricing viewpoint ComReg and An Post sought to bring tariffs into line with the geared to cost / cost orientation principle in a phased way (starting in April 2002 and illustrated graphically at slide 30 of the Hearn/Devereux presentation previously cited) while Postcomm / Royal Mail went for a "big bang" type changeover in August 2006. There is no harmonised model (see slide 32 of Hearn/Devereux) and weight is still a feature of all tariffs. Your attention is also drawn to section 4.4 of ComReg's Document No. 02/111 which deals with the issue in some detail.

¹ ComReg's predecessor

What might be observed here is a need to ensure that the definitions used for size reflect the actual practices of each specific operator.

ComReg Document No. 02/111 disclosed the position that only around 5% of costs were weight related, and a concern of ComReg which remains to be addressed is the number and range of weight steps that might be warranted. It is interesting to note that in the parcels segment of the market most of the innovative operators are moving to volumetric (dimensional) pricing (and of course this has been a feature of the airline industry for many years). See for example:

DHL: → <http://www.dhl-servicepoints.ch/de/pakete/dhl-a-pac-nationaler-versand.html>
or

→ <http://www.dhlservicepoint.co.uk/sizeprice.htm>

GLS: → http://www.gls-group.eu/276-I-PORTAL-WEB/resources/ps_pricelist_ie.pdf

La Poste: → http://www.colissimo.fr/portail_colissimo/ficheProduitAction.do?f=FR-2 (I understand that the weight limits are only fixed in relation to the ability of the package to withstand transit).

4 II. D. How analytical accounts can measure this impact?

It is noted that the paper states that " The recourse to a relevant information system and faithful is the most robust solution, but in the large majority of cases, accounting information does not allow to assign to each product a direct assessment of costs depending on its weight or its format." This statement needs to be challenged. Experience suggests that it is true postal operators' cost accounting systems do not disaggregate costing information to the necessary level of detail to do so, but this does not mean that it cannot and should not be done. For example the actual sorting process is invariably organised on a format basis (and this was the case 50 years ago when manual sorting was the norm). In principle, there should be no reason why the resources involved in each stream of processing cannot be separately recorded, costed, and directly allocated to the relevant products. Similarly the processes to plan the routes of the delivery persons, whether manual or computerised, done periodically or daily, will enable the time/cost attributable to specific services, a mixture of services, or all services to be identified. In this regard, I would draw your attention to a report by Copenhagen Economics published on 8 May 2008 and entitled "The cost of Post Danmark's universal service obligation ". Please see document at link below.

<http://www.copenhageneconomics.com/Publications/Competition---Regulation.aspx>

It contains useful information about the amount of time that is spent simply delivering unaddressed mail. Again there is a need for much further study.

The Postal Directives are of course quite prescriptive in requiring the use of EPMU (equi proportional mark up) to allocate common costs.

5 Conclusion

I hope you will find these few comments helpful. They are in no way meant to be prescriptive, but simply to point you in the direction of areas for further study.