

AUSTRALIA POST PRICE NOTIFICATION – STATEMENT OF REASONS

DECISION

Pursuant to section 22(2)(b)(ii) of the *Prices Surveillance Act 1983* (PS Act), the Australian Competition and Consumer Commission (ACCC) has no objection to the proposed price changes to Australia Post's Ad Post service.

REASONS FOR DECISION

Background

In December 2001, Australia Post lodged a notification with the ACCC proposing changes to the pricing of its Ad Post service in accordance with the PS Act and following procedural advice from the ACCC. This notification is identical to a draft notification that was lodged with the ACCC in November 2001. The draft notification is a revised form of an earlier draft notification lodged with the ACCC in June 2001. The proposed changes would phase out the current content-based Ad Post discount for all customers except charities.

This is not the first notification proposing changes to the Ad Post discount structure. In March 1999, Australia Post lodged a notification that included a reduction in Ad Post discounts from 26.5 percent to 21 percent. The reduced discount was introduced in April 2000.

The Ad Post service commenced in 1976 as a discounted price incentive for advertising mail. Australia Post argues that its original purpose was to foster the use of direct mail advertising, then a relatively new marketing medium. Australia Post argues that direct mail is now a mature medium representing \$1.3 billion of expenditure in Australia in 1999.

Australia Post contends that Ad Post prices have not changed substantially since 1992 (with the exception of the April 2000 removal of the higher discount) for items that prompted a mailed response. Australia Post also argues that during this 10-year period the consumer price index will have increased by some 23 percent net of estimated GST effects.

In Australia Post's view, discontinuation of the Ad Post service will see customers migrate to the equivalent Barcode Pre-sort service. The phase out is proposed in two stages:

- ? a 10 percent increase in Ad Post Prices from 1 July 2002; and
- ? the discontinuation of the Ad Post service in 1 January 2003, resulting in a further 9 percent price increase as customers migrate to the equivalent Barcode Pre-sort service.

Australia Post argues that as the change will be made in two stages, each six months apart, customers will have an extended period of time to adjust to the removal of the discount.

As noted previously, a separate mailing category is to be created for registered charities, at current Ad Post rates. Australia Post proposes that only charities endorsed by the Australian Tax Office as Income Tax Exempt Charities would be able to register as charities for Ad Post discounts. Australia Post notes that the detail of the new arrangements is the subject of consultation and discussion with charities and their representative bodies.

Assessment Process

On 22 June 2001, the ACCC received a draft notification from Australia Post. The ACCC received detailed briefings from Australia Post about the notification. After lodgement of the draft notification, the ACCC sought additional information on the proposal. This information was provided to the ACCC on 9 July 2001.

The ACCC called for submissions or comments from various user groups on this proposal. Representative bodies, including the Major Mail Users of Australia (MMUA), the Australian Direct Marketing Association (ADMA), the Australian Consumers' Association, Reader's Digest (Australia), Printing Industries Association of Australia and the Fundraising Institute-Australia were contacted. Eleven parties made submissions to the ACCC on the proposed changes (refer to Appendix A for the list of parties who made submissions).

Subsequently, Australia Post withdrew the initial draft notification and undertook further consultation with interested parties.

In November 2001, the ACCC received a revised form of the earlier draft notification lodged with the Commission in June 2001. The ACCC called for further submissions from various user groups on this proposal. Representative bodies, including MMUA, ADMA, the Australian Consumers' Association, Reader's Digest (Australia), Printing Industries Association of Australia and the Fundraising Institute-Australia were contacted. It is important to note that the magnitude of price increase remained unchanged from that submitted in the draft notification that was lodged in June. The main purpose in seeking further submissions was to enable interested parties to raise any further issues. Four parties made submissions to the ACCC on the revised draft notification (refer to Appendix B for the list of parties who made submissions). Because the revised notification contains identical price increases to the original draft notification, the ACCC has also had regard to comments made in relation to the earlier draft notification for the purposes of considering the revised notification.

Australia Post's Position

Australia Post argues that the justification for the effective price increase for advertising mail is two fold.

Profitability

Australia Post's principal argument in support of the notification is that the Ad Post price increases are needed as the service has incurred substantial losses for many years. Ad Post pricing is approximately 20 percent below the equivalent Pre-sort product, and the revenue from the Ad Post service represents 12.7 percent of all letters revenue.

Even with recent reductions in the discount, Australia Post anticipates a modest loss for the service in 2000/2001.

Administrative Burden

Pricing of the Ad Post service is based on content. Consequently, Australia Post argues that the discount bears no relationship to costs. Australia Post notes that the processing and delivery costs are the same for all addressed mail regardless of content. However, Australia Post claims that the costs of acceptance of Ad Post mail are higher than for other mail due to the need for submission by the customer and approval by Australia Post of mail contents. Australia Post argues that this is an administrative burden for both Australia Post and customers which will be removed under this proposal.

Feedback From Users

A number of companies reported that they rely heavily on the Ad Post service and will therefore incur significant additional costs because of the proposed price increases. There was consistent feedback from users over a number of key issues.

Feedback From Users On Initial Draft Notification

Consultation

A majority of interested parties originally raised concerns with Australia Post's consultation process. It has been argued that despite the fact that there are avenues of consultation between Australia Post and its customers over pricing and service issues, no consultation took place prior to Australia Post informing users of the proposed price increase.

MMUA, a peak body whose members include Mailing Houses, claims that the process followed ignored the Australia Post – MMUA Code of Practice of October 1999. The Code of Practice states that "Australia Post will consult with users of its bulk mail services and the MMUA in developing new prices for the Reserved Services." This issue of inadequate consultation between Australia Post and users of the Ad Post service is also voiced by ADMA, a peak body representing the direct mail and direct marketing industry in Australia. Reader's Digest (Australia), a signatory to the Code of Practice, also concurs with the arguments of the MMUA and ADMA.

Permail, a mailing service provider, also maintains that considering the magnitude and the rapid implementation proposed for the price increases, there should have been adequate consultation with users of the Ad Post service regarding the price increases and any effect that these increases may have on the users. Printing Industries Association of Australia, a major representative organisation of users of the mail system, expressed the same concerns.

Lead Time

As a related issue, interested parties have argued that the lead-time for the introduction of the Ad Post pricing changes is insufficient. Interested parties note that they were only given notice of the proposed pricing changes after having completed budgets for the 2001-02 financial year. According to the MMUA, most companies in the industry

budget 18-months ahead, some report a 24-month lead period. A number of interested parties have also contrasted the implementation process for the Ad Post price rises with the transparent consultation and implementation process for the Barcode Project.

Reader's Digest (Australia), a global publisher and user of direct marketing services, and ADMA also expressed concern at the lack of sufficient notice given to users of the Ad Post service in light of the timing of the proposed price increases.

Flow on Effects of Ad Post Expenditures

Interested parties have also raised a number of issues in relation to the reasons outlined by Australia Post in support of the notification. In particular, a number of users of the service have indicated that cost incurred in the provision of Ad Post services have flow on (or multiplier) effects on other postal products and services. ADMA submits that one of the major values of the Ad Post service is that it multiplies the use of the mail service in a number of ways, namely: business reply mail; shipment of products; invoices; payments; returned items; product replacements; repeat orders; customer inquiries; and response to inquiries. Coles Myer and the Advertising Federation of Australia (AFA) concur with ADMA's submission.

These parties, therefore, take issue with the claims concerning the profitability of Ad Post, arguing that any analysis should take into account the impact that any spending by Australia Post in the provision of the Ad Post service would have on other postal products and services.

Administration Cost in Providing Ad Post Services

Interested parties also disagree with Australia Post's arguments concerning the "administrative burden" of complying with the Ad Post arrangements. Users generally argue that the administrative burden is minimal and, to the extent that it does exist, Australia Post should change the system of administering Ad Post rather than dismantling the whole service.

Health Pride and Magnamail, both mail order companies, argue that any time a lodgement is made with Australia Post for advertising material, a form is filled in by the customer and is lodged with a sample of the mailing piece to Australia Post. The lodgement is accompanied with an appropriate fee as determined by Australia Post from time to time. Health Pride and Magnamail maintain that this fee charged by Australia Post is meant to compensate for the "administrative burden".

Mouth and Foot Painting Artists, an organisation of disabled artists, argues that the administrative burden is minimal and that it takes a few minutes for customers to lodge samples of the mailing piece to Australia Post and similarly for Australia Post to approve. Permail, a mailing service provider, supports these arguments.

Demand Response to Changes in Ad Post Pricing

At present there appears to be no substantial shift away from mail, but the Direct Marketing industry is actively exploring and using alternate channels. It has been argued by users of Australia Post's Ad Post service that e-mail, telemarketing and alternate mail delivery services are emerging as effective alternatives to Ad Post.

ADMA argues that increases in the price of Ad Post services will accelerate the growth of these alternate channels of distribution.

ADMA contends that lower postal costs associated with lodging mail in some overseas countries, combined with lower printing, preparation and handling costs has encouraged some in the industry to begin exploring the viability of using international re-mail services. Should this option prove feasible, this would mean moving some of the services provided by Australia Post off shore.

ADMA claims, therefore, that any increase in profitability that Australia Post may expect to gain by raising Ad Post prices is likely to be offset by a fall in demand for this product.

Feedback From Users Regarding Revised Draft Notification

Magnitude of Price Increases

The Advertising Federation of Australia, Australian Retailers Association, Coles Myer, Doubleday and Reader's Digest all argue that the proposed price increases are excessive. All argue that the price increase will change the mailing patterns of Ad Post users and/or be passed on to consumers.

Consultation

Doubleday Australia, a direct marketing company, and Coles Myer, a large user of the Ad Post service, agree with earlier submissions that no consultation took place prior to Australia Post informing users of the proposed price increase. As such, users have not been given sufficient time to plan for changes to the current pricing structure.

Following the withdrawal of the original draft notification, Australia Post undertook further consultation with users of the Ad Post service. Reader's Digest submits that along with others in the mailing industry, it has had discussions with Australia Post about the proposed increases in Ad Post prices. MMUA notes it and Australia Post have agreed upon a formal consultation process protocol and consultations based on the protocol were held.

Lead Time

Coles Myer submits that users of the Ad Post service have not been given sufficient time to plan for the changes to the current pricing structure.

MMUA and Reader's Digest argue that following further consultation with Australia Post, they have agreed in principle with Australia Post on the revised introduction dates. MMUA notes that in deciding not to raise any further objection to the proposed pricing increases, it has been influenced by the manner in which Australia Post shared with MMUA its reasonings, planning concepts and its agreed willingness to work with MMUA in the future in a permanent task force to address matters of common interest in the special area represented by Ad Post services.

Administration Cost in Providing Ad Post Services

Doubleday agrees with other users of the Ad Post service that the administrative burden is minimal. The company notes that any time a lodgement is made with Australia Post for advertising material, a form is filled in by the customer and is lodged with a sample of the mailing piece to Australia Post. The lodgement is accompanied with an appropriate fee as determined by Australia Post from time to time. Doubleday argues that to the extent that the Ad Post service does exist, Australia Post should change the system of administering Ad Post in order to improve the system.

Demand Response to Changes in Ad Post Pricing

Doubleday concurs with earlier submissions that the increase in Ad Post prices will force it to look for alternative suppliers overseas. It adds that the decision to use overseas mail services also carries the possibility of moving Doubleday's brochure, letter and envelope printing business offshore along with its mail processing business. If no suitable offshore solution can be found, Doubleday argues that it will be forced to either reduce its direct mail activity or pass on cost increases to its customers.

ACCC's Assessment

Australia Post originally submitted a draft notification of changes to the price of the Ad Post service in June 2001. In the ACCC's public consultation process on this original draft notification, interested parties raised significant concerns with the consultation process surrounding the proposed price increase. It was argued that despite the fact that there were agreed avenues of consultation between Australia Post and its customers over pricing and service issues, no consultation took place prior to Australia Post informing users of the proposed price increase.

It was further claimed that the process followed ignored the Australia Post – MMUA Code of Practice of October 1999 which states that "Australia Post will consult with users of its bulk mail services and the MMUA in developing new prices for the Reserved Services."

As a related issue, interested parties argued that the lead-time for the introduction of the Ad Post pricing changes was insufficient. Interested parties noted that they were only given notice of the proposed pricing changes after having completed budgets for the 2001-02 financial year. Major interested parties also contrasted the implementation process for the Ad Post price rises with the transparent consultation and implementation process for the Barcode Project.

The ACCC shared the concerns of interested parties with the consultation procedures and lead-time in the original draft notification. However, the ACCC is of the view that these issues have now substantially been addressed.

After withdrawing the original draft notification in July, Australia Post engaged in further consultation with users. Further, Australia Post has developed consultation process protocols with both ADMA and the MMUA. A key element of the protocols is that consultation will take place with major users of Australia Post's bulk mail services prior to the ACCC being formally notified of proposed price changes. Information and views expressed in this consultation process are to be taken into account by Australia

Post in formulating its proposals. The ACCC supports the development of this consultation process.

The process of further consultation has delayed the proposed introduction of the initial 10 percent price increase for eight months, from 1 November 2001 to 1 July 2002. Given that major users were made aware of proposed price increases to the Ad Post service in June 2001, the ACCC considers that the lead time for the introduction of the proposed price increase is now adequate. The ACCC is of the view that the revised proposal allows companies to plan forward budgets in the knowledge of the increases.

While the revised draft notification proposes delaying the timing of the price increases, the magnitude of the price increases remains the same. There is a proposed 10 percent increase in the price of the Ad Post service from 1 July 2002, with a further 9 percent increase from 1 January 2003.

Australia Post argues that the fundamental reason that these price increases are necessary is that the Ad Post service has incurred significant losses for many years. The ACCC sought clarification from Australia Post on costs, revenues and profits associated with the Ad Post service. The data provided to the ACCC indicates that Australia Post will make a loss on the Ad Post service for 2001/02.

A number of users of the service have suggested that Ad Post expenditures create flow on effects to other postal products and services. They, therefore, take issue with the claims concerning the profitability of Ad Post, arguing that any analysis should take into account the flow on impacts of any Ad Post spending. The ACCC acknowledges that, although it may be difficult to quantify, Ad Post expenditures will have some flow on effects on other Australia Post services.

Interested parties also disagree with Australia Post's arguments concerning the "administrative burden" of complying with the Ad Post arrangements. Users generally argue that the administrative burden is minimal and, to the extent that it does exist, Australia Post should change the system of administering Ad Post rather than dismantling the whole service. It appears likely that the administrative burden of complying with the Ad Post arrangements may be minimal, and therefore the ACCC does not accept it as a material reason for the price increases which will phase out the Ad Post service.

On balance, however, the ACCC concludes that there doesn't appear to be grounds for a discount on the Ad Post service relative to other services. As noted by Australia Post, Ad Post prices have not changed substantially since 1992, with exception of the April 2000 reduction in the level of discount. As a result, Australia Post has consistently recorded a low rate of return on the Ad Post service.

The ACCC considers that it is also important to remember that Ad Post commenced as a discounted price incentive for advertising mail. Given that direct mail advertising is now a mature marketing medium, the ACCC considers that there does not appear to be a case for obliging Australia Post to provide a discounted mail service, when the price of the service does not cover its costs.

The ACCC considers that in making pricing decisions Australia Post would be likely to consider profitability across a range of its services, rather than just for Ad Post in

isolation. It is, however, difficult for the ACCC to assess the profitability of an individual service, such as Ad Post, without assessing the profitability of the total reserved service.

Appendix A

The following parties made submissions to the ACCC in response to Australia Post's initial draft notification.

- ? Australian Direct Marketing Association
- ? Australia Mailing
- ? Buscombe Limited
- ? Fundraising Limited Australia
- ? Health Pride Pty Ltd
- ? Magnamail Pty Ltd
- ? Major Mail Users of Australia Ltd
- ? Mouth and Foot Painting Artists Pty Ltd
- ? Permail Pty Ltd
- ? Printing Industries Association of Australia
- ? Reader's Digest (Australia) Pty Ltd

Appendix B

The following parties made submissions to the ACCC in response to Australia Post's revised draft notification.

- ? Advertising Federation of Australia Ltd
- ? Australian Retailers Association
- ? Coles Myer Ltd
- ? Doubleday Australia Pty Ltd
- ? Major Mail Users of Australia Ltd
- ? Reader's Digest (Australia) Pty Ltd