



# **Review and assessment of An Post's application for changes to the charges for postal services within the scope of the universal postal service**

**A REPORT PREPARED FOR COMREG**

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## Executive Summary

An Post, the designated Universal Service Provider, has made an application to ComReg for changes to the charges for postal services within the scope of the universal postal service, for items weighing up to 50g.

An Post's application is governed by the Communications Regulation Act 2011. Section 30 (12) of the Act allows that pending the making of a price cap decision under subsection (2), unless otherwise directed by the Commission under section 28(5), no change shall be made by An Post to any charge that applies immediately before the passing of this Act for postal services within the scope of the universal postal service relating to postal packets weighing less than 50 grams without the prior consent in writing of the Commission.

Frontier Economics have been commissioned to assist ComReg as it determines whether to consent to the proposed price increase. In line with our terms of reference we have identified the following four key issues for review.

- An Post's volume and revenue forecasts, and the assumptions made around e-substitution in Ireland;
- price elasticities in the Irish mail market and the resulting volume and revenue response to An Post's proposed price changes;
- the affordability of An Post's proposed price changes; and
- a review of costs and the cost reflectivity of An Post's proposals.

## An Post's proposals

For products requiring prior consent by ComReg<sup>1</sup>, An Post has applied for an average 12% price increase for domestic products and an 11% price increase for international outbound products. An Post has applied to increase the price of a stamped letter by 18% from 55c to 65c. For those products requiring notification but not prior consent by ComReg<sup>2</sup>, An Post has already introduced an average 10% price increase for domestic products and an 8% price increase for international outbound products.

An Post has also proposed the introduction of a bulk mail product An Post refers to as a Downstream Access (DSA) product. This product would be available [€], compared to a price of €0.41 for the current bulk product, and would have additional requirements to existing bulk mail products.

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<sup>1</sup> Up to 50 grams in weight

<sup>2</sup> Greater than 50 grams in weight

An Post proposed additional discounts for certain customer segments, including:

- a reduction of the volume threshold for meter customers to avail of discounts (from 350 to 200 items); and
- the online availability of bulk stamp purchases, with a minimum order quantity of 300.

## Context

Postal operators are facing challenges as they adapt to significant shifts in demand and falling volumes. Historically, there has been a strong link between economic growth and mail volume growth. In the early 2000s, this link started to breakdown as the importance of e-substitution increased. While economic growth remained an important driver of volumes, mail volumes initially grew by less than the economy, and then started to fall in absolute terms.

In consequence, over the last five years, a combination of the European-wide recession and increasing e-substitution by customers, have provided significant operational and financial challenges for operators and regulators. In Ireland, the economic crisis and its depressing impact on economic activity appear to have had a substantial negative impact on mail volumes.

Since 2007, An Post has experienced a year-on-year decline in mail volumes. Between 2007 and 2011, core mail volumes (excluding publicity post and election volumes) declined by 20%<sup>3</sup>. As part of this, domestic volumes declined by around 16%.

This decline in volumes has also impacted on the financial position of the USO. While An Post has implemented a cost reduction programme, the reduction in costs has not offset the decline in revenues associated with the USO. ComReg have recently issued a decision (ComReg document 12/81) setting out the services to be provided by An Post as part of the USO. As this was issued after An Post's price application, we have not been able to assess the overall financial position of the USO.

Looking at the magnitude of the price increases requested by An Post, they appear to be substantially above inflation. Prices last increased in March 2007. Since then, inflation has been relatively modest, with the CPI increasing by

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<sup>3</sup> In An Post's application it states that "[i]n the period from 2008 to 2011 An Post's mail volumes declined by 23.5%", page 6. In its response to Frontier's information request of 25<sup>th</sup> June 2012 it explains that this figure is based on core mail revenue, stating that "[v]olumes have actually declined by 20%" between 2007 and 2011.



4.4%<sup>4</sup>. If prices had increased in line with inflation over the period, the domestic price today for sending a stamped letter would be 2c higher at 57c.

In terms of international comparisons, An Post's current prices appear relatively low when compared to mail operators in other European jurisdictions<sup>5</sup>. Ireland also compares favourably on price to a number of jurisdictions with higher per capita mail volumes. A number of European postal operators have increased prices recently. It is too early, however, to see the impact on mail volumes or viability of the USO.

## An Post's volume and revenue forecasts

From 2013 onwards, An Post has assumed a uniform 3% per annum decline in volumes across the board (before taking into account the impact of the proposed price increase). An Post suggests that this is based on its internal assessment of micro- and macro-economic factors, and a range of international benchmarks and comparisons. Our assessment is that An Post's forecast appears optimistic, and, even before we consider the impact of the proposed price increase, there is a very substantial risk that volume declines will be significantly higher than currently forecast by An Post. This creates a risk that, in the event of ComReg allowing the proposed price increase, the subsequent decline in volumes will appear exaggerated and will be associated with the price increase, rather than an error in An Post's forecast.

- Current trends in the decline in mail volumes are substantially higher than those being forecast by An Post for 2013 and 2014. However, An Post has indicated that volume declines this year are running ahead of forecast at c.7%, compared with an original forecast of 5% for 2012.
- Estimating a decline of 3% for domestic letters, flats and international mail in 2013 and a uniform decline of 3% in 2014 is also inconsistent with the evidence of trends in volume declines in the last few years. These trends show substantial differences in the rate of decline of different products, and that volumes for some products, such as parcels, have held up well as a result of the growth in fulfilment mail. Moreover, while the adverse macro-economic situation might be expected to have a generally depressing impact on mail volumes, some products, such as letters, may also be subject to greater additional downward pressures from e-substitution. Overall,

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<sup>4</sup> The inflation figure here relates to the period March 2007 to May 2012.

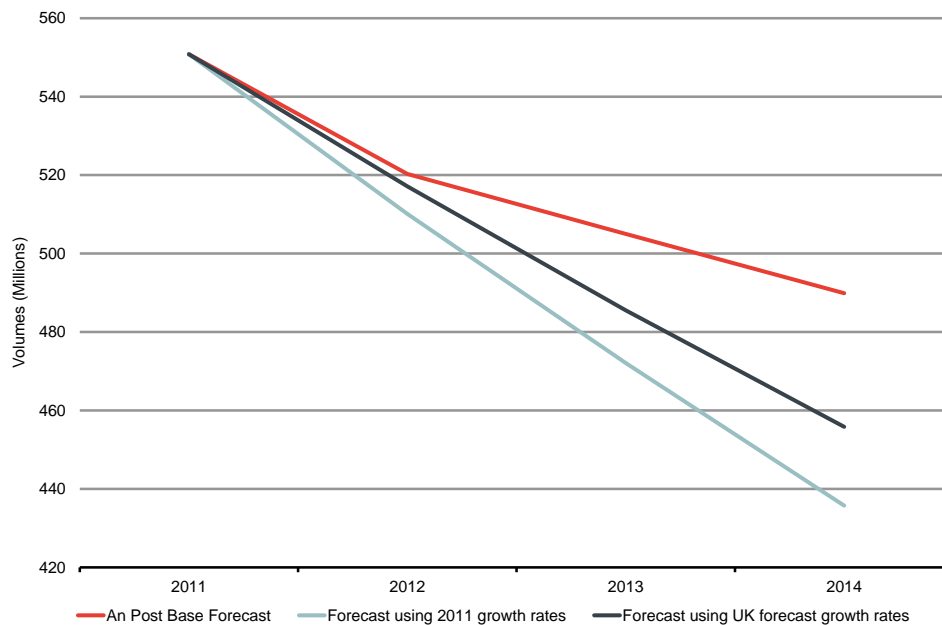
<sup>5</sup> Note, such international comparisons must be considered with caution given the differences both in service levels (e.g. in some countries there is a 2<sup>nd</sup> class as well as a 1<sup>st</sup> class postal service), and in postal networks, that can both have a substantial impact on costs.

therefore, it is difficult to understand how a uniform volume estimate for all mail products is appropriate.

- An Post's forecast is at the low end of the range of international comparisons it has considered. Moreover, it is not clear that Ireland is at the same point in the cycle as the countries to which it is being compared (either in terms of e-substitution or economic growth). For example, in the UK, Royal Mail is forecasting annual declines of 5%. If An Post's volume declines were to trend towards Royal Mail declines, we would expect An Post to show declines of c.6%, double the 3% decline in their forecast from 2013 onwards.
- It is not clear that Ireland has experienced the full impact of e-substitution, particularly with respect to transactional mail. Assessment of trends in volumes for An Post's largest customers suggests that volume declines have only been observed in the last two years, and that the volume declines may be driven by the current economic crisis in addition to e-substitution.
- It is unlikely that An Post's proposed DSA bulk mail product will be able to mitigate the impact of e-substitution. An Post has assumed that [X] of bulk volumes will switch to its proposed DSA product in a relatively short period of time, and so will face an effective price cut. However, given the proposed terms and conditions associated with the DSA bulk mail product, and ComReg's recent regulation regarding the specification of the USO with respect to bulk mail, this appears unlikely. In consequence, we suggest that in excess of [X] of bulk mail is likely to face a price increase as a result of An Post's price proposals. We have not been able to assess the impact that such an increase might have in terms of accelerating e-substitution. However, it is not unreasonable to assume it will have a negative impact on volumes.

As a result, it is probable that An Post's baseline forecasts will underestimate the decline in volumes in the medium term. Figure 1 illustrates the sensitivity of these forecasts to alternative growth rates. If the yearly decline were to trend towards Royal Mail declines, the volume decline for the period would increase from 11.1% to 17.2%. The volume decline would increase to 20.9% if current Irish trends were to continue.

**Figure 1.** Sensitivity of An Post's baseline volume forecasts to alternative growth rates



Source: Frontier analysis of An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

## The impact of An Post's price proposals

An Post has estimated that its proposed price increases will yield an additional €16.3 million in the first full year of implementation, and accelerate volume declines by only one percentage point. We have reviewed An Post's methodology and analysis, and we believe that An Post have presented a quite optimistic scenario in terms of the impact of their proposed price increase.

- The consumer survey evidence provided by An Post suggests there may be considerable consumer resistance to the proposed price increases. Almost 50% of consumers surveyed indicated that they would not be prepared to pay 65c for a stamp. This is of particular concern given already declining volumes and the potential for e-substitution to increase.
- The independent price elasticity analysis commissioned by An Post provides a reasonable range of four estimates for price elasticity, and is based on standard econometric approaches to the estimation of price elasticities. An Post has taken the lowest estimate from the range in its analysis, although we note that two of the other elasticity estimates are similar to that used by An Post. In consequence An Post has presented the 'best case' assessment of

the revenue and volume impacts of the proposed price increases<sup>6</sup>. An Post has also included as its base case, a high take up rate for the DSA bulk mail product. On this basis, An Post forecasts that the proposed price increase would accelerate volume declines by just 1.2 percentage points, and would improve An Post's revenue position by 6 percentage points relative to the baseline.

- Our sensitivity analysis shows that higher volume declines and lower revenue impacts may arise. Figure 2 illustrates the range of volume declines that could occur under alternative price elasticity estimates. In particular, An Post's proposed price increase could result in accelerating volume declines of up to 3.2 percentage points relative to the baseline, and result in an improvement in An Post's net revenue position of up to 3.6 percentage points relative to the baseline by 2014.

Under An Post's modelling, in comparison, they estimate a 1.2 percentage point acceleration in volume declines relative to the baseline, and an improvement in net revenue position of 6.1 percentage points. An Post expects an increased loss for domestic and international outbound mail (excluding parcels) of €52 million in 2014 under their baseline scenario<sup>7</sup>. An Post's model estimates that the expected loss in 2014 would reduce by €22 million to €30 million with the proposed price changes<sup>8</sup>. This estimate is mainly driven by the expected increase in revenues, along with an estimated small reduction in costs of €846,000.

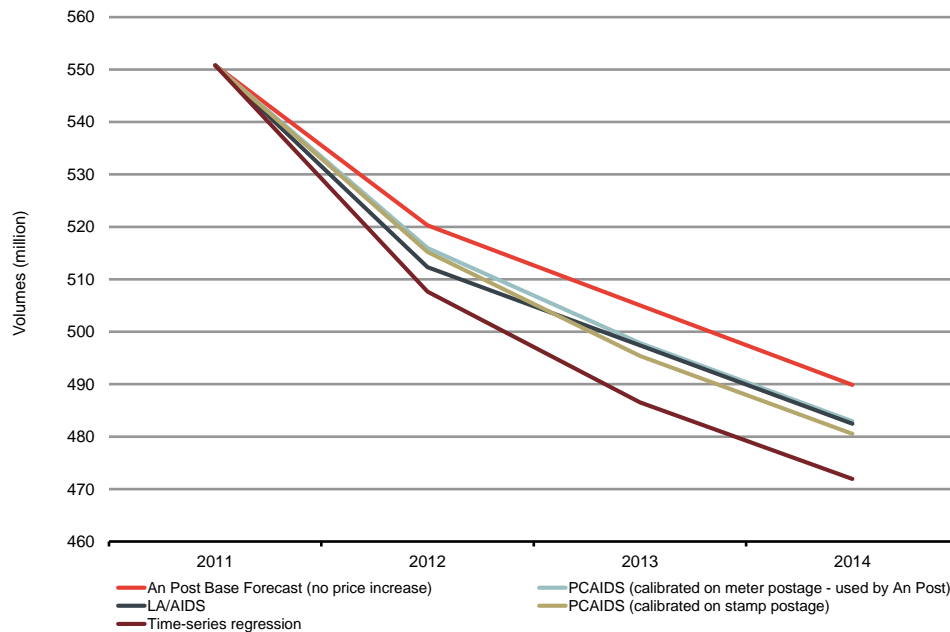
In comparison, our sensitivity analysis suggests that the loss may only be reduced by €14 million to €38 million, a difference of €8 million. The sensitivity analysis has been unable to capture the impact of lower DSA take up. Given that customers that do not opt for the DSA product face a price increase, this should result in greater volume declines than those estimated above. An effective price increase for bulk customers may be of particular concern as it runs the risk of accelerating e-substitution.

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<sup>6</sup> An Post have argued that they believe that this also represents the most realistic estimate.

<sup>7</sup> As noted earlier, this baseline does not correspond to ComReg's revised USO specification.

<sup>8</sup> Note, the profitability figures presented here exclude the impact of the proposed DSA product. That is, it looks at the difference between An Post's profits with and without the proposed price increases, assuming that the DSA product is introduced in both scenarios. An Post's model does not allow for the DSA product being excluded in the without price increase scenario.

**Figure 2.** Comparison of the volume impact of alternative price elasticity estimates

Source: Frontier analysis of An Post's price application - App 3 Revenue and Volumes Model 2010-12 with DSA\_65c

## The affordability of An Post's proposals

An Post has argued that there will be no affordability issues for any customer groups. They suggest that for residential customers, customer research suggests price is not a major factor for customers, and post makes up a small proportion of total expenditure. For SMEs, An Post argues that the majority of customers will face only a negligible increase in costs and/or will be able to avail of additional discounts. For large customers, An Post argues that the availability of the DSA bulk mail product provides these customers with an effective discount and so there can be no affordability issues.

We find that there is unlikely to be a material affordability issue for residential customers. However, some business customers are likely to face substantial increases in postal costs. An Post has not provided evidence to demonstrate that these increases will not give rise to affordability concerns for business customers.

- For residential customers there appear to be no substantial affordability impact, as even for the lowest decile income group the price increase results in a less than 0.1% decline in disposable income. However, it is important to note that results from an An Post consumer survey on consumer willingness to pay suggest that there may be some price resistance.

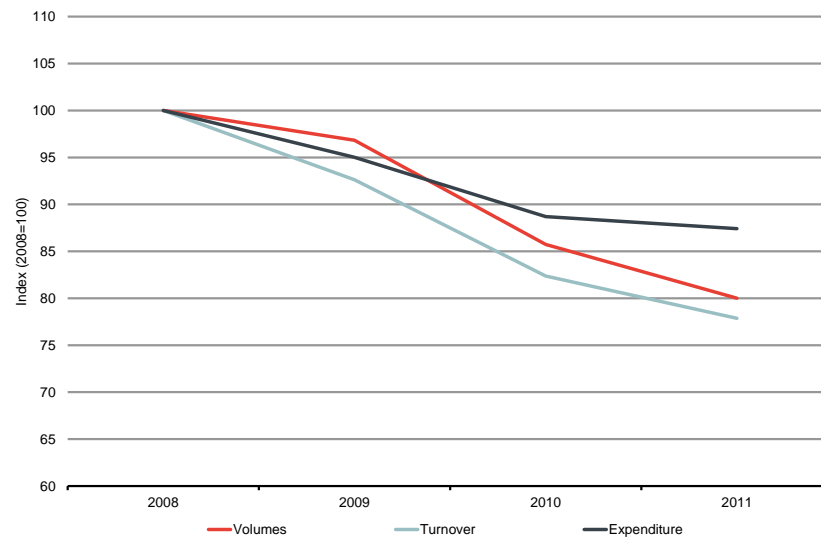
- For SMEs the evidence is less clear-cut. The majority of meter customers [X] would face an average annual increase in postage costs of [X] per year if they were to maintain their current volume of mail. However, for a small proportion of customers, annual postage costs may increase by more than [X] per year.
- For large customers, it is less clear that they will avail of the DSA product. This will largely depend on the additional costs associated with fulfilling the requirements of the product and therefore whether large customers will be effectively facing a price increase. For customers that do not avail of the DSA product, the increase in postage costs may be substantial. For example, the 27 largest customers would face an average postage cost increase of in excess of [X] for the same volume of mail, and An Post's largest customer would face an increase of over [X] in postage costs.

## An Post's costs and the cost reflectivity of their proposals

Our key findings in relation to An Post's costs and the cost reflectivity of their proposals are as follows:

- As illustrated in figure 3 below, An Post has reduced its costs by 12% since 2008, compared to volume reductions of c.20% over the same period. This indicates that An Post has achieved a cost elasticity of 0.6 (i.e. every 1% decline in volumes leads to a 0.6% decline in costs). An Post has, however, indicated that looking ahead they believe their cost elasticity will be closer to 0.2. This suggests that further unanticipated declines in the USO volumes will have a more significant impact on the financial position of the USO. We note also that the Act provides for ComReg to set a price cap for An Post, and it will be important for An Post to consider the scope for further efficiencies in that context.

**Figure 3.** 2008-11 Index of volumes, turnover, expenditure, number of FTEs and Headcount



Source: An Post's Regulatory accounts

\*Total headcount figures exclude casual staff

- We note that 60% of cost reductions have come through reductions in payroll. To date, these appear to have been achieved through reductions in staff costs and reductions in the number of casual staff. As illustrated in figure 3 above, while the number of FTEs has declined by [X] since 2008, headcount reduction for permanent and contract staff has been [X]. As can be seen from the figure above, the decline in headcount and FTEs has been substantially lower than volume and turnover declines over the same period.
- A comparison of unit costs and An Post's price proposals suggests that the changes An Post is proposing would improve cost reflectivity (as benchmarked against the costs set out by An Post in its application).
- An Post has submitted that the proposed changes to the level of discounts offered are justified on the grounds of cost difference. However, ComReg has previously made clear that discounts must reflect only the difference in avoided cost associated with the payment method.

# 1 Introduction

On the 3<sup>rd</sup> February 2012, An Post, the designated Universal Service Provider, made an application to ComReg for changes to the charges for postal services within the scope of the universal postal service, for items weighing up to 50g.

An Post's price application is governed by the Communications Regulation (Postal Services) Act 2011, which provides for regulation of postal services in Ireland. Specifically, Section 30 (12) of the Act allows that pending the making of a price cap decision under subsection (2), unless otherwise directed by the Commission under section 28(5), no change shall be made by An Post to any charge that applies immediately before the passing of this Act for postal services within the scope of the universal postal service relating to postal packets weighing less than 50 grams without the prior consent in writing of the Commission.

Frontier Economics has been commissioned to assist ComReg in determining whether to consent to the proposed price increase. The terms of reference under which Frontier has been appointed to review and assess An Post's application require us to carry out five key services.

1. A high-level examination and review of An Post's forecast volumes for no changes in charges and for the proposed changes in charges.
2. A review as to whether An Post's proposed changes to the charges for postal services within the scope of the universal postal service are affordable.
3. A high-level examination and review of the allocation of costs by An Post to postal services within the scope of the universal postal service to assess whether the proposed changes to charges are cost-reflective, and that unit revenues and unit costs are aligned<sup>9</sup>.
4. A review as to whether the proposed changes to the charges for postal services within the scope of the universal postal service are transparent and non-discriminatory.
5. A high-level examination and review of the efficiency of the costs incurred / forecast to be incurred by An Post in relation to postal services within the scope of the universal postal service.

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<sup>9</sup> An examination and review of An Post's compliance with the Accounting Direction is currently being carried out by Analysys Mason and does therefore not come under the remit of Frontier's work.



In order to complete our assessment, we have reviewed An Post's price application in detail, as well as An Post's responses to a number of requests for further information. This report provides our assessment of An Post's price application with respect to each element of the terms of reference described above. It is structured as follows:

- section 2 provides the background and mail market context to this review, and summarises the key areas which we analyse in detail;
- section 3 reviews An Post's volume and revenue forecasts, including an assessment of the potential impact of e-substitution on An Post's forecast volumes;
- section 4 evaluates An Post's estimates of price elasticities in the Irish mail market and An Post's estimate of volume and revenue responses to the proposed price changes;
- section 5 provides a review of the affordability of An Post's proposed price changes;
- section 6 assesses An Post's costs, in particular their cost reduction programme, the cost reflectiveness of the proposed changes, and the relationship between volumes and costs; and
- section 7 summarises our key findings.

## 2 Overview of An Post's proposals and market context

In this section we:

- provide a summary of the key elements of An Post's proposed price application;
- set out the main provisions of the 2011 Act which determine the factors which ComReg must take into consideration when assessing An Post's price application;
- provide a high level overview of the performance of the mail sector in Ireland over the last few years; and
- discuss the key issues which must be considered as part of an assessment of An Post's price application.

### 2.1 An Post's proposals

An Post has applied for ComReg's consent to increase prices across the current suite of USO products up to 50g. In addition, An Post notified ComReg of price increases for their USO products greater than 50g. This latter set of price increases came into effect on the 1<sup>st</sup> May 2012.

For those products requiring prior consent by ComReg, An Post has applied for a 12% price increase for domestic products and an 11% price increase for international outbound products overall on their current suite of products. Likewise, for those products requiring notification but not prior consent by ComReg, An Post has introduced a 10% price increase for domestic products and an 8% price increase for international outbound products overall.

On an individual product basis, all USO letters, flats and packets are facing increases of at least 8%. The main domestic tariff increases proposed by An Post are shown in Figure 4, with the main outbound international tariff increases shown in Figure 5. The largest proposed price increase is for stamped letter mail at 18.2%.

**Figure 4.** Main domestic tariff increases proposed by An Post

	Letters tariffs (€s)			Flats tariffs (€s)			Packets tariffs (€s)		
	Current	Proposed	% increase	Current	Proposed	% increase	Current	Proposed	% increase
<b>Stamped</b>	0.55	0.65	18.2%	0.95	1.05	10.5%	2.2	2.4	9.1%
<b>Metered</b>	0.54	0.6	11.1%	0.95	1.05	10.5%	2.2	2.4	9.1%
<b>Bulk (Fully Paid)</b>	0.54	0.6	11.1%	0.95	1.05	10.5%	2.2	2.4	9.1%
<b>Bulk Discount (Lowest)</b>	0.41	0.45	9.8%	0.76	0.84	10.5%			

Source: Appendix 1 of An Post's price application

**Figure 5.** Main international tariff increases proposed by An Post

	Letters tariffs (€s)			Large envelopes tariffs (€s)			Packets tariffs (€s)		
	Current	Proposed	% increase	Current	Proposed	% increase	Current	Proposed	% increase
<b>Zone 2 - Great Britain</b>	0.82	0.90	9.8%	1.50	1.65	10.0%	2.70	3.00	11.1%
<b>Zone 3 - Europe</b>	0.82	0.90	9.8%	1.50	1.65	10.0%	2.70	3.00	11.1%
<b>Zone 4 - Rest of World</b>	0.82	0.90	9.8%	1.50	1.65	10.0%	2.70	3.00	11.1%

Source: Appendix 1 of An Post's price application

An Post is also proposing a number of other initiatives. The main additional initiative is the introduction of a bulk mail product An Post refers to as a Downstream Access (DSA) product. This product would be available at a composite rate of [X], compared to a price of €0.41 for the current bulk mail product, and have additional requirements to existing bulk mail products. The main terms and conditions of the product are listed in the box below.

### Terms and conditions of An Post's proposed DSA product

[X]

An Post is also proposing to provide discounts to certain customer segments. These include:

- a reduction of the volume threshold for meter customers to avail of discounts (from 350 to 200 items); and
- the online availability of bulk stamp purchases, with a minimum order quantity of 300.

## 2.2 Relevant legislation and regulations

The Communications Regulation (Postal Services) Act 2011 provides for regulation of postal services in Ireland. The Act also provides for the implementation of the key European Directives dealing with postal regulation and market liberalisation – Directives 97/67/EC, 2002/39/EC and 2008/6/EC.

The key provisions of the Act of relevance to this study are:

- the provisions for An Post to increase the price charged for any element of postal services falling within the definition of the Universal Service; and
- the provisions for tariffs under the universal service.

We briefly set out our understanding of each below.

### *Provision for a price increase*

Section 30 of the Act provides for ComReg to set a price cap for An Post. However, Section 30 (12) of the Act allows that pending the making of a price cap decision under subsection (2), unless otherwise directed by ComReg under section 28(5), no change shall be made by An Post to any charge that applies immediately before the passing of this Act for postal services within the scope of the universal postal service relating to postal packets weighing less than 50 grams without the prior consent in writing of ComReg.

### *Tariff requirements*

Section 28 (1) of the Act requires that the tariffs for each postal service or part of a postal service provided by a universal postal service provider in the provision of a universal postal service shall comply with the following requirements:

- (a) prices shall be affordable and be such that all postal service users may avail of the services provided;
- (b) prices shall be cost-oriented, that is to say, the prices shall take account of, and reflect the costs of, providing the postal service or part of the postal service concerned;
- (c) subject to any decision made by ComReg under *paragraph (b) of subsection (2)*, prices shall comply with the uniform tariff referred to in that subsection; (d) tariffs shall be transparent and non-discriminatory; and
- (e) where postal service providers apply special tariffs, including special tariffs for postal services for businesses, bulk mailers or consolidators of mail from different postal service users, tariffs and associated conditions shall be transparent and non-discriminatory.

## Overview of An Post's proposals and market context

We note that Section 30 (3) of the Act requires that when ComReg make a price cap decision it have regard to its objectives set out in Section 12 (1)(c) of the Principal Act, in particular the protection of the interests of postal users and SMEs.

## 2.3 Mail market context

Postal operators across Europe are facing challenging times as they adapt to significant shifts in demand and falling volumes. Historically, there has been a strong link between economic growth and mail volume growth. In the early 2000s, this link started to breakdown. While economic growth remained an important driver of volumes, mail volumes initially grew by less than the economy, and then started to fall in absolute terms.

In consequence, over the last five years, a combination of the European-wide recession and increasing e-substitution by customers provides significant operational and financial challenges for operators and regulators. In Ireland, the economic crisis and its depressing impact on economic activity appear to have had a substantial negative impact on mail volumes.

To enable us to review An Post's application, it is therefore important to consider the proposed price changes in the appropriate context. In this section, we therefore examine the overall mail market and An Post's financial position, as well as how both have changed in recent years. In particular, we provide an overview of:

- how current prices compare to inflation over the period and international benchmarks;
- the current split of An Post's USO volumes and revenues;
- recent trends in mail volumes; and
- the current financial position of the USO.

### A comparison of current prices to inflation and international benchmarks

An Post last increased prices in March 2007 for items up to 50 grams. Since then, inflation has been relatively modest, with the CPI increasing by 4.4%<sup>10</sup>. Table 1 illustrates what An Post's headline domestic prices would currently be if they had been linked to CPI since March 2007. The domestic price for sending a stamped letter would be 2c higher at 57c.

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<sup>10</sup> Based on the period March 2007 to May 2012.

**Table 1.** Illustrative current headline prices if linked to CPI

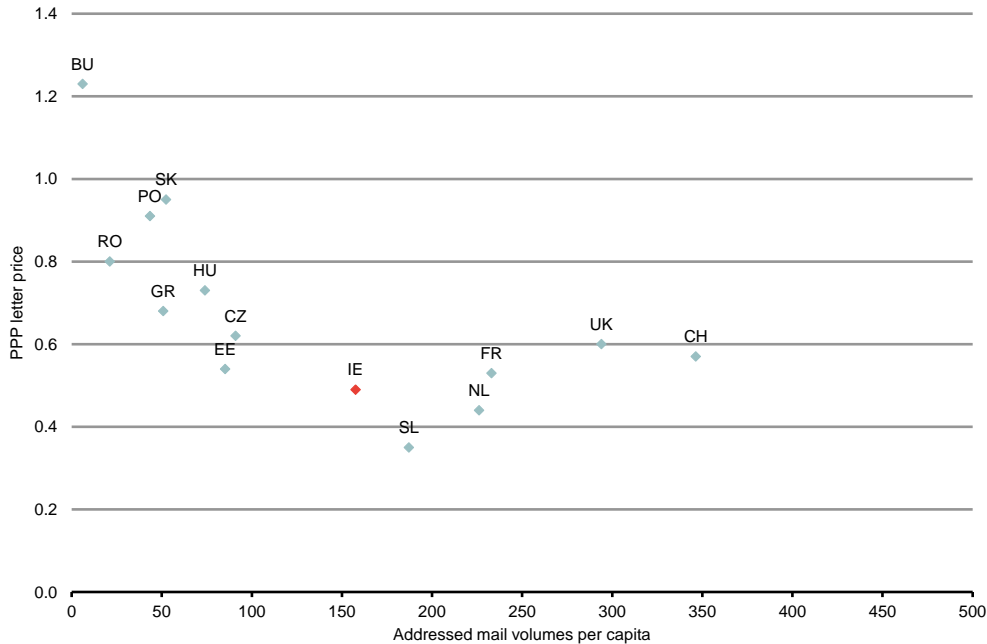
	Letters tariffs (€s)		Flats tariffs (€s)		Packets tariffs (€s)	
	Actual	CPI linked	Actual	CPI linked	Actual	CPI linked
<b>Stamped</b>	0.55	0.57	0.95	0.99	2.20	2.30
<b>Metered</b>	0.54	0.56	0.95	0.99	2.20	2.30
<b>Bulk (Fully Paid)</b>	0.54	0.56	0.95	0.99	2.20	2.30
<b>Bulk Discount (Lowest)</b>	0.41	0.43	0.76	0.79		

Source: Frontier analysis - An Post current price data, Irish monthly CPI data (CSO)

Figure 6 looks at the relationship between mail letter prices, adjusted for purchasing power parity (PPP), and mail volumes per capita across fourteen European countries. An Post's prices appear low when compared to mail operators in other European jurisdictions. In addition, Ireland compares favourably on price to a number of jurisdictions with higher per capita mail volumes.

We note that the results of such high level comparisons need to be considered carefully, as countries have different postal services and cost due to postal network (e.g. some have 2nd class service which is not the case in Ireland and other countries have very different cost structure to Ireland due to size of postal network (UK and France post would use rail and air infrastructure which is less required in Ireland)). However, they do show that postal prices in Ireland appear to be lower than in many European countries.

**Figure 6.** Relationship between mail letter prices (PPP) and yearly addressed mail volumes per capita (millions of items)



Source: Frontier economics analysis based on DHL study "Letter prices in Europe", IPC, Global Postal Industry Report and UPU database

### The current split of USO volumes and revenues according to An Post

This section sets out an overview of USO volumes and revenues on the basis of information provided by An Post in its price application. We note that the services to be provided by An Post as part of the USO have only recently been specified by ComReg. In consequence, the volumes, revenues, cost and profitability of the USO as specified by ComReg is currently unknown. The analysis that follows is based on the information on volumes and revenues provided by An Post as part of their price application, and An Post's claimed cost for USO which is based on the old specification of the universal service according to An Post. It is also important to note that the methodology to calculate the net cost for the USO has not been established. Any such cost of the USO has to be based on the efficient cost of service provision. This report has not considered in detail whether An Post's current costs are efficient,<sup>11</sup> and so we can provide no comment on the likely net cost of the USO.

<sup>11</sup> Such a detailed assessment is outside the scope of the study. In this study we have reviewed An Post's cost reduction programme, compared some high-level benchmarks of postal prices and assessed An Post's estimate of its cost elasticity against relevant benchmarks. It has been beyond the scope of the study to conduct a detailed benchmarking analysis to assess the efficiency of An

In 2010<sup>12</sup>, An Post report total USO volumes were approximately 680 million, with USO revenues at €454 million. Figure 7 shows how this is split across domestic, outbound international and inbound international mail. Domestic mail makes up by far the largest proportion of USO volumes and revenues. In 2010 domestic mail made up 82% of USO mail volumes and 74% of USO mail revenues.

Figure 8 shows the breakdown of domestic USO volumes between bulk, metered and stamped mail products. This shows that nearly [X] of these volumes came from bulk and business reply mail. Of this [X], nearly [X] again was sent by An Post's top 27 customers. Overall, therefore, An Post's largest 27 customers account for approximately [X] of domestic mail volumes.

### Figure 7. Breakdown of 2010 USO volumes and revenues

[X]

Source: Appendix 4 of An Post's Price Application

### Figure 8. Breakdown of 2010 USO domestic volumes (excluding parcels)\*

[X]

Source: Frontier analysis of Appendix 3 of An Post's price application and of An Post's response to ComReg's initial information request.

\*Parcel volumes have been excluded here as An Post does not provide a breakdown of parcel volumes in their volume and revenue modelling.

## Recent trends in mail volumes

Since 2007, An Post has experienced a year-on-year decline in mail volumes. Between 2007 and 2011, core mail volumes (excluding publicity post and election volumes) declined by 20%<sup>13</sup>. As part of this, domestic volumes declined by around 16%.

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Post's costs. Such an exercise is likely to be required as part of any postal price control, and is likely to involve a detailed review of An Post's cost allocation between USO and non-USO services; detailed bottom up cost modelling of An Post's key cost drivers (routes and mail centres); and a more extensive comparative benchmarking exercise across postal operators.

<sup>12</sup> 2010 volume and revenue figures are the most recent actuals given in An Post's volume and revenue modelling as a result of the timing of their application. 2011 figures onwards are forecasts.

<sup>13</sup> In An Post's application they state that "[i]n the period from 2008 to 2011 An Post's mail volumes declined by 23.5%", page 6. In their response to Frontier's information request of 25<sup>th</sup> June 2012

## Overview of An Post's proposals and market context



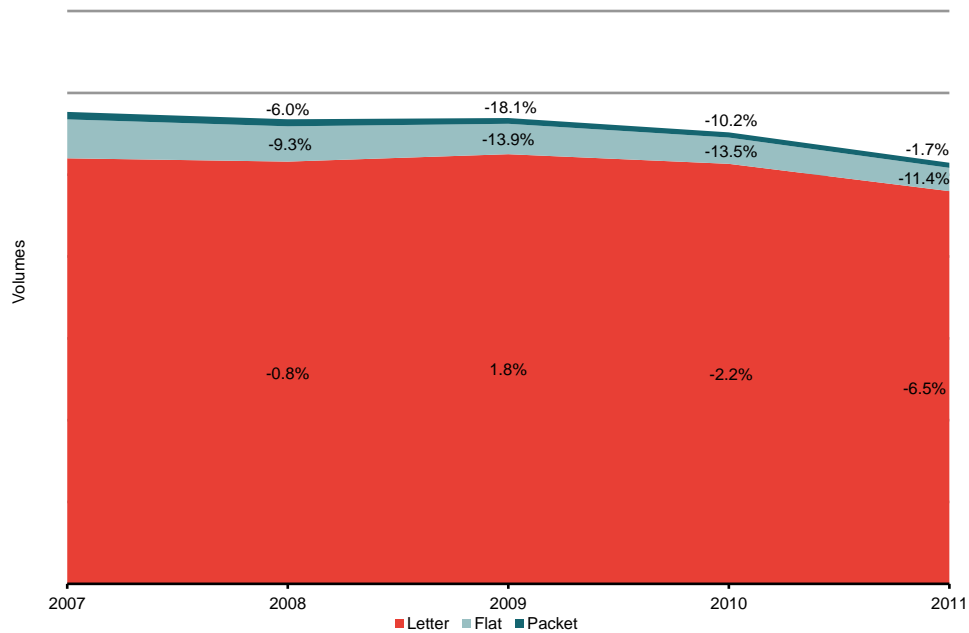
Figure 9 illustrates the evolution of domestic letters, flats and packets volumes between 2007 and 2011<sup>14</sup>. These figures suggest that flats and packets have experienced the largest declines over the period. However, An Post has explained that for comparative purposes, it is more appropriate to include flats up to 100g to get a true measure of the overall rate of letter volume decline since 2007. This is because, over this period, they have been actively encouraging customers to switch from flats to letters, particularly for flats below 100g which can be folded to the size of a letter. The rate of decline for letters when lighter flats are included is 10%, which suggests that all formats have suffered large declines over the period, not just flats and packets as figure 9 suggests.

For packets, however, the decline in volumes slowed considerably in 2011. An Post has highlighted that packet volumes are performing better than letters and flats due to e-fulfilment. This effect has also been seen with parcels, which experienced a 2% volume increase in 2011.

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they explain that this figure is based on core mail revenue, stating that '[v]olumes have actually declined by 20%' between 2007 and 2011.

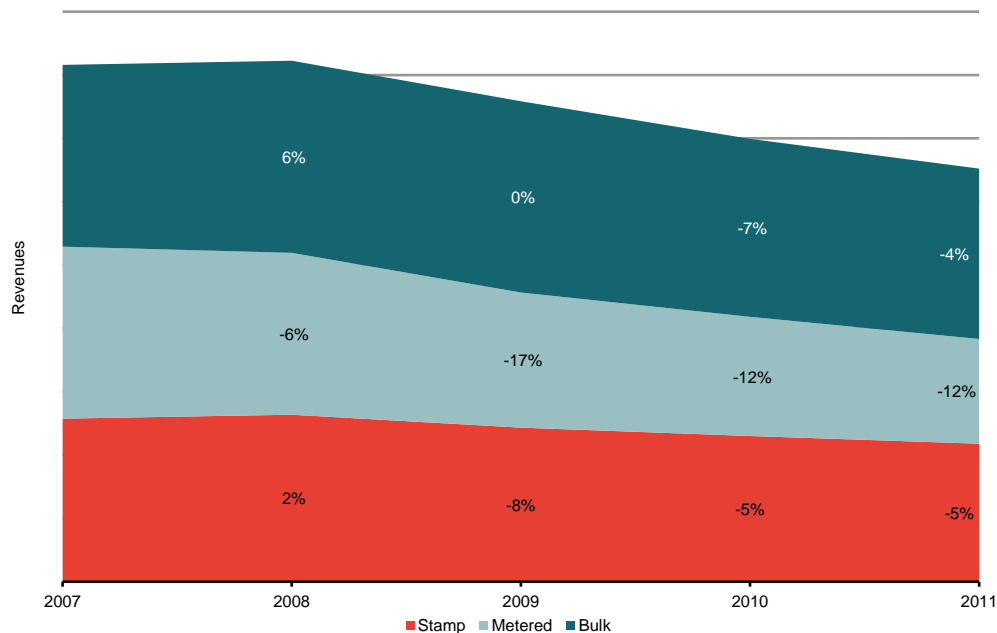
<sup>14</sup> An Post has informed us that these figures may be influenced by some methodological changes over the period and the actual declines of each format may be slightly higher. The impact of the change is likely to be in the region of 2-3%.

**Figure 9.** Evolution of domestic mail volumes 2007-2011 split by format

Source: Frontier analysis of An Post data

Figure 10 shows the evolution of domestic stamp, meter and bulk revenue between 2007 and 2011. Since 2007, stamped mail has shown the smallest relative reduction of the three categories. There has been a significant fall in meter revenues, compared to stamp and bulk. An Post suggests that this is due to customers switching from meter to stamp and bulk. An Post believes that, as a result of the recession, customers have become more cost conscious and sought cheaper alternatives. They have therefore moved to avoid costs such as meter rental/maintenance costs<sup>15</sup>.

<sup>15</sup> Some meter customers have switched to bulk where they have large enough volumes of mail. This has allowed them to not only avoid meter rental/maintenance costs, but also avail of cheaper per item prices. At the other end of the scale, meter customers with low volumes of mail have switched to stamped mail as the meter rental/maintenance costs are greater than the per item savings that they are able to avail of.

**Figure 10.** Evolution of stamp, meter and bulk revenues 2007-2011

Source: Frontier analysis of An Post data

### The financial position of the USO

Below we set out An Post's assessment of the financial position of the USO. Again, we note that the services to be provided by An Post as part of the USO have only recently been specified by ComReg. In consequence the profitability of the USO as specified by ComReg is currently unknown. The analysis that follows is based on the information on profitability provided by An Post as part of their price application. We also note that this project did not involve verifying/validating An Post's allocation of costs between USO and non-USO services.

In 2007, the USO, according to An Post, made a profit of €11.9 million. However, as we have seen above, the USO (and postal volumes more generally) has seen substantial volume and revenue declines since 2007. An Post has implemented a cost reduction programme. However, the reduction in costs has not offset the decline in revenues associated with the USO. Consequently, according to An Post, the USO has been incurring increasing losses over the last four years. In 2010 An Post claimed the USO lost €50 million. This €50 million consists of:

- [X] from domestic mail;
- [X] from inbound international mail; and

- [§<] from outbound international mail.

An Post forecast that in 2012, losses associated with the USO will be €63 million. It is important to note that any claim for the net cost of the USO will be subject to ComReg's assessment of what the efficient net cost of providing the USO is. It is also important to stress that this loss associated with the USO that is claimed by An Post does not reflect the latest universal service specification which took a 'de minimis' approach in specifying the universal postal services.

## 2.4 Key areas for review

Bearing in mind the market context set out above, and the terms of reference set out in section 1, we identified the following four key issues for review.

- **An Post's volume and revenue forecasts, and the assumptions made around e-substitution in Ireland**, including how the volume and revenue forecasts have been modelled, what they tell us about future trends and how these compare to recent trends;
- **The potential price elasticities in the Irish mail market and the resulting volume and revenue response to An Post's proposed price changes**, including price elasticity estimates, how these have been used and the sensitivity of the volume and revenue forecast to alternative price elasticity estimates;
- **The affordability of An Post's proposed price changes**, including the affordability impact on residential customers, SMEs and large customers; and
- **An Post's costs**, including their cost reduction programme, the cost reflectiveness of the proposed changes, and the relationship between volumes and costs.

### 3 Forecast volumes, revenues and e-substitution

The previous section has highlighted the substantial decline in mail volumes that has occurred over the past four years. This decline has had a substantial negative impact on the profitability of the USO, and is a key driver of An Post's request for a price increase. In the light of this, it is important to understand what the likely medium term evolution of volumes and revenues will be, so that a robust baseline can be established against which the impact of the proposed price changes can be considered.

The first step in assessing An Post's proposals, therefore, is to consider the base case – what will happen to volumes and revenues up to 2014 without the proposed price increases? To answer this question, we begin by reviewing An Post's forecasts without the proposed price increase for the 2011 to 2014 period. Given the observed impact of e-substitution in other jurisdictions, we consider in particular the extent to which e-substitution has already impacted on Irish volumes, or might be anticipated to do so over the next few years.

#### 3.1 An Post's volume and revenue forecasts

An Post provided a copy of the model used to forecast USO volumes and revenues from 2011 to 2014, with and without the proposed price increases. As set out above, we focus in this section on the forecasts for the scenario where there are no price increases. We first review the assumptions used in An Post's model and then go on to set out their volume and revenue forecasts, comparing these to past trends<sup>16</sup>.

##### Modelling assumptions

There are two main sets of assumptions used in An Post's volume and revenue model:

- yearly volume growth rates; and
- take up rates of the DSA bulk mail product.

##### Volume growth rates

The assumed letters, flats, packets and international mail growth rates used in An Post's volumes and revenue model are set out in the Table below. From 2012, An Post assumes that the current trend of volume declines will slow sharply, and

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<sup>16</sup> It is important to note that our assessment has been based on the information provided by An Post, and the project has not undertaken any validation of the volume data provided to us by An Post.

that all volumes, apart from packets in 2013, will face a yearly decline of 3% from 2013 onwards.

**Table 2.** 2011-2014 growth rates used in An Post's volume and revenue modelling

	Letter	Flat	Packet	International mail
<b>2011</b>	-7.8%	-7.8%	-4.0%	-4.0%
<b>2012</b>	-5.9%	-5.9%	0%	-4.0%
<b>2013</b>	-3.0%	-3.0%	0%	-3.0%
<b>2014</b>	-3.0%	-3.0%	-3.0%	-3.0%

Source: An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

An Post has stated that their forecast is based on a number of macro- and micro-economic factors, along with international benchmarking<sup>17</sup>.

An Post highlighted the following international comparisons in support of their forecast:

- **Copenhagen Institute for Future Studies, Role of Mail in 2020 - Report prepared on behalf of IPC:** – This forecast is based on a survey of postal operators, and suggests that overall mail volumes will decline by 2-3% annually;
- **Boston Consulting Group (BCG) review of the decoupling of GDP with mail volumes “The Postman Always Brings Twice – Receiver driven Transformation of the Mail Business Model”:** BCG estimate a CAGR loss to substitution in the range of 2-5% over the next ten years ; and
- **IPC and BCG, Focus on the Future – Building a new compelling position for posts (April 2012):** This paper provides three forecast scenarios for mail volumes in France, Germany, Italy, the UK and US. A ‘base’ scenario which forecasts declines of 3% pa. A ‘recession’ scenario, which forecasts declines of 5% pa and an ‘acceleration’ scenario which forecasts declines of 7% pa.

<sup>17</sup> An Post has informed us that they used various strands in compiling these forecasts. These include international benchmarking, review of bulk mail customers on a customer by customer basis by the sales team and a review of macro environmental factors which influence mail volumes. Although An Post provided us with links to three of the international benchmarking reports used, they did not provide any detailed analysis on the other strands.

While An Post's forecast is consistent with this evidence, we note that:

- The An Post forecast is at the lower end of the range (with the exception of the survey of postal operators).
- The forecasts in the papers above do not cover Ireland. It appears that the decline in mail volumes may have begun later in Ireland than in some other jurisdictions. For example, the UK has experienced a 25% decline in volumes over the last six years (compared to c. 20% for domestic volumes in Ireland), and Royal Mail forecasts that volumes will decline at a rate of 5% pa over the medium term. An Post has highlighted that Jeffrey Saunders of the Copenhagen Institute of Future Studies was retained to adapt his international research to an Irish context. This adaptation, however, has not been made available to us for review.
- An Post's forecast implies that current volume decline trends will slow sharply (see below for further analysis) over the next year. An Post have suggested that this assessment is based, in part on an assumption of a return to growth for the Irish economy over the medium term. However, An Post has informed us that since submission of their price application and volume forecasts earlier this year, volume declines for 2012 are running substantially ahead of target at c. 7%, compared with an original forecast of 5% for 2012<sup>18</sup>. We note that if the economy returns to the growth levels underpinning An Post's forecasts this may result in some slowing in the rate of decline of mail volumes. However, we note also that there has been a general decoupling of the link between economic performance and mail volumes. We have also identified concerns regarding the potential for e-substitution to negatively impact on volumes over the medium term, and which might well cancel any effects associated with an improvement in economic growth.
- Estimating a decline of 3% for domestic letters, flats and international mail in 2013 and a uniform decline of 3% in 2014 is also inconsistent with the evidence of trends in volume declines in the last few years. These trends show substantial differences in the rate of decline of different products, and that volumes for some products, such as parcels, have held up well as a result of the growth in fulfilment mail. Moreover, while the adverse macro-economic situation might be expected to have a generally depressing impact on mail volumes, some

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<sup>18</sup> At the time of writing this report, An Post was unable to provide an updated version of its volume and revenue model as volume outturn figures were yet to be approved by the board. Our analysis is therefore based on the original version of the model provided with the price application.

products, such as letters, may also be subject to greater additional downward pressures from e-substitution. Overall, therefore, it is difficult to understand how a uniform volume estimate for all mail products, excluding packets in 2013, is appropriate.

An Post did not include forecasts for parcels in its model. However, the volume summary included in *Appendix 4 – PL 2010-2013 forecasts* of the price application suggest the growth rates for parcels that are set out in Table 3. It appears that a decline of 3% has also been applied to parcel volumes from 2014 to produce the figures in Appendix 4 of the price application. Again, this would appear to be highly inconsistent with the historic trends for parcels and for the forecasts in earlier years. However, An Post has explained that this was an error and will be corrected in the updated forecasts. .

**Table 3.** 2011-2014 Parcel growth rates indicated by An Post's USO parcel volume forecasts

	Growth rates	
	Domestic parcel volumes	International parcel volumes
<b>2011</b>	2.0%	2.2%
<b>2012</b>	2.0%	2.1%
<b>2013</b>	2.2%	0.0%
<b>2014</b>	-3.0%	-3.0%

Source: Frontier analysis of An Post's price application - *App 4 PL 2010-2013 forecasts*

### *DSA bulk mail product take up*

An Post's volume and revenues model assumes that the proposed DSA bulk mail product will have [8<] take up by bulk customers in 2012, rising to [8<] in 2013<sup>19</sup>. The model uses these assumptions for the volume and revenue forecasts with and without the proposed price changes.

An Post has suggested that the forecast uptake rates are based on its understanding of customer intentions, and previous observed rates of take up for new products.

<sup>19</sup> These take up rates were based on the assumption that the DSA product would be introduced by mid-2012. An Post have since indicated that these rates are designed to be associated with the first and second year after the introduction of the product.

## Forecast volumes, revenues and e-substitution



## Future trends in volumes and revenues

An Post's model creates volume and revenue forecasts at both an aggregate level and at a disaggregated level by product and format<sup>20</sup>. The following sections look at:

- the overall trends that are forecast by An Post's model (without any price increases); and
- the format and product trends that are forecast by An Post's model (without any price increases).

## Overall volume and revenue trends

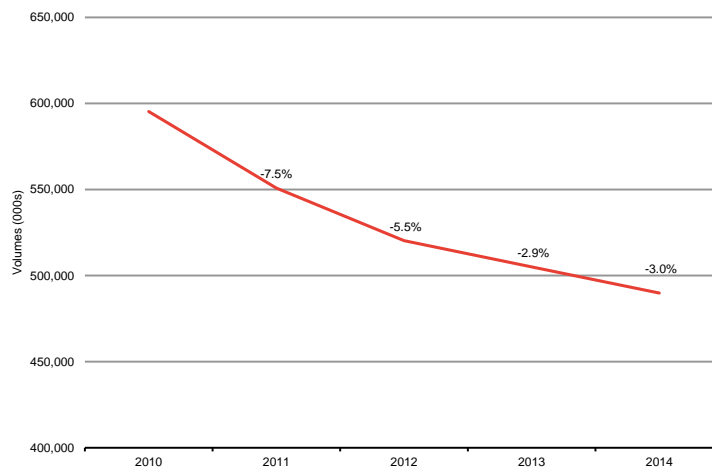
Before the impact of any price increase is taken into account, An Post forecast that:

- volumes will fall by a further 11.1% between 2011 and 2014; and
- revenues will decline by a further 12.1% between 2011 and 2014.

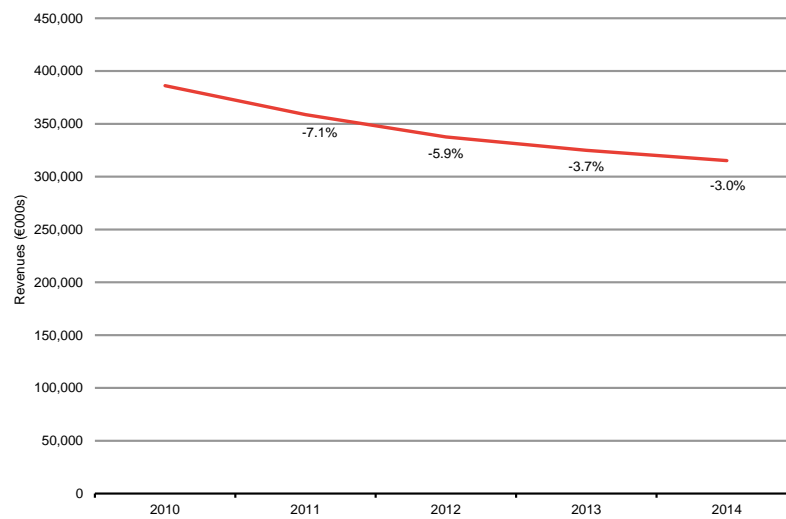
Of the 11.1% decline in volumes indicated by the model, domestic volumes are expected to decline by 11.3% and outbound international volumes by 8%. Of the 12.1% decline in revenues indicated by the model, domestic revenues are expected to decline by 12.8% and outbound international by 8.4%. Figures 8 and 9 below set out the evolution of volumes over the three years.

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<sup>20</sup> Given the inherent unpredictability of inbound international volume, the model excludes these from its forecasts.

**Figure 11.** Forecast USO volumes (excluding parcels)

Source: An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

**Figure 12.** Forecast USO revenues (excluding parcels)

Source: An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

Forecast volumes, revenues and e-substitution

### *Trends in format and product mix*

An Post's aggregate forecast can also be broken down by format. Letters and registered mail are expected to see the largest declines over the period. In particular, the forecasts for domestic USO mail volumes suggest that between 2011 and 2014:

- letters will decline by 11.5%;
- flats will decline by 10.2%;
- packets will decline by 3%; and
- registered mail will decline by 11.5%.

Finally, we look at how An Post's model forecasts that this overall 11.3% decline in domestic USO volumes is split by product. These forecasts suggest that between 2011 and 2014:

- stamped mail will decline by 11.3%;
- labelled mail will decline by 7.5%;
- metered mail will decline by 11.2%;
- fully paid ceadunas mail will decline by 11.4%;
- discounted ceadunas mail will decline by 81.2% (as a result of the switch to DSA); and
- business reply mail will decline by 11.3%.

Discounted Ceadunas is expected to face the largest volume decline of all the products as customers switch to the proposed DSA product. This is as a result of An Post's modelling of DSA volumes which begin in 2012. In addition to the assumption that 80% of current discounted bulk customers will take up the DSA product by the end of 2013, further year-on-year decline is also modelled for this segment.

### *Comparison of recent and forecast trends in volumes*

Table 4 below compares the forecast trends in USO mail volumes, based on format, to those seen since 2007. In almost all cases, the forecast volume declines are significantly smaller than historic volume declines over the last four years.

**Table 4.** Comparison of CAGRs for USO mail volumes between 2007-2011 and 2011-2014

		2007-2011 Volumes CAGR	2011-2014 Volumes CAGR
<b>Domestic</b>	<b>Letters</b>	-2%	-4%
	<b>Flats</b>	-12%	-3.5%
	<b>Packets</b>	-9%	-1%
<b>Outbound International<sup>19</sup></b>	<b>Letters</b>	-10%	-3%
	<b>Flats</b>	-11%	-3%
	<b>Packets</b>	-18%	-3%

Source: An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c* and historic trends

Domestic flats experienced large volume declines over 2007-2011, but this decline is forecast to slow significantly over 2011-2014. Domestic packets also experienced large volume declines over 2007-2011. However, in An Post's modelling it forecasts 0% growth for 2012 and 2013, followed by a return to decline in 2013.

An Post has also suggested that the decline observed in the data over 2007 to 2011 is likely to be an underestimate due to a methodology change. An Post has indicated that the impact of the change in the methodology for domestic volumes is likely to be in the region of an additional 2-3 percentage point decline.

The data on domestic letters indicates a 2% overall decrease in volumes between 2007 and 2011. However, as mentioned in section 2.3, An Post has explained that it is more appropriate to include flats up to 100 grams to get a true measure of the rate of overall letter volume decline since 2007. This is because, over this period, they have been actively encouraging customers to switch from flats to letters, particularly for flats below 100g which can be folded to the size of a letter. The rate of overall letter volume decline when lighter flats are included is 10%.

For international letters, flats and packets<sup>21</sup>, An Post expects a significant slowing in the decline in volumes compared to recent years.

<sup>21</sup> From 2010, outbound international volumes are determined based on RMS rather than terminal dues. As such, these numbers aren't directly comparable. They do, however, provide an indication of how An Post's forecasts compare to recent trends.

Overall, it appears that An Post expect the rate of volume declines to slow by almost 50% compared to the observed rate of decline since 2007 (i.e. 11.1% compared to the 20% decline that has been seen). On an annual basis, the An Post forecast suggests that growth rates will move from around -7% to -3%. Other than the international comparisons identified above, An Post has provided no rationale for the forecast assumption that the rate of decline in mail volumes will slow substantially over the next few years.

By contrast, in the UK, where mail volumes have declined by 25% over the last 6 years, Royal Mail is forecasting that volumes will continue to decline at trend rate (5% pa) over the next five years<sup>22</sup>.

## 3.2 E-substitution

An Post highlighted in its application that e-substitution is a key threat to mail volumes. This is in keeping with experience in other jurisdictions, where e-substitution is considered to have given rise to substantial volume declines.

It is therefore important to understand where Ireland currently is in relation to the e-substitution cycle, and to review how An Post has taken account of e-substitution in its forecasts.

We understand that An Post has not provided any specific analysis in relation to expected e-substitution trends or the degree of e-substitution to date. An Post suggests that they have considered e-substitution within the wider context of the overall expected volume decline of 3% per year. An Post has further argued that the rationale behind their proposed DSA product is to mitigate e-substitution.

In light of this, we consider the following:

- e-substitution trends in other jurisdictions to date;
- e-substitution trends in Ireland to date;
- potential e-substitution risks; and
- the expected role of the DSA bulk mail product in mitigating e-substitution.

### Trends in other jurisdictions

Mail volumes can be split into five segments based on the content type of the mail being sent. These are:

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<sup>22</sup> We note that some of the decline in volumes in the UK may have been associated with price increases. However, we understand that the UK's forward looking volume forecasts have not factored in any further price increases.

- transactional;
- direct;
- social;
- publication; and
- fulfilment.

The mail content types that have seen the most e-substitution are:

- **transactional** – this mail segment has been negatively impacted by the movement to online payment and billing systems;
- **social** – this mail segment has been negatively impacted by the movement to email and other forms of electronic correspondence; and
- **fulfilment** – this mail segment has been negatively impacted by the switch to online content.

Overall, large mail customers still predominantly send transactional mail and it is this segment that currently makes up the majority of total volumes. Although e-substitution in social mail is a well-established trend in other jurisdictions, e-substitution in transactional mail is occurring at an increasing pace. A recent report by the IPC suggested that transactional mail has declined in many postal markets over the last decade, falling by as much as 11 per cent between 2007 and 2009, as electronic alternatives have emerged.

It is therefore the transactional mail segment that is expected to see the biggest losses going forward. This is particularly the case as, once large transactional mailers invest in the systems necessary to move to online billing, they have strong incentives to encourage customers to switch away from transactional mail.

### Trends in Ireland and potential e-substitution risks

As set out in section 2.3, An Post's largest 27 customers account for [X] of mail volumes, and approximately [X] of domestic bulk revenues. As in other jurisdictions, these large customers predominantly send transactional mail.

Analysis of An Post's volumes and revenues from this customer group between 2007 and 2011 would suggest that the e-substitution effect for this set of customers is lower in Ireland so far than in other jurisdictions.

The total mail volumes sent by An Post's top 27 customers increased by 2% between 2007 and 2011. Part of this increase was driven by the volumes of two new customers<sup>23</sup>. Excluding these customers, volumes declined slightly (by 2%)

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<sup>23</sup> An Post has informed us that the list of customers in the top 27 has been relatively stable over this period, with only two new customers being added.

## Forecast volumes, revenues and e-substitution

over the period. Moreover, only 12 of the top 27 customers reduced the amount of mail sent between 2007 and 2011.

Looking at trends within the period, we see that mail volumes sent by the top 27 customers actually grew by [X] between 2007 and 2009 ([X] excluding the new customers) and then declined by [X] between 2009 and 2011 ([X] excluding new customers). This suggests that e-substitution only began to hit this customer segment in the last two years, a significant lag compared to some jurisdictions. We are also aware that a number of these large mailers have invested in online systems and are beginning to actively encourage the migration of customers across to these systems. We note that as part of this strategy a number of large utilities are also offering customers incentives to switch to payment by direct debit. This will also have a depressing impact on mail volumes to the extent that it reduces the extent to which customers use the postal service to pay bills (e.g. by cheque).

In the absence of the proposed DSA bulk mail product, large bulk mail customers would be facing a price increase of approximately 10%. In the context of this level of price increase, there is therefore a risk that the proposed price increases may accelerate e-substitution trends that would have otherwise occurred at a slower rate, thus triggering larger volume declines. An Post suggests that its proposed new DSA bulk mail product will mitigate this risk, as it offers an effective price discount to large mailers compared to the discounted Ceadúnas product. We discuss the extent to which the DSA product might be expected to mitigate e-substitution risks below.

### **The expected role of the DSA bulk mail product**

The stated rationale behind An Post's proposed DSA bulk mail product is to mitigate e-substitution by its large customers. An Post's price application suggests that the composite price for the DSA product will be [X]. This is [X] below the current cheapest bulk mail product and therefore provides a price decrease to large mailers. An Post hopes that this price decrease will reduce the movement to electronic alternatives in the medium term.

An Post has suggested that there is considerable interest in the proposed service. [X] In consequence, it has not included any provision in its model for the proposed price increase to trigger a possible acceleration in e-substitution.

We believe that there are three reasons to suggest that this may be an overly optimistic approach.

### ***It is not clear how large the effective price reduction will be***

In order to avail of the DSA bulk mail product, customers must provide their mail in a particular format to An Post. In consequence, these customers will only experience a price decrease if the additional costs of meeting the DSA

## **Forecast volumes, revenues and e-substitution**

requirements do not exceed [X] per item. An Post has suggested that the only additional costs faced by customers would be those associated with the pre-sortation requirement. An Post argues that many bulk mail customers already pre-sort their mail and therefore will [X] in meeting the terms and conditions of the DSA product. For those bulk mail customers who decide to out-source the pre-sortation, An Post believes that they will face a cost up to a maximum of [X].

We note that An Post has not provided any independent evidence to support this view. Rather it is based on its view of the market and feedback from their bulk mail customers.

### *Not all bulk mail customers will be able to access the DSA bulk mail product directly*

Part of the terms and conditions for the DSA bulk mail product, is a volume requirement of [X] per year. Currently, only [X] of An Post's customers could avail of the product based on 2011 volumes. The remaining customers would have to use an aggregator. The aggregator would need to offer the service at less than [X] for these customers to experience an effective price decrease.

Given that An Post will increase its price for its discounted Ceadúnas product to €0.45 from €0.41, it is not obvious that aggregators will be constrained to offer a price for their service of less than [X]. Moreover, even on the basis of An Post's forecast volume declines, fewer customers will be able to access the DSA product directly each year. By 2014, according to An Post's projections, only 12 of An Post's customers would have sufficient volumes to meet the current thresholds.

### *The proposed DSA product is not in the USO*

In ComReg 12/81 "Postal Regulatory Framework, Implementation of the Communications Regulation (Postal Services) Act 2011" ComReg set out the services to be provided by An Post with respect to the USO. With respect to bulk mail as universal postal services, ComReg has retained two of the three bulk mail services from its 2005 working definition of universal postal services:

- 'delivery only' for mail sorted by delivery office; and
- 'deferred delivery'.

We understand that these two type of bulk mail products accounted for the majority of bulk mail volumes in 2011. However, we also understand that An Post's proposed DSA bulk mail product does not fall within the definition of the USO. One important implication of this is that An Post may be required to charge VAT on the proposed product. For VAT exempt organisations (such as financial services, charities and government departments), this is likely to mean

## Forecast volumes, revenues and e-substitution



that, with VAT included, the DSA bulk mail product would be more expensive than the VAT exempt USO bulk mail service. An Post, in its response to ComReg 12/38, suggests that such customers account for approximately 50% of bulk mail volumes. However, in a liberalised market these large customers may be able to negotiate bespoke bulk mail products.

### Summary

The analysis above suggests that it is unlikely that the proposed DSA product will be as effective in mitigating the risk from e-substitution as An Post hopes. On the basis of our assessment, we suggest that take up of the DSA service may well be considerably lower than that envisaged by An Post. In consequence, a substantial proportion of bulk mail customers are likely to face an increase as a result of An Post's proposals.

It is difficult to model the impact of such a price increase, as An Post's model includes [X] of the DSA bulk mail product as part of its baseline scenario, and so we have not had sight of what might be expected to happen to volumes in the event that take up of DSA is lower than An Post anticipate.

## 3.3 Key findings in relation to An Post's volume and revenue forecasts

This section has reviewed An Post's forecast revenues and volumes to 2014. From 2013 onwards An Post has assumed a uniform 3% per annum decline in volumes (this is the base case and excludes the impact on volumes of any price increase). An Post suggests that this is based on its internal assessment of micro- and macro-economic factors, and a range of international benchmarks and comparisons.

Our assessment is that An Post's forecast appears optimistic, and there is a very substantial risk that, even before consideration is given to the impact of a price increase, volume declines will be significantly higher than currently forecast by An Post.

This is on the basis that:

- Current trends in the decline in mail volumes are substantially higher than those being forecast by An Post for 2013 and 2014. An Post has provided no evidence to suggest that these declines are likely to slow substantially over the next 2-3 years;
- An Post's forecast is at the low end of the range of international comparisons considered. Moreover, it is not clear that Ireland is at the same point in the cycle as the countries to which it is being compared (either in terms of e-substitution or economic growth). For example, in

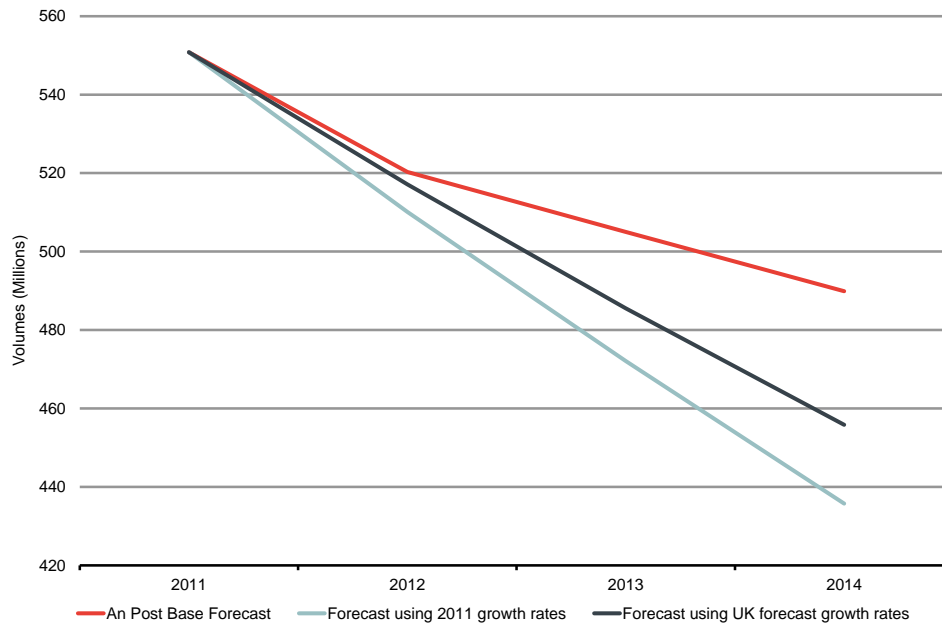
### Forecast volumes, revenues and e-substitution

the UK, mail volumes have declined by 25% over the past 6 years, and Royal Mail is forecasting continued annual declines of 5%.

- It is not clear that Ireland has yet experienced the full impact of e-substitution, particularly with respect to transactional mail. Assessment of trends in volumes for An Post's largest customers suggests that volume declines have only been observed in the last two years, and that the volume declines may be driven by the current economic crisis in addition to e-substitution.
- It is unlikely that An Post's proposed DSA bulk mail product will be able to mitigate the impact of e-substitution. An Post has assumed that [X] of bulk volumes will switch to its proposed DSA product in a relatively short period of time, and so will face an effective price cut. However, given the terms and conditions associated with the DSA product, and ComReg's recent decision regarding the scope of the USO with respect to bulk mail, this appears unlikely. In consequence, we suggest that in excess of [X] of bulk mail is likely to face a price increase as a result of An Post's price proposals. We have not been able to assess the impact that such an increase might have in terms of accelerating e-substitution. However, it is not unreasonable to assume it will have a negative impact on volumes.

As a result, it is probable that An Post's baseline forecasts will underestimate the decline in volumes in the medium term. Figure 13 illustrates the sensitivity of these forecasts to alternative growth rates. If the yearly decline were to trend towards Royal Mail declines, the volume decline for the period would increase from 11.1% to 17.2%. The volume decline would increase to 20.9% if current Irish trends were to continue.

**Figure 13.** Sensitivity of An Post's baseline volume forecasts to alternative growth rates



Source: Frontier analysis of An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

The high level of optimism and uncertainty associated with An Post's forecasts create two issues for ComReg. First, it is difficult for ComReg to understand the likely true financial position of the USO, and whether An Post has in place an appropriate set of measures (including pricing measures) that will ensure the sustainability of the USO. Second, there is a risk that, in the event of ComReg allowing the proposed price increase, the subsequent decline in volumes will appear exaggerated and will be associated with the price increase, rather than any error in An Post's forecast.

We recommend that An Post should consider carefully whether there are improvements that can be made to both its forecasting methodology and its baseline forecast, in order to provide ComReg with a robust baseline forecast against which it can assess the sustainability of the USO and the impact of An Post's proposed price changes.

## 4 The impact of an Post's proposed price changes

The next element of our assessment considers the likely impact that An Post's proposed price changes will have on the USO volumes and revenues. In their price application, An Post provided two pieces of analysis that were of direct relevance to an understanding of the impact of the proposed price increases:

- findings from a consumer survey which considered residential consumers' willingness to pay a higher stamp price; and
- An independent report estimating price elasticities for the Irish postal market.

Below we provide our assessment of this evidence, focussing in particular on the way in which An Post has used the price elasticities in their assessment of the impact of the proposed price changes. In particular, we review:

- Indecon's price elasticity estimates;
- how these are used by An Post in its modelling; and
- the sensitivity of the volume and revenue forecasts to alternative price elasticity estimates.

### 4.1 Residential consumer survey evidence

As part of its submissions, An Post provided residential consumer research carried out by Millward Brown in March 2012 (sample of just over 1,000 adults aged 15 and over). The focus of the research was on:

- spontaneous awareness of the current price of a stamp for standard postage within Ireland; and
- willingness to pay 65c to post a standard letter to anywhere in Ireland.

With respect to current price awareness 65% of respondents were aware of the exact current price of a stamp, 18% thought a stamp cost less than 55c and 9% thought it cost more.

With respect to willingness to pay, consumers were asked:

*"Would you be prepared to pay 65c to post a standard letter anywhere in Ireland for next working day delivery?"*

Once 'don't knows' are excluded, 53% of respondents stated that they would be prepared to pay the higher price, while 47% of respondents stated that they would not. There were no substantial regional or socio-economic differences.

## The impact of an Post's proposed price changes

However, in terms of age profile, more than 50% of consumers aged over 65 indicated that they would not be prepared to pay the higher price.

Clearly, it is difficult to infer directly from this research the likely impact of the proposed price increases on USO volumes. Volumes are highly unlikely to decline by 50% in the face of An Post's proposed price increases. However, the research does suggest that there may be strong consumer resistance to the proposed price increase. This is particularly worrying given that mail volumes are already declining and consumers are demonstrating their willingness to substitute away from postal products.

Finally, we note that the survey related only to residential consumers. An Post provided no survey evidence in relation to business customers (either SMEs or large business users). We suggest that a survey of business customers would have been helpful given that:

- business customers account for a substantially larger proportion of volumes than do residential customers; and
- business customers may be in a position to switch to aggregators in the event of a price increase.

## 4.2 An Post's price elasticity estimates

As part of its price application, An Post submitted an independent report prepared by Indecon, which estimates price elasticities for the Irish mail market. Indecon's report includes a number of different estimates of price elasticity, based on a number of different econometric regression specifications. In particular, Indecon estimated price elasticities on the basis of the following specifications:

- the linear approximate almost ideal demand system (LA/AIDS) model;
- the proportionally calibrated almost ideal demand system (PCAIDS) model; and
- a time-series regression.

We have carried out a detailed review of Indecon's methodology and analysis, and overall we conclude that:

- the regression approaches adopted by Indecon are in line with standard methodologies to estimate price elasticities;
- the estimated price elasticities are in line with findings from similar studies in other jurisdictions (although the different models specifications produce quite a wide range of estimated elasticities); and

- there is no clear evidence to suggest any particular model specification should be relied on more strongly than the others<sup>24</sup>.

Figures 10 and 11 below set out the estimates from Indecon's three model specifications.

**Figure 14.** LA/AIDS and PCAIDS price elasticity estimates

LA/AIDS			
% Δ Price of			
% Δ Quantity of	Stamps	Metered	Bulk
Stamps	-0.22	0.88	0.02
Metered	0.8	-0.39	0.17
Bulk	0.07	0.18	-1.17
PCAIDS (calibrated on meter)			
% Δ Price of			
% Δ Quantity of	Stamps	Metered	Bulk
Stamps	-0.22	0.02	0.03
Metered	0.02	-0.22	0.03
Bulk	0.03	0.03	-0.22
PCAIDS (calibrated on stamps)			
% Δ Price of			
% Δ Quantity of	Stamps	Metered	Bulk
Stamps	-0.39	0.10	0.12
Metered	0.10	-0.38	0.12
Bulk	0.12	0.12	-0.37

**Figure 15.** Time series price elasticity estimates

Time-series regression estimates	
	Price Elasticity
Stamped postage	-0.45
Metered postage	-0.58
Bulk postage	-0.629

The key estimates from the Figures above are as follows:

- **Own price elasticity of stamped mail:** This ranges from -0.22 (LA/AIDS and PCAIDS) to -0.45. This suggests that a 10% increase in

<sup>24</sup> We note in particular, that Indecon have not provided any analysis as to whether the additional restrictions associated with the PCAIDS model are statistically valid.

the price of stamped mail, would lead to a decline in volumes purchased of stamped mail of between 2.2% and 4.5%;

- **Own price elasticity of metered mail:** This ranges from -0.22 to -0.58. Again, this suggests that a 10% increase in the price of metered mail would lead to a decline in volumes of between 2.2% and 5.8%; and
- **Own price elasticity of bulk mail:** This ranges from -0.22 to -1.17. This suggests that a 10% increase in the price of bulk mail would lead to a decline in volumes of between 2.2% and 11.7%.

### 4.3 An Post's use of price elasticities in its impact analysis

An Post's price application includes an assessment of the proposed price increase on USO volumes and revenues. However, in carrying out its analysis, it chose to use only one of the three sets of price elasticity estimates developed by Indecon. An Post chose the results from the PCAIDS model, which were the lowest set of elasticities estimated by Indecon. These are set out in Figure 16. An Post provided no rationale for its choice of elasticity estimates, and did not provide any sensitivity analysis using the results from the alternative model specifications.

**Figure 16.** Indecon's price elasticity estimates used by An Post

PCAIDS (calibrated on meter)			
% Δ Price of			
% Δ Quantity of	Stamps	Metered	Bulk
Stamps	-0.22	0.02	0.03
Metered	0.02	-0.22	0.03
Bulk	0.03	0.03	-0.22

Given the potential introduction of the price increases part way through 2012, An Post's approach to incorporating this set of price elasticities into the model was to assume that half of the price increase would be felt in 2012 and half in 2013. Note, with respect to bulk mail, An Post's model assumes that there will be [X] take up of the proposed DSA bulk mail product. Given that An Post assumes these customers face a price decrease, An Post does not apply the elasticity results to this element of volumes.

An Post's volume and revenue model forecasts that the price increases will accelerate volume declines over the period. However, given the size of the price increases, they are forecast to cause revenue declines to slow compared to the status quo. Figure 17 illustrates the difference in forecast volumes and revenues with and without the proposed price increases. By 2014, volumes in the price

### The impact of an Post's proposed price changes

increase scenario are 1.4% lower than those in the no price increase scenario. 2014 revenues are 6.83% higher in the price increase scenario than in the no price increase scenario.



**Figure 17.** Volume and revenue impact of An Post's proposed price changes



Source: Frontier analysis of An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

Table 5 provides a destination and format breakdown of the volume and revenue growth between 2011 and 2014 with and without the price increases<sup>25</sup>. Within

<sup>25</sup> Annex 1 contains a more detailed look at the volume and revenue forecasts created by An Post's model. This compares the forecasts with and without the proposed price changes.

domestic mail, flats are expected to see the largest percentage point volume and revenue differences between the two scenarios. Within international outbound mail letters are expected to see the largest percentage point volume and revenue differences between the two scenarios.

**Table 5.** Volume and revenue impact of An Post's proposed price changes

	Volume growth 2011-2014		Revenue growth 2011-2014	
	Without price increase	With price increase	Without price increase	With price increase
<b>Overall</b>	<b>-11.1%</b>	<b>-12.3%</b>	<b>-12.1%</b>	<b>-6.1%</b>
<b>Domestic</b>	<b>-11.3%</b>	<b>-12.5%</b>	<b>-12.8%</b>	<b>-6.6%</b>
- Letters	-11.5%	-12.7%	-14.3%	-8.0%
- Flats	-10.2%	-11.8%	-10.5%	-3.0%
- Packets	-3.0%	-4.5%	-3.0%	-2.8%
- Registered	-11.5%	-11.9%	-11.5%	-7.9%
<b>International Outbound</b>	<b>-8.0%</b>	<b>-9.8%</b>	<b>-8.4%</b>	<b>-3.6%</b>
- Letters	-8.7%	-10.9%	-8.7%	-1.1%
- Flats	-8.7%	-10.7%	-8.7%	-2.1%
- Packets	-8.7%	-9.9%	-8.7%	-6.0%
- Registered	-8.7%	-9.2%	-8.7%	-7.0%

Source: Frontier analysis of An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

## 4.4 Sensitivity analysis of An Post's forecasts

In order to test the sensitivity of An Post's findings, we re-applied the An Post model using the estimates derived from the alternative specifications of the price elasticity regression analysis.

This sensitivity analysis shows that the volume declines associated with the proposed price increase may be greater than those estimated by An Post. They also indicate that the proposed price increase may not have as substantial an impact on revenues as An Post indicates. Table 6 compares the volume and

### The impact of an Post's proposed price changes

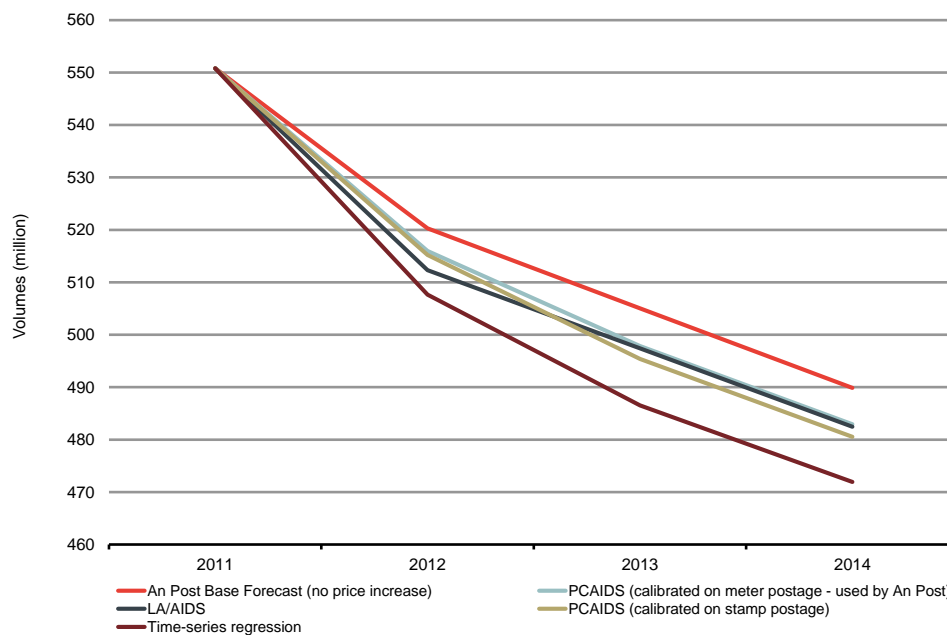
revenue growth forecasts for 2011-2014, with the proposed price increases, under different price elasticity estimates.

**Table 6.** Comparison of the volume and revenue impact of alternative price elasticity estimates

Price elasticity estimates used in An Post's model	Volume 2011	Volume 2014	Volume growth 2011-2014	Revenue 2011	Revenue 2014	Revenue growth 2011-2014
<b>Baseline – no price increase</b>	<b>550,789</b>	<b>489,873</b>	<b>-11.1%</b>	<b>358,758</b>	<b>315,180</b>	<b>-12.1%</b>
<b>PCAIDS (calibrated on meter postage – used by An Post)</b>	<b>550,789</b>	<b>482,922</b>	<b>-12.3%</b>	<b>358,758</b>	<b>336,695</b>	<b>-6.1%</b>
LA/AIDS	550,789	482,474	-12.4%	358,758	336,781	-6.1%
PCAIDS (calibrated on stamp postage)	550,789	480,526	-12.8%	358,758	334,663	-6.7%
Time-series regression	550,789	471,935	-14.3%	359,758	328,432	-8.5%

Source: Frontier analysis of An Post's price application - *App 3 Revenue and Volumes Model 2010-2012 with DSA\_65c*

Graphically, the Figure below shows that An Post's baseline is the most optimistic. The price elasticity forecasts produced by the other LA/PCAIDS models produce very similar results to each other.

**Figure 18.** Comparison of the volume impact of alternative price elasticity estimates

Source: Frontier analysis of An Post's price application - App 3 Revenue and Volumes Model 2010-12 with DSA\_65c

As illustrated above, the price elasticity estimates that have the most substantial impact on forecast volume and revenues in comparison to those used by An Post (An Post use the PCAIDS estimates from the Table above) are those from the time-series regression model. The time-series elasticities suggest a volume decline between 2011 and 2014 as high as -14.3% (compared to -11.1% in the absence of a price increase), with an 8.5% decline in revenues (compared to a decline of -12.1% in the absence of a price increase). This suggests that the proposed price increases could result in:

- an improvement in An Posts' revenue position of just 3.6 percentage points relative to baseline;
- in comparison, the volume decline would be accelerated by 3.2 percentage points relative to baseline.

Overall, therefore, the results of the price elasticity analysis suggest that the proposed price increases will:

- improve An Post's revenue position by between 3.6 percentage points and 6 percentage points; and
- will accelerate volume declines by between 1.2 percentage points and 3.2 percentage points.

## The impact of an Post's proposed price changes

Note, given the way An Post's model is structured, our sensitivity analysis does not include an assessment of the impact of lower take up of the DSA product. Given that customers that do not opt for the DSA product face a price increase, this should result in greater volume declines than those estimated above. As noted in the previous chapter, an effective price increase for bulk customers may be of particular concern as it runs the risk of accelerating e-substitution.

## 4.5 Profitability impact of An Post's proposed price changes

Overall, An Post estimates that the proposed price changes will lead to a positive profitability impact of €22 million by 2014<sup>26</sup>. Under the baseline case, An Post estimates that its USO profitability<sup>27</sup> on domestic and international outbound mail will continue to decline from a loss of €48 million in 2011, resulting in a loss of €52 million by 2014. An Post's modelling estimates that with its proposed price changes profitability would improve, resulting in a reduced loss of €30 by 2014.

In order to estimate the profitability impact under the worst-case price elasticity scenario, we have replicated An Post's profitability analysis. As shown in Table 7, our sensitivity analysis suggests that the loss may only be reduced by €14 million to €38 million, a difference of €8 million.

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<sup>26</sup> Note, the profitability analysis presented here excludes the impact of the proposed DSA product. That is, it looks at the difference between An Post's profits with and without the proposed price increases, assuming that the DSA product is introduced in both scenarios. As discussed above, An Post's model does not allow for the DSA product being excluded in the without price increase scenario.

<sup>27</sup> Again, we note that the services to be provided by An Post as part of the USO have only recently been specified by ComReg. In consequence the profitability of the USO as specified by ComReg is currently unknown. The analysis in this section is based on the information on profitability provided by An Post as part of their price application. We also note that this project did not involve verifying/validating An Post's allocation of costs between USO and non-USO services.

<sup>28</sup> The 2011, '2014 – An Post Baseline' and '2014 An Post with price changes' revenue and cost figures are taken from An Post's price application – 'App 4 PL 2010-2013 forecasts'. The sensitivity analysis revenue estimates presented here are those produced from the reapplication of An Post's model using Indecon's time series regression price elasticity estimates. The cost estimate for this scenario is calculated using the costs under '2014-An Post with price changes'. It is assumed that these costs would be reduced due to the addition loss of volumes in line with An Post's cost elasticity estimate of 0.2.

**Table 7.** USO profitability impact of An Post's proposed price changes (Domestic and International Outbound mail)

	2011	2014 – An Post Baseline	2014 – An Post with price changes	2014 – Sensitivity analysis with price changes
<b>Revenues (€m)</b>	358.76	315.18	336.70	328.43
<b>Costs (€m)</b>	406.79	367.37	366.53	366.36
<b>Profit (€m)</b>	<b>-48.03</b>	<b>-52.19</b>	<b>-29.83</b>	<b>-37.93</b>

Source: Frontier analysis of An Post data

## 4.6 Key findings in relation to An Post's volume and revenue impact analysis

This section has reviewed An Post's assessment of the likely revenue and volume impacts associated with its proposed price changes. In summary, we find that:

- The consumer survey evidence provided by An Post suggests there may be considerable consumer resistance to the proposed price increases. This is of particular concern given already declining volumes and the potential for e-substitution to increase. We note that An Post did not survey business customers, who account for the largest proportion of mail volumes, and who may be in a position to switch to aggregators, an option not available to residential customers).
- The independent price elasticity analysis commissioned by An Post provides a reasonable range of estimates for price elasticity, and is based on standard econometric approaches to the estimation of price elasticities.
- An Post has used only the lowest of the price elasticity estimates in its analysis, and in consequence it has presented the 'best case' assessment of the revenue and volume impacts of the proposed price increases. An Post has also included as its base case, a high take up rate for its proposed DSA bulk mail product.
- Sensitivity analysis shows that higher volume declines and lower revenue impacts may arise. In particular, An Post's proposed price increase could result in accelerating volume declines by a further 3.2 percentage points relative to the baseline, and result in an improvement in An Post's net revenue position of 3.6 percentage points. Although

### The impact of an Post's proposed price changes

An Post's profitability appears to still improve under these scenarios, the positive profitability impact of the proposed price increase could be reduced by around €8.1 million.

- The sensitivity analysis has been unable to capture the impact of lower DSA product take up. Given that customers that do not opt for the DSA product face a price increase, this should result in greater volume declines than those estimated above. As noted in the previous chapter, an effective price increase for bulk customers may be of particular concern as it runs the risk of accelerating e-substitution.





## 5 Affordability

One of the key tariff requirements set out in section 28(1) of the Communications Regulation (Postal Services) Act 2011 is that “prices shall be affordable and be such that all postal services users may avail of the services provided.”

In reviewing An Post’s application, we have therefore considered whether the proposed prices could be considered affordable. We have considered affordability with respect to two groups:

- residential customers; and
- business customers.

### 5.1 Residential customers

An Post has suggested that the proposed price increases are likely to be affordable for residential customers. In its price application, An Post highlights that:

- qualitative research into the national need for communication and distribution services, carried out on behalf of ComReg, ranks cost as the least important factor by consumers in assessing postal services;
- average household expenditure on postal services is low.

In order to assess An Post’s approach we have reviewed data on household expenditure on postal services, and household income data.<sup>29</sup> This suggests that:

- the net disposable income of the lowest decile of income earners is €8,904 per year;
- consumers in this group post 6.3 items per month on average, or 75.6 items per year;
- their direct postal costs are therefore €41.58 per year, which represents less than 0.5% of their net disposable income;

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<sup>29</sup> We use data from:

- An Post’s annual residential survey (last available year is 2010) for average household mailings; and
- CSO data on income distribution taken from SILC (Survey on Income and Living Conditions). The most recent SILC data is from 2010, and was published in March this year.

- the proposed 18.2% increase in stamped letter prices would add €7.57 to annual postal costs, which is an increase of less than 0.1% of annual disposable income.
- The proposed increase in stamped letter prices would have a smaller impact on disposable income for all other income deciles.

Our analysis therefore suggests that the proposed price increases are unlikely to raise significant affordability concerns for residential customers.

## 5.2 Business customers

An Post's business customers can be split into two groups: small and medium enterprises (SMEs) and large customers. Each has separate mailing characteristics, including the volume of mail sent. As a result, each group will use different mail products and discount levels. Here we consider whether An Post's proposed price changes will be affordable for each customer group.

### Small and medium enterprises (SMEs)

SMEs will mainly make use of stamped and metered mail. In considering affordability for this customer group, An Post has focussed on meter users.

An Post has argued that it does not anticipate that for [X] of meter users with an average weekly spend of [X], that the proposed price increases will have any real impact as this level of expenditure is low in the context of other weekly commitments. These customers represent about [X] of An Post's meter revenue. For the remaining [X] of customers, that have a weekly average spend of [X], An Post anticipates that it will see increased take up of discounts associated with the reduction of the volume threshold for meter discounts from 350 to 200 items.

We note that for meter users, An Post's proposals will result in a price increase of 11%. This implies that:

- the [X] of meter users with a weekly spend of [X], face an average annual increase in postal costs of [X]; and
- the [X] of customers that have a weekly average spend of [X], face an average annual increase of over [X] (before the benefit of any additional discounts as a result of lower thresholds is taken into account).

An Post has provided no other evidence with respect to affordability for this customer segment. There is therefore more uncertainty around the affordability impact for this customer segment.

### Affordability

## Large customers

Large customers currently mainly make use of bulk mail products. An Post argues that this segment of mail users will experience a price decrease due to the introduction of its DSA bulk mail product and there will therefore be no affordability issue.

However, as highlighted in section 3.2, there is currently some uncertainty around the additional costs associated with fulfilling the requirements of the product and therefore whether large customers will be effectively facing a price increase.

Customers that do not avail of the proposed DSA bulk mail product face an increase in price of approximately 10%. If none of An Post's top 27 customers were to avail of the proposed DSA bulk mail product, they would face an aggregate increase in postage costs of [X], based on 2011 volumes and revenues. This equates to more than [X] per customer. An Post's largest customer would face an increase in postage costs of over [X] per annum.

## 5.3 Key findings in relation to affordability

An Post has argued that there will be no affordability issues with respect to any customer groups. In particular it suggests that:

- for residential customers, customer research suggests price is not a major factor for customers, and post makes up a small proportion of total expenditure;
- for SMEs, An Post argues that the majority of customers will face only a negligible increase in costs and/or will be able to avail of additional discounts as a result of lower thresholds for discount products; and
- for large customers, An Post argues that the availability of its proposed DSA bulk mail product provides these customers with an effective discount and so there can be no affordability issues.

In reviewing An Post's assessment, we find that:

- for small customers there appears to be no substantial affordability impact, as even for the lowest decile income group the price increase results in a less than 0.1% decline in disposable income;
- for SMEs the evidence is less clear-cut. The majority of meter customers ([X]) face an average annual increase in postage costs of [X] per year. However, for a small proportion of customers, annual postage costs may increase by more than [X] per year; and

- for large customers, it is less clear that they will avail of An Post's DSA product. This will largely depend on the additional costs associated with fulfilling the requirements of the product and therefore whether large customers will be effectively facing a price increase. For customers that do not avail of the DSA product, the increase in postage costs may be substantial. For example, the 27 largest customers would face an average postage cost increase of in excess of [redacted], and An Post's largest customer would face an increase of over [redacted] in postage costs per annum. We note that while these costs appear large in absolute terms, they may not necessarily raise an affordability issue in relation to the entity concerned. It is possible, however, that they will encourage large business consumers to consider substitutability options for An Post's service.

## 6 Review of An Post's costs and the cost reflectivity of An Post's proposals

Section 28 (1) (b) of the Act requires that the prices charged by a universal postal service provider in the provision of a universal postal service shall be cost-oriented, that is to say, the prices shall take account of, and reflect the costs of, providing the postal service or part of the postal service concerned.

We note that a very detailed assessment of An Post's cost and efficiency is outside the scope of the study. In this study we have reviewed An Post's cost reduction programme, compared postal prices in Ireland against high-level benchmarks of postal prices and assessed An Post's estimate of its cost elasticity against relevant benchmarks.

It has been beyond the scope of the study to conduct a detailed benchmarking analysis to assess the efficiency of An Post's costs. Such an exercise is likely to be required as part of any postal price control, and is likely to involve a detailed review of An Post's cost allocation between USO and non-USO services; detailed bottom up cost modelling of An Post's key cost drivers (routes and mail centres); and a more extensive comparative benchmarking exercise across postal operators.

In the following sections we set out our findings with respect to the following issues:

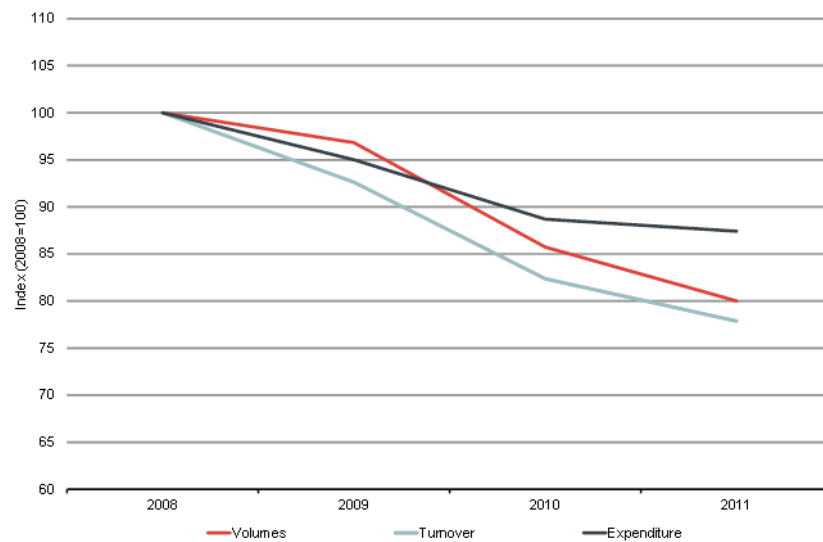
- An Post's cost reduction programme which is aimed at offsetting the financial impact of declining mail volumes within the USO.
- the cost reflectivity of An Post's proposals, and in particular, the discounts being offered by An Post;
- the degree of flexibility in An Post's costs to allow it to cope with unanticipated declines in volumes. This is of particular concern, given that there is uncertainty as to the precise volume impact of the proposed price increases. If the proposed price increases were to trigger unexpected volume losses (for example, due to an acceleration in e-substitution), it is important to understand the extent to which An Post was able to flex its costs relatively quickly in response. This is also likely to be an important issue for An Post in the context of any future price cap, which will include efficiency adjustments.

### 6.1 Cost reduction programme

In response to the decline in volumes and revenues, An Post has developed and implemented a cost reduction programme. An Post states that the aim of this programme is for costs to be €100 million lower in 2012 than in 2008. The

Figure below sets out the evolution of volumes, turnover, costs and staff levels since 2008. As can be seen, the decline in headcount and FTEs has been substantially lower than volume and turnover declines over the same period.

**Figure 19.** 2008-11 Index of volumes, turnover, expenditure, number of FTEs and Headcount



Source: An Post's Regulatory accounts  
\*Total headcount figures exclude casual staff

Table 7 details the cost reductions that An Post suggests have been made so far. According to An Post, total expenditure has been reduced by €72 million (12.6%) since 2008, with over 60% of cost savings coming from payroll.

**Table 8.** Changes in An Post's USO turnover and costs 2008-11

	2008	2009	2010	2011	Changes 2008-11	% Reduction
<b>Turnover (€000s)</b>	551,807	511,146	454,474	429,643	122,164	22.1%
<b>Total expenditure</b>	571,806	543,310	507,197	499,833	71,973	12.6%
<b>Payroll</b>	[X]	[X]	[X]	[X]	[X]	[X]
<b>Non-payroll</b>	[X]	[X]	[X]	[X]	[X]	[X]
<b>FTE – Mails</b>	[X]	[X]	[X]	[X]	[X]	[X]
<b>Headcount Mails</b>	[X]	[X]	[X]	[X]	[X]	[X]

Source: An Post's regulatory accounts and submissions to ComReg

Note: Figures have been adjusted to take account of the election in 2011. Costs have been reduced by €8.2 million and revenues by €27 million.

In An Post's application it explains that initiatives have been put in place in the following areas:

- realigning workforce – downsizing/flexible workers, changing work practices and restructuring pension liabilities;
- operations and supply chain efficiencies – automation, route optimisation, delivery days and energy efficiencies; and
- asset reorganisation/alternative revenue streams – point of sale revamp, redesign of ownership structure (franchisee) and new product offerings.

The first of these is the area that has seen the largest cost reductions so far. These initiatives have included a reduction in FTEs of [X] since 2008, as shown in Table 7 above. As indicated by the smaller reduction in headcount over the same period, this reduction has come from a reduction in payroll costs rather than a reduction in headcount. In considering the headcount figures, it is important to note that these include casual staff alongside permanent and contract staff. When casual staff are excluded, headcount has reduced by [X] over the period.

In assessing An Post's cost reductions, it is important to bear in mind that the cost reduction of 12.6% has been achieved at a time of declining volumes and revenues. Revenues have fallen by 22.1% during this period, and volumes by approximately 20%. Comparing the volume and cost declines suggest that An Post has achieved a cost elasticity of approximately 0.6 – i.e. for every 1% decline in volumes, An Post has achieved a cost reduction of 0.6%.

## 6.2 Cost reflectivity

Under section 28 of the Communications Regulation (Postal Services) Act 2011, the USO tariffs charged by An Post must be cost-orientated and non-discriminatory. Article 12 of the Postal Directive also requires that costs shall be cost-orientated and that they must give incentives for efficient universal service provision. We understand that ComReg's position, therefore, is that each price point must be cost orientated.

To review the extent to which An Post's proposals comply with these criteria, we have carried out a comparison of the unit cost information that An Post provided<sup>30,31</sup>, and the proposed prices. As An Post has not provided us with cost information for each price point, we have had to apply weighting assumptions in order to make costs and prices comparable<sup>32</sup>. Our analysis has enabled us to draw some conclusions around cost orientation and non-discrimination, although these should be considered in the context of the weighting assumptions that we were required to make. This section summarises our findings.

### Cost-orientation

Using the unit cost information provided by An Post, along with the current and proposed tariff structure, we have estimated the gross profit for each product, as well as gross profit as a proportion of cost. This provides a good indication of

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<sup>30</sup> An Post has not provided cost information for each price point. We understand that ComReg requires cost information to be at this level of detail. This has previously been noted in ComReg's initial responses to An Post's price application, along with the Accounting Direction, which requires an estimation of costs for each price point.

<sup>31</sup> It was outside the scope of this work to review the accuracy of the unit cost information provided to us by An Post. This has been covered in Analysys Mason's August 2012 report 'Review and assessment of An Post's compliance with the Accounting Direction'.

<sup>32</sup> The unit cost information provided by An Post was only available at an aggregated level, rather than split by price-point. For most products, we were able to map across to the proposed tariff structure. However, to enable us to carry out a comparison between unit costs and price, we first had to calculate weighted average prices across the weight steps for each product. Due to the weighting, the figures produced by this comparison are only estimates and should be treated as such. Given the nature of the international tariff structure we were unable to carry out this comparison for international outbound products.



how cost reflective the proposed tariffs are and how this compares to the cost reflectiveness of the current tariffs.

These results indicate that overall the current tariffs are not particularly cost reflective<sup>33</sup>. For example, An Post (based on the cost information provided by An Post) are currently experiencing a loss of over 10% of costs on stamped, labelled, metered and business reply letters. In particular, the loss on stamped and labelled letters is around 30% of cost. In comparison, An Post is currently making profits on some of the Ceadunas products for letters and flats, and on all packet products apart from stamped packets.

Turning to An Post's proposed prices, we find that An Post's proposals will improve overall cost orientation. In particular, the losses that An Post is currently experiencing on their stamped, labelled, metered and business reply letters will be reduced. However, cost orientation does worsen for some products where An Post is currently making profits as these profits would increase under the proposals. For example, labelled and metered packets.

A detailed breakdown of the estimated gross profit and gross profit as a proportion of cost for letters, flats and packet products is shown in annex 2.

### Non-discrimination

In addition to looking at the cost orientation of tariffs, it is important to consider whether the tariff structure is discriminating against certain groups of customers. Here we need to consider how discriminatory the current structure is and how this might change with An Post's proposed changes to the tariff structure. In particular, we need to understand the extent to which An Post's proposed discounts are cost reflective.

With the unit cost data that An Post has provided and the current and proposed weighted average prices, we can analyse the price differential and the cost differential between different sets of products. This allows us to assess whether the price differential is representative of the cost differential between products and therefore indicate whether the current and proposed tariff structures are non-discriminatory.

In the following sections we consider the differentials between<sup>34</sup>:

- standard stamp and meter;
- standard stamp and bulk stamp and

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<sup>33</sup> Note, the assessment of cost reflectivity is based on An Post's actual costs. It was beyond the scope of this study to benchmark An Post's costs to that of an efficient operator.

<sup>34</sup> This analysis makes the assumption that the unit cost information provided by An Post is based on an accurate allocation of costs. As explained in section 6.2, Analysys Mason are separately reviewing An Post's compliance with the Accounting Direction

- meter and other bulk.

In the case of the first two sets of differentials, the price discounts provided by An Post for meter mail and bulk purchases of stamps are related to the payment method. We understand that, in ComReg's current view, to be considered non-discriminatory, these discounts should therefore reflect the cost avoided with the use of the payment method, for example, in the case of meter there are some sorting costs avoided as all meter mail must be front facing, sorted by size, sorted between Dublin and all other places etc. as opposed to other characteristics e.g. if address is typed or not. In assessing whether these discounts are non-discriminatory, we also look at the costs associated with revenue collection for these products.

### *Differentials between standard stamp and meter*

Table 9 sets out the current and proposed price and cost differentials for stamped and metered mail across letters, flats and packets. For letters the current price differential between stamped and metered mail is €0.01, this compares to a cost differential of [redacted].

For flats and packets, there is currently no price differential between stamped and metered mail, but there is a cost differential of [redacted] for flats and [redacted] for packets. This remains the case for An Post's proposed price changes.

**Table 9.** Current and proposed price and cost differentials between domestic stamped and metered mail

	Price Differential		Cost differential	
	Current	Proposed	Current	Proposed
<b>Letters</b>	0.01	0.05	[redacted]	[redacted]
<b>Flats</b>	0.00*	0.00*	[redacted]	[redacted]
<b>Packets</b>	0.00*	0.00*	[redacted]	[redacted]

Source: Frontier analysis of An Post data

\*Simple average used rather than a weighted average due to the distortion that weighting creates

An Post has provided a breakdown of the unit costs associated with different domestic letter products for 2010 by the key pipeline components. We understand that metered mail has a lower unit cost than stamped mail. But further information on the costs avoided is required from An Post in order to support the proposed meter discount of 5c. No information on avoided costs has been provided for flats, packets or parcels for us to assess whether the lack of

## Review of An Post's costs and the cost reflectivity of An Post's proposals

discount for these payment methods is discriminatory. We note that this information was requested from An Post.

### **Differentials between standard stamp and bulk stamp**

An Post's proposed price changes include the introduction of a 5% discount for customers buying more than 300 stamps in one transaction. As set out earlier, An Post has informed us that the revenue collection costs associated with stamped domestic letters are [X], or around [X] of the total unit costs for stamped mail. An Post has not provided an estimate of the revenue collection costs it avoids through the bulk purchasing of stamps (the information was requested). We cannot therefore assess whether the proposed discount is justified in terms of the avoided costs associated with the payment method.

### **Differentials between meter and other bulk**

Table 10 sets out the current and proposed price and cost differentials for metered and bulk mail across letters and flats. Although the cost differentials between metered mail and bulk mail that An Post offers are also currently greater than the price differentials, they are more representative of the cost savings associated with bulk in comparison to meter than in the case of stamped and metered mail. Under the proposed tariff changes, this is set to improve further for both letters and flats.

**Table 10.** Current and proposed price and cost differentials between domestic metered and bulk mail

	Price Differential		Cost differential	
	Current	Proposed	Current	Proposed
<b>Letters</b>				
- Discount 3 Ceadunas	0.12	0.14	[X]	[X]
- Discount 6 Ceadunas	0.13	0.15	[X]	[X]
- Discount10 Ceadunas	0.11	0.13	[X]	[X]
- Discount 11 Ceadunas	0.06	0.08	[X]	[X]
- Discount 12 Ceadunas	0.09	0.11	[X]	[X]
<b>Flats</b>				
- Discount 3 Ceadunas	0.25	0.28	[X]	[X]
- Discount 6 Ceadunas	0.36	0.39	[X]	[X]
- Discount10 Ceadunas	0.34	0.39	[X]	[X]
- Discount 11 Ceadunas	0.34	0.38	[X]	[X]
- Discount 12 Ceadunas	0.05	0.38	[X]	[X]

Source: Frontier analysis of An Post data

\*Note: For flats, discount 11 and discount 12 Ceadunas have very low volumes. Some caution should therefore be taken around the results for these products.

### 6.3 Ability of An Post's costs to flex in the case of an unanticipated decline in volumes

The final issue we consider is the extent to which An Post can flex its costs in response to an unanticipated volume decline. Notwithstanding the general uncertainty around mail volumes, there is a real risk that the proposed price increases could trigger volume declines that are larger than those which An Post is currently anticipating. This is particularly true if large customers were to face an effective price increase for bulk mail products. If this occurred one would be less concerned about the impact on the USO if An Post was able to flex its costs relatively quickly in response.

#### Review of An Post's costs and the cost reflectivity of An Post's proposals

An Post has suggested that the assessment of costs needs to be considered separately for mails processing centres and the collection and delivery operation. In mails processing they estimate a cost elasticity of 0.5, i.e. for every 1% decline in volumes, a cost saving of 0.5% could be achieved. In collection and delivery they estimate a cost elasticity of 0.01, i.e. for every 1% decline in volumes, a cost saving of 0.1% could be achieved. The combined cost elasticity is estimated to be 0.2.

This overall cost elasticity appears to be low relative to both the cost savings An Post has achieved to date, and relative to benchmarks from other countries. It also suggests that in the event of sharper declines in volumes than anticipated, there appears to be a relatively limited scope for an off-setting cost reduction.

## 6.4 Key findings in relation to costs

In this section we have reviewed An Post's costs, and the cost reflectivity of An Post's proposals. We find that:

- An Post has reduced its costs by 12% since 2008, compared to volume reductions of c.20% over the same period. This indicates that An Post has achieved a cost elasticity of 0.6 (i.e. every 1% decline in volumes leads to a 0.6% decline in costs). An Post has, however, indicated that looking ahead they believe their cost elasticity will be closer to 0.2<sup>35</sup>. This suggests that further unanticipated declines in the USO volumes will have a more significant impact on the financial position of the USO.
- We note that 60% of cost reductions have come through reductions in payroll. To date, these appear to have been achieved through reductions in staff costs and reductions in the number of casual staff. While the number of FTEs has declined by [X] since 2008, headcount reduction for permanent and contract staff has been [X].
- A comparison of unit costs and An Post's price proposals suggests that the changes An Post is proposing would improve cost reflectivity (as benchmarked against An Post's current costs).
- An Post has set out that the proposed changes to the level of discounts offered are justified on the grounds of cost difference. However, ComReg has previously made clear that discounts must reflect only the difference in avoided cost associated with the payment method.

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<sup>35</sup> An Post have explained that the achieved cost elasticity of 0.6 contained an element of catch up and also what could be described as "low hanging fruit". It is therefore not directly comparable with their future cost elasticity estimate of 0.2.

- No information on avoided costs has been provided for flats, packets or parcels for us to assess whether the lack of discount for these payment methods is discriminatory. We note that this information was requested from An Post.

## 7 Summary of findings

We have reviewed a number of aspects of An Post's price application. We believe that the following are the key issues which ComReg should be mindful of as it considers whether to allow An Post's proposed price increase.

- An Post has presented a very optimistic assessment of volume and revenue trends to 2014. Its assessment of the impact of the proposed price increases is also likely to be a 'best case' scenario, as it uses the lowest estimates of price elasticity and assumes a very high DSA take up rate.
- With respect to volume forecasts, we suggest that volume declines to 2014 may be substantially higher than those estimated by An Post:
  - An Post's forecast volume decline is small compared to trends in the last few years. We have seen no evidence to suggest that the rate of volume decline is decreasing;
  - An Post's DSA assumptions look optimistic, and in the absence of DSA take up, bulk mail customers will face a substantial price increase, which may further accelerate volume declines; and
  - an assessment of data for An Post's top 27 customers suggests e-substitution may not be as advanced in Ireland as in other jurisdictions.
- Our sensitivity analysis suggests that the proposed price increases may have a greater impact on volume declines and a less positive impact on revenues. In particular, An Post's proposed price increase may result in a net revenue impact of 3.6% in 2014, while volume declines may be accelerated by as much as 3.2 percentage points. Further, the An Post estimated positive profitability impact of the proposed price increases could be reduced by up to €8.1 million.
- This revenue position could be eroded further given that An Post's impact analysis assumes a high take up of its proposed DSA product. If the proposed DSA product take up is lower, this may result in a further acceleration of volume declines, and could potentially accelerate e-substitution.
- An Post has indicated that its forward looking cost elasticity is low, at 0.2. This means that if the proposed price increase has a higher impact on volume declines than anticipated there is relatively limited flexibility for costs to adjust to offset the impact. In consequence, the risk to the financial position of the USO associated with an unanticipated high impact of the proposed price increases is substantial.

- In terms of affordability, An Post's proposals are unlikely to give rise to affordability issues for Residential customers. For SMEs the evidence is less clear-cut. If they were to maintain their current mail volumes, while the majority of SMEs [X] would face an average annual increase in postage costs of [X] per year for a small proportion of meter customers, annual postage costs may increase by more than [X] per year. For large customers, it is less clear that they will avail of An Post's DSA product. For customers that do not avail of the DSA product and maintain their current volume of mail, the increase in postage costs may be substantial. For example, the 27 largest customers would face an average postage cost increase of in excess of [X], and An Post's largest customer would face an increase of over [X] in postage costs per annum.
- An Post's proposed price changes appear to improve cost reflectivity. In relation to the non-discrimination review, further information in relation to the costs avoided is required from An Post in order to support the proposed discounts.

To conclude, our assessment is that An Post's forecast for the price increase application appears optimistic, and there is a very substantial risk that the proposed price increases could result in volume declines significantly higher than that forecasted by An Post.



## 8 Annex 1: Volume and revenue forecasts

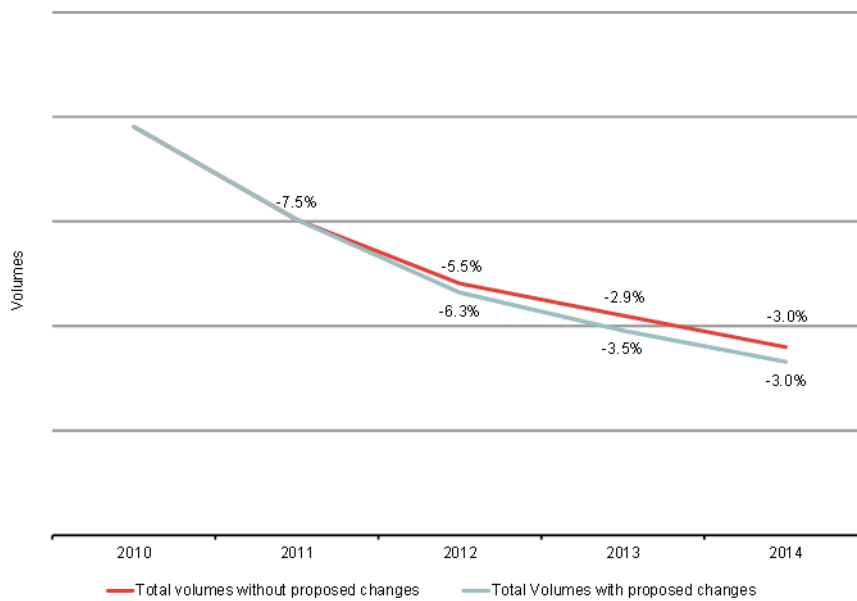
To complement the information set out in section 3, this annex provides a detailed summary of what An Post's forecasts suggest with regards to:

- overall volume trends with and without the proposed changes;
- trends in product and format mix with and without the proposed changes; and
- the overall forecast impact on revenues.

### Overall volume trends

Overall, An Post forecasts that their proposed changes will increase the rate of volume decline for 2012 and 2013 in comparison to their baseline. This is illustrated in Figure 20.

**Figure 20.** Comparison of overall volumes with and without proposed changes to charges 2010-2014



Source: Frontier analysis of An Post data

### Trends in format and product mix

An Post's model also allows us to look at their forecast trends in format and product mix, with and without the proposed price changes.

### Format mix

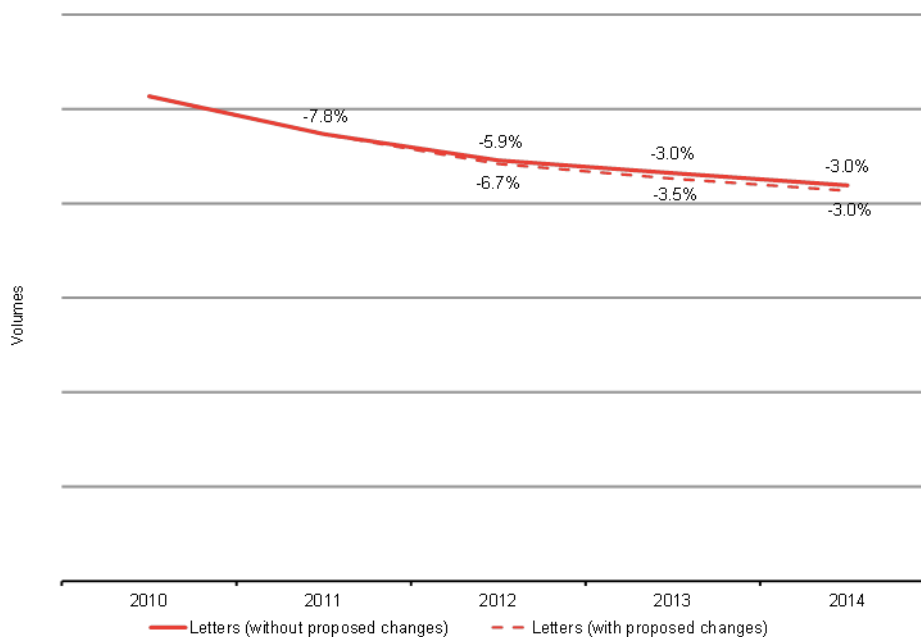
In relation to format mix, Figure 21 illustrates the forecast trends in domestic mail volumes, with and without the proposed price changes, for:

- letters;
- flats;
- packets; and
- registered mail.

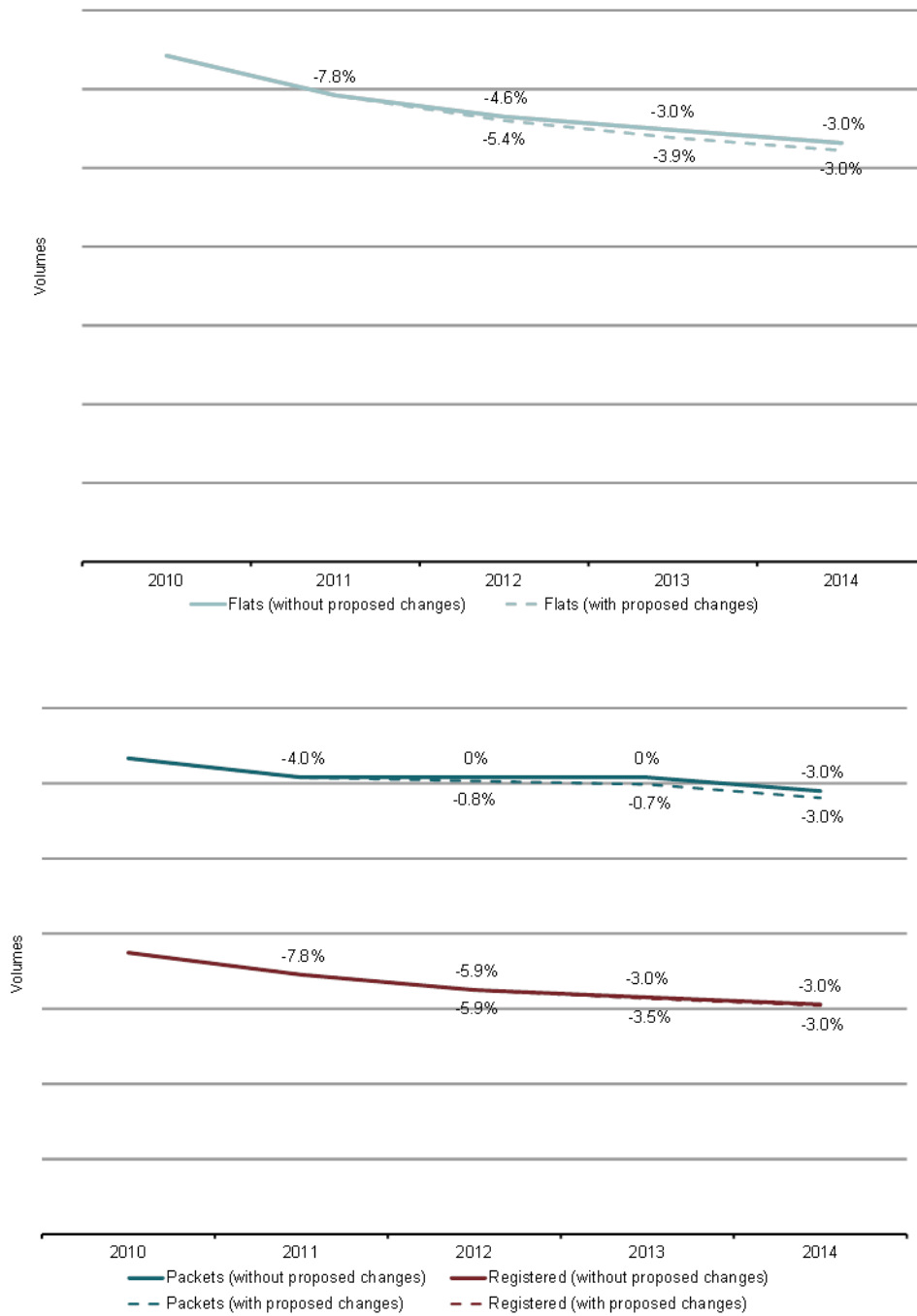
In section 2, we saw that there has been a significant decrease in flats historically. However, this isn't mirrored in the forecasts.

For packets, An Post forecasts a minimal decline in volumes with proposed changes for 2012 and 2013, despite a decrease in 2010 and 2011. An Post has explained that this reduction in volume decline is a result of e-fulfilment. In 2014, the model forecasts a return to decline, with -3% growth. An Post has since indicated that they believe packets will perform better than this with the e-fulfilment trends continuing. However, at the time of writing this report, An Post was unable to provide an updated version of its volume and revenue model as volume outturn figures were yet to be approved by its board.

**Figure 21.** Comparison of domestic mail volumes split by format 2010-2014 with and without proposed changes to charges



## Annex 1: Volume and revenue forecasts



Source: Frontier analysis of An Post data

**Product mix**

In relation to product mix, Figure 22 illustrates the forecast trends in domestic mail volumes, with and without the proposed price changes, for:

- stamps;

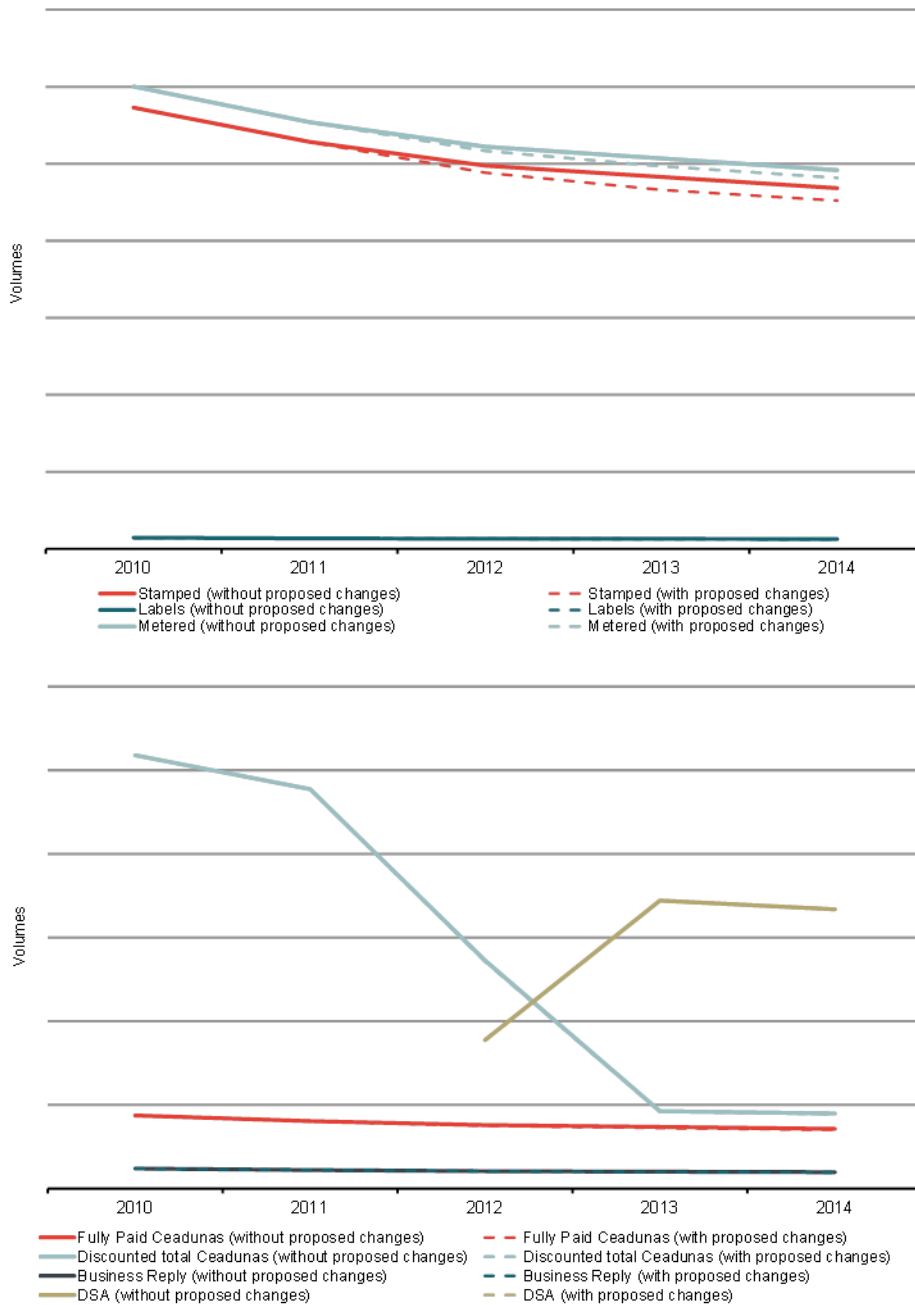
- labels;
- meter;
- fully paid ceadunas;
- discounted ceadunas;
- business reply; and
- DSA.

Table 11 details the year-on-year forecast volume growth rates, with and without the proposed price changes, for each of these products.

Due to the way it has been modelled by An Post, the introduction of the proposed DSA product is forecast to reduce discounted ceadunas volumes significantly through switching.

For fully paid ceadunas and business reply mail, there is little change between the forecast volumes with the proposed price changes and without the proposed price changes.

**Figure 22.** Comparison of domestic mail volumes split by product 2010-2014 with and without proposed changes to charges



Source: Frontier analysis of An Post data

**Table 11.** Year-on year change of domestic mail volumes split by product 2010-2014 with and without proposed changes to charges

	2010	2011	2012	2013	2014
<b>Stamp (without proposed changes)</b>		-7.8%	-5.8%	-3.0%	-3.0%
<b>Stamp (with proposed changes)</b>		-7.8%	-7.5%	-4.6%	-3.0%
<b>Labels (without proposed changes)</b>		-6.1%	-3.1%	-1.5%	-3.0%
<b>Labels (with proposed changes)</b>		-6.1%	-4.1%	-2.4%	-3.0%
<b>Metered (without proposed changes)</b>		-7.7%	-5.7%	-2.9%	-3.0%
<b>Metered (with proposed changes)</b>		-7.7%	-6.7%	-3.9%	-3.0%
<b>Fully Paid Ceadunas (without proposed changes)</b>		-7.8%	-5.9%	-3.0%	-3.0%
<b>Fully Paid Ceadunas (with proposed changes)</b>		-7.8%	-6.6%	-3.8%	-3.0%
<b>Discounted total Ceadunas (without proposed changes)</b>		-7.8%	-42.9%	-66.1%	-3.0%
<b>Discounted total Ceadunas (with proposed changes)</b>		-7.8%	-43.1%	-66.1%	-3.0%
<b>DSA (without proposed changes)</b>				94.0%	-3.0%
<b>DSA (with proposed changes)</b>				94.0%	-3.0%
<b>Business Reply (without proposed changes)</b>		-7.7%	-5.8%	-2.9%	-3.0%
<b>Business Reply (with proposed changes)</b>		-7.7%	-6.5%	-3.8%	-3.0%

Source: Frontier analysis of An Post data

## Impact on revenues

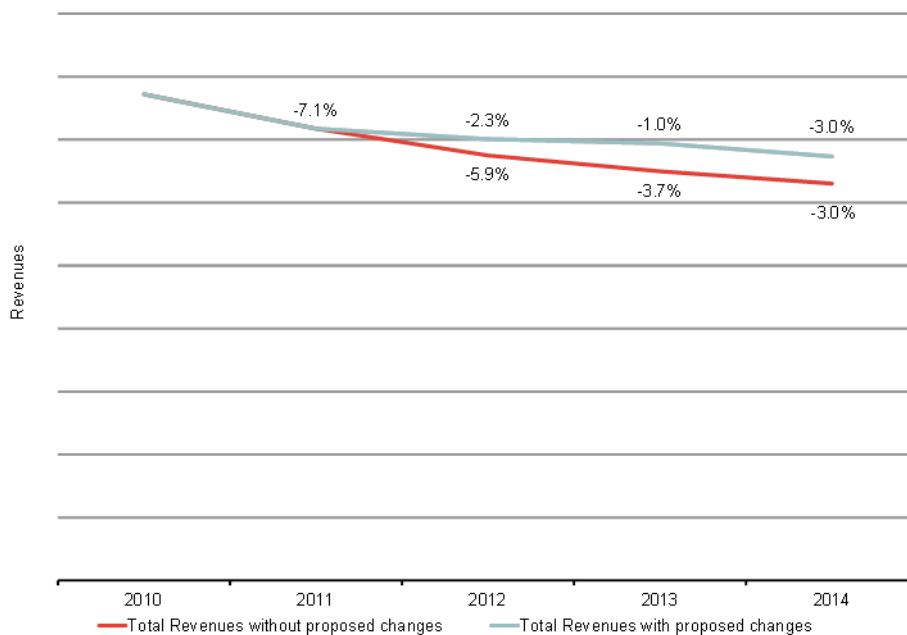
With regards to forecast revenues, on the other hand, we look at the impact on revenues, with and without the proposed price changes, of:

- overall volume decline;
- changes in format mix; and
- changes in product mix.

### Overall volume decline

Figure 23 shows the impact of the overall volume decline on revenues with and without proposed changes. The proposed changes have a positive overall revenue effect. Due to the design of An Post's model, the rate of revenue decline is expected to be -3% in 2014 in both the with and without proposed price changes scenarios.

**Figure 23.** Comparison of overall forecast revenues 2010-2014 with and without proposed changes to charges



Source: Frontier analysis of An Post data

### Changes in format mix

Figure 24 shows the impact on revenue of the forecast changes in format mix with and without the proposed price changes. This covers the following formats:

- letters;

- flats;
- packets; and
- registered mail.

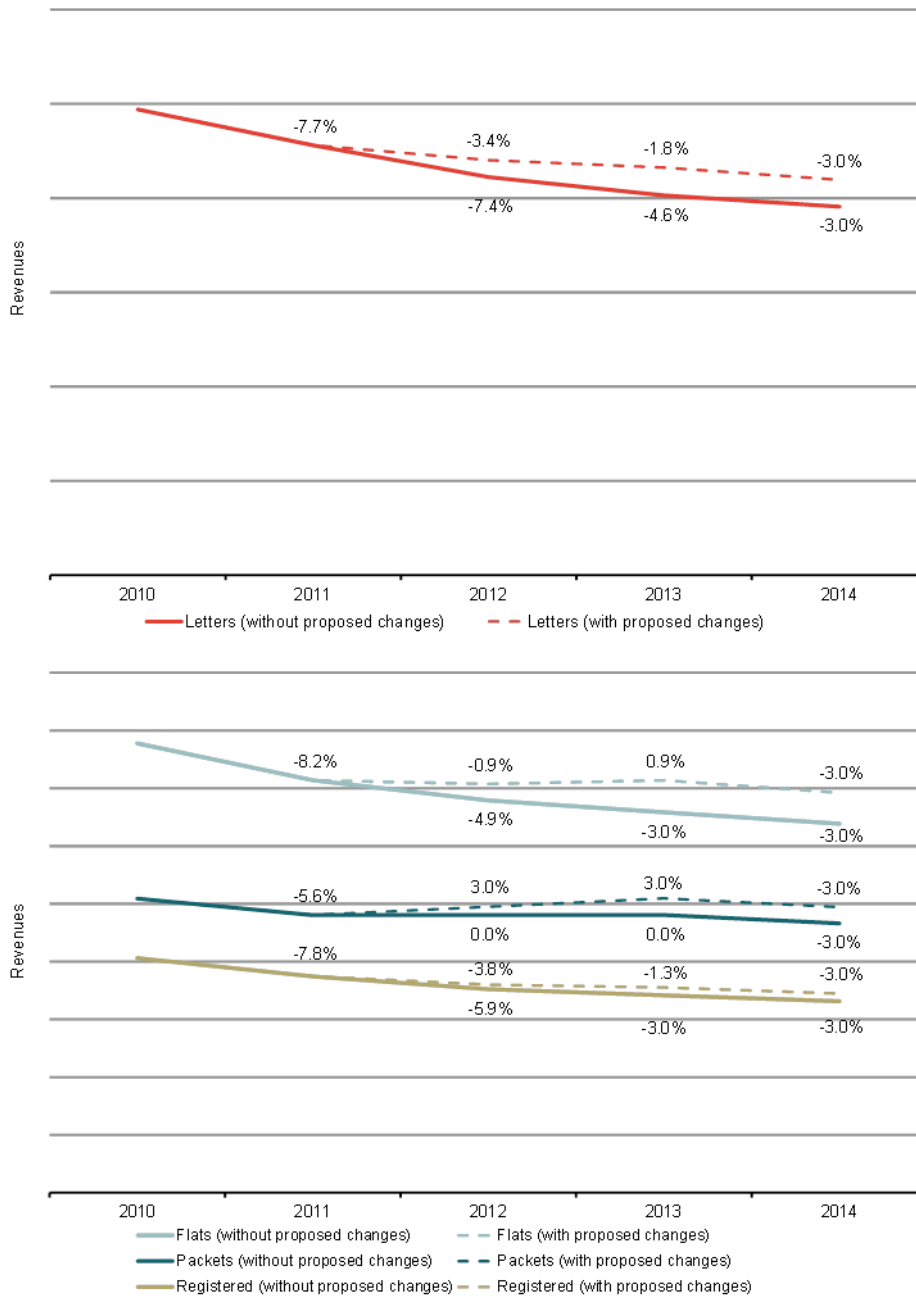
Flats and registered mail are estimated to have seen the largest revenue falls in 2011, but the rate of decline in letters revenue is set to catch up to 2014. Between 2011 and 2014, letter revenues are forecast to see larger declines than flats and registered mail.

The volume growth assumptions imposed by the model on packet volumes create positive forecast growth in revenues in 2012 and 2013.

As with the impact of overall forecast volume declines, the revenue decline for 2014 is set to be -3.0% for all formats, with and without the proposed price increases.



**Figure 24.** Comparison of forecast revenues with and without proposed changes split by format



Source: Frontier analysis of An Post data

### *Changes in product mix*

Figure 25 shows the impact on revenue of the forecast changes in product mix with and without the proposed price changes. This covers the following products:

- stamps;
- labels;
- meter;
- fully paid ceadunas;
- discounted ceadunas;
- business reply; and
- DSA.

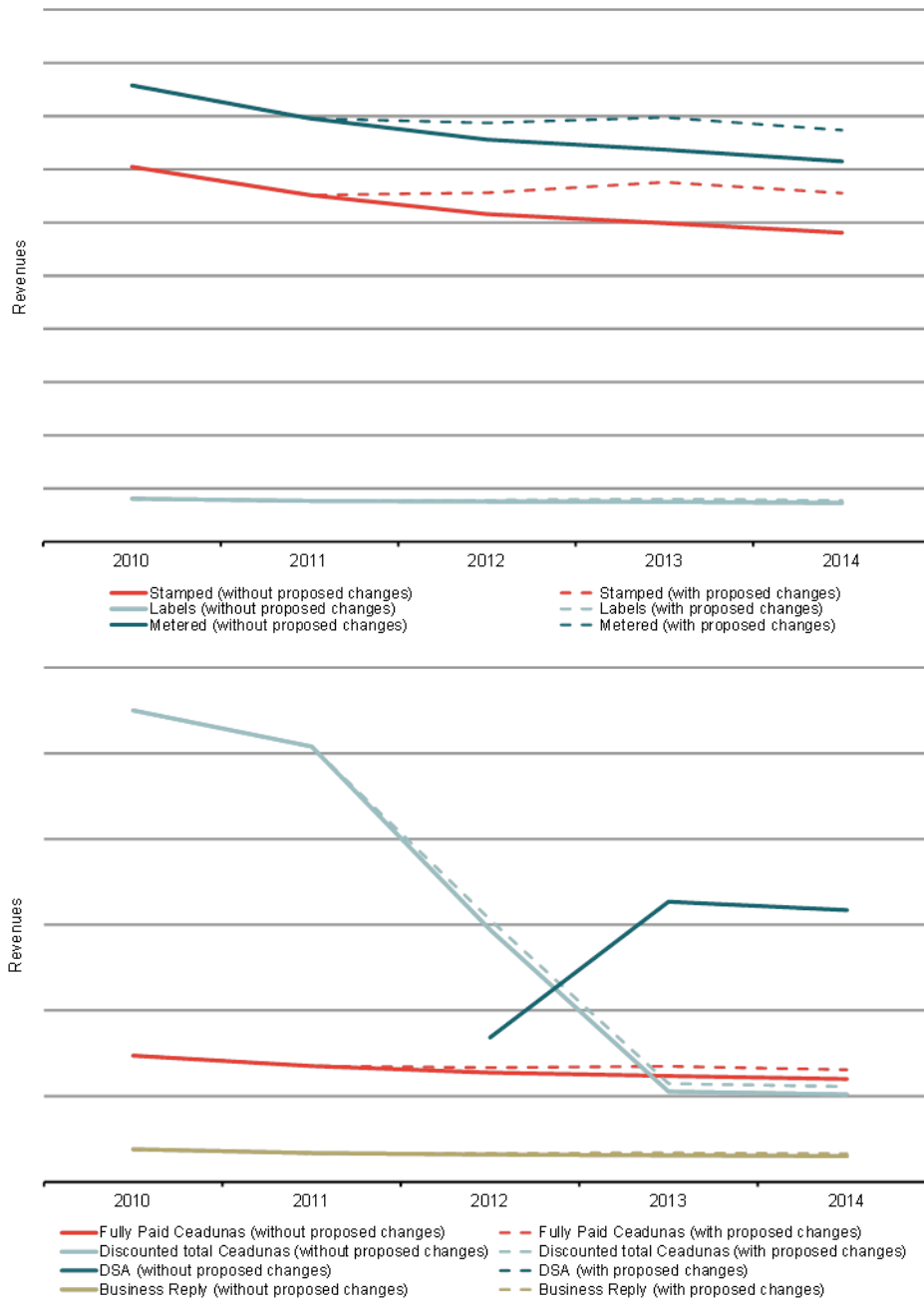
Table 12 details the year-on-year forecast revenue growth rates, with and without the proposed price changes, for each of these products.

Business reply mail and fully paid ceadunas are estimated to have seen the largest declines in 2011.

The proposed changes to prices are forecast to turn the revenue decline around for stamp and labels mail in 2012 and 2013. For all other products (excluding discounted ceadunas), the proposed price changes are forecast to turn around the revenue decline in 2013.

As with the impact of overall forecast volume declines and the changes in format mix, the revenue decline for 2014 is set to be -3.0% for all product, with and without the proposed price increases.

**Figure 25.** Comparison of forecast revenues with and without proposed changes split by products



Source: Frontier analysis of An Post data

**Table 12.** Year-on year change of domestic mail revenues split by product 2010-2014 with and without proposed changes to charges

	2010	2011	2012	2013	2014
<b>Stamp (without proposed changes)</b>		-7.5	-5.5	-2.8	-3.0
<b>Stamp (with proposed changes)</b>		-7.5	0.6	3.0	-3.0
<b>Labels (without proposed changes)</b>		-5.0	-1.5	-0.7	-3.0
<b>Labels (with proposed changes)</b>		-5.0	1.6	2.3	-3.0
<b>Metered (without proposed changes)</b>		-7.2	-5.0	-2.5	-3.0
<b>Metered (with proposed changes)</b>		-7.2	-1.1	1.3	-3.0
<b>Fully Paid Ceadunas (without proposed changes)</b>		-8.3	-5.7	-2.9	-3.0
<b>Fully Paid Ceadunas (with proposed changes)</b>		-8.3	-1.4	1.2	-3.0
<b>Discounted total Ceadunas (without proposed changes)</b>		-7.7	-42.1	-64.2	-3.0
<b>Discounted total Ceadunas (with proposed changes)</b>		-7.7	-39.8	-62.5	-3.0
<b>DSA (without proposed changes)</b>				94.0	-3.0
<b>DSA (with proposed changes)</b>				94.0	-3.0
<b>Business Reply (without proposed changes)</b>		-11.5	-5.4	-2.7	-3.0
<b>Business Reply (with proposed changes)</b>		-11.5	-1.1	1.4	-3.0

Source: Frontier analysis of An Post data

## 9 **Annex 2: Detailed breakdown of cost orientation analysis**

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[✂]

[✂]

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