



THE MCKELL INSTITUTE

Digital Post:

**Business transformation
and the future sustainability
of Australia Post**

MARCH 2015

Abstract

The McKell Institute is conscious of the important role that [Australia Post](#) continues to play in essential service delivery, particularly in rural and remote Australia. Australia Post is also a very large employer, with 32,000 staff across all States and Territories.

However, Australia Post is experiencing a trend decline in the performance and profitability of its traditional mail service - to the stage that it now impacts negatively on the overall functioning of the business.

This report focuses primarily on proposals to secure the financial strength of [Australia Post](#) and at the same time ensure continuation of its role as a key employer and provider of essential services, particularly in rural and regional areas.

Background

The authors of this paper have utilised a range of publicly available information and our own analysis in compiling this paper, along with information provided from various industry participants.

About the McKell Institute

The [McKell Institute](#) is an independent, not-for-profit, public policy institute dedicated to developing practical policy ideas and contributing to public debate. The McKell Institute takes its name from New South Wales' wartime Premier and Governor-General of Australia, William McKell.

William McKell made a powerful contribution to both New South Wales and Australian society through significant social, economic and environmental reforms

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The project team would like to acknowledge the time made available by senior staff in Australia Post, the Department of [the](#) Communications in Canberra and the NSW Postal and Telecommunications Union, NSW Branch in discussions relating to the project.





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Foreword

As Australia's oldest, continually operating organisation, Australia Post is a national icon that has been providing a core essential service for over 200 years.

As the employer of over 32,500 people across several categories, Australia Post is a key provider of jobs to regional areas with 58 per cent of its 4,427 retail outlets operating in a rural or remote environment. It has a strong commitment to the employment of culturally diverse demographics within our community making up 23 per cent of employees and people with disabilities constituting a further 6.9 per cent.

However, Australia Post is entering difficult times. Since it reached what is now referred to as 'peak mail' in 2007-08, mail volume has dropped by a substantial 20.1 per cent. For the first time since it became a government owned enterprise in 1989, the company booked its first half-year loss between January and July 2014. The forecast is that things are likely to get worse before they get better, with Australia still being well behind other nations in terms of the decline in overall letter volumes.

Though it has been active in undertaking reforms to ensure financial viability, it is important that the future response to these challenges is not to impetuously cut jobs and services, particularly in regional areas.

It is inevitable that the company will need to undergo some degree of reform, and an examination of the company's Community Service Obligations will be central to this. The McKell Institute recognises that there is a legitimate place for debate about pricing and delivery, though we stress that any reforms must not unduly undermine accessibility for regional areas, our elderly, or the technologically challenged.

Where possible, Australia Post should also seek to build synergies with other government departments, such as the ATO, Centrelink and Medicare. As an alternative to further closures, regional communities would be far better served by Australia Post outlets that provide an enhanced suite of government services.

The McKell Institute also believes that Australia Post would benefit from expanding the services that it

offers to Australian households and businesses. Internationally, postal companies have been establishing new innovative methods of expanding services. Swiss Post, for example, has introduced the first nationwide electronic patient record in compliance with Switzerland's eHealth strategy. That reform has seen Swiss Post become one of the largest IT employers in that country.

The McKell Institute firmly believes that Australia Post would do well to follow the lead of similar organisations overseas, and leverage its trusted brand to deliver new innovative, digital and logistical services.

Australia cannot afford to go down the Canadian path, where mail delivery to the home has now been abolished. The solution to the financial problems plaguing Australia Post won't be found by closing outlets and shedding jobs. Instead, Australia Post should leverage its brand and skilled workforce to deliver new products and services to our community.

A new narrative will be required to engage the community in a realistic discussion about the long term challenges and opportunities facing Australia Post. This report hopes to be the beginning of that conversation.



The Hon John Watkins
CHAIR,
MCKELL INSTITUTE



Sam Crosby
EXECUTIVE DIRECTOR,
MCKELL INSTITUTE

Executive Summary

A turning point for Australia Post

The financial year 2013-14 has been seen as a turning point for Australia Post. Over the period January to June 2014, Australia Post booked its first ever half-year loss since becoming a government owned enterprise in 1989. This was a direct result of heavy losses occurring in Australia Post's mail business, losses that were in excess of profits generated across the rest of its operations.

Losses in the mail business have largely been driven by declining mail volumes as people and organisations switch from traditional letters mail to digital alternatives. There are also substantial costs associated with meeting Australia Post's Community Service Obligations (CSOs) that govern delivery frequency, delivery timetables, public access, and pricing. Remarkably, Australia Post's CSO requirements were last reviewed 16 years ago, well before the acceleration of digital transformation across the services sector.

To offset these losses, Australia Post has been looking to grow its business in the developing digital environment, including through opportunities presented by the growth in e-commerce, and through strategies that make strategic use of Australia Post's extensive network of retail outlets. It has also asked the Government for new tools to reduce the scale of the losses in the letters business, including the freedom to set more cost-reflective prices and more freedom in scheduling deliveries.

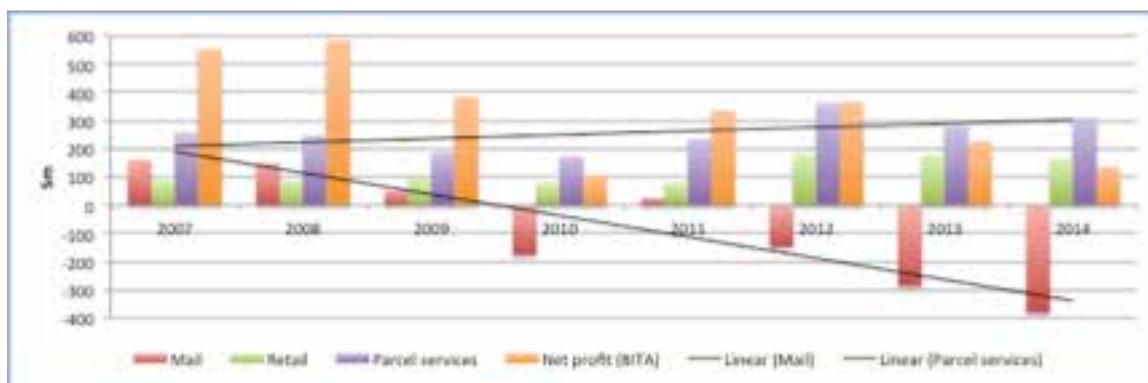
The McKell Institute is conscious of the important role Australia Post continues to play in essential service delivery and as a large employer across regional Australia. This report seeks to focus primarily on strategies to increase the financial strength of Australia Post, while at the same time acknowledging Australia Post's role as a key employer and provider of essential services, particularly in rural and regional areas. This report examines proposals currently being canvassed for change at Australia Post and identifies some alternative proposals that could enhance the financial viability of the corporation.

The decline of traditional mail is threatening an Australian icon

What is now referred to as peak mail was reached in 2007-08. Since then, mail volume has fallen by 1.1 billion items per annum, or 20.1 per cent. The GDP adjusted fall in volumes has been 25 per cent.

Australia Post's reserved letter business section is struggling. The reserved services business fell into a loss making position in 2007-08. By 2009-10 the reserved mail service section's annual losses had reached \$250m. Between 2007 and today, the cumulative cross subsidy to the reserved mail section from other parts of Australia Post business has totaled \$1 billion. The impact of the mail losses on the overall business is represented in Figure 1:

FIGURE 1:
HEADING TO COME



The decline in traditional mail has also had a negative impact on the Commonwealth Government's budget through a steep drop in its return on equity. In 2013-14, the declared dividend to the Commonwealth was just \$78.8m. This is 82.3 percent lower than the \$446.2m delivered in 2007-08.

Forecasts paint an even bleaker picture. Reserved letter volumes are expected to decline even further at an average rate of between eight and eleven percent between now and 2020 (Boston Consulting Group, 2014). Without change, it is estimated that the corporation will incur some \$12.1 billion in cumulative losses in letters over the next ten years, offsetting profit growth across the rest of the company and resulting in total losses across the whole enterprise of some \$6.6 billion.

These forecasts are largely based on an examination of trends at comparable overseas companies. Compared to other countries, Australia is still relatively early in its fall from peak volumes. Among International Post Corporation members, the greatest decline has been recorded in Denmark,

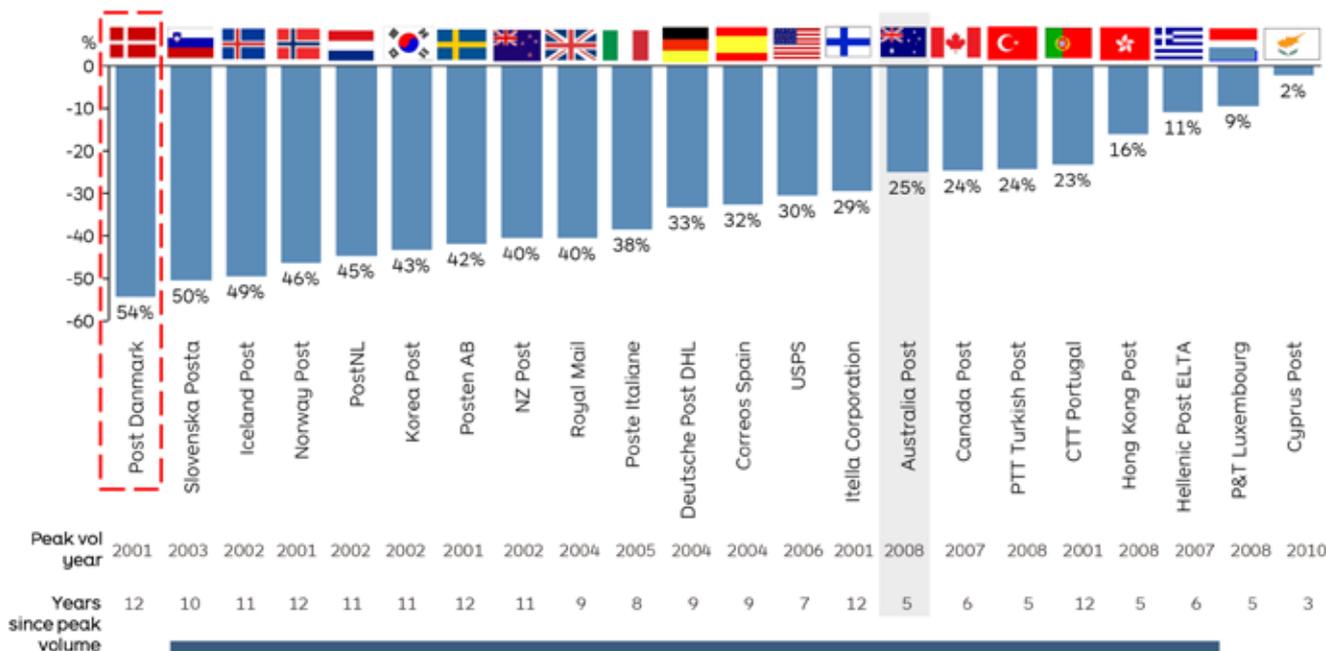
which has seen a 54% decline in volumes since 'peak mail' was recorded in 2001. Several other European countries also reached peak mail in 2001 or 2002, with declines mostly in excess of 40 per cent. This is over twice the decline experienced in Australia to date (20%), indicating that volumes will likely continue falling at a very rapid rate.

Government communications with businesses and the community represents a substantial component of all correspondence sent in Australia. However, both major political parties now envisage having 80 per cent of government communications with citizens online by 2017. If this is the case, Australia will reach the same level of government adoption as Denmark and Norway within the next three years. Australia Post Managing Director Ahmed Fahour has warned that "if that is the case then our letter volumes will literally fall off a cliff".

To ensure that Australia Post is able to survive this transition, reforms must be pursued in order to secure the financial sustainability of the organization.

FIGURE 2:
HEADING TO COME

Postal operators GDP-adjusted mail volume decline from peak volume to 2011-2012
(Peak year varies, GDP-adjusted %)



We are still relatively early in our fall from peak volume relative to our peers

Note: China's GDP-adjusted volume decline from peak is 63%, however absolute volume declines from peak (not GDP-adjusted) are only 7%. Given the impact the country's rapid economic growth has had on this metric we have excluded China (and some other developing economies) from this analysis. Comparison year to peak volume year varies according to availability of data. Source: Australian Bureau of Statistics, IPC, Team analysis



Australia Post as a regional employer and employer of disadvantaged groups

The future financial sustainability of Australia post is incredibly important, particularly to communities and businesses in regional Australia. Australia Post has a retail network of over 4,417 retail outlets, 2,560 (58%) of which are in rural or remote areas. These Post Offices are more than service points:

most are small business entities owned and operated by independent business people engaged in the sale of goods and services.

Australia Post employs 32,500 people across several employment categories. The largest single employment category is postal delivery, comprising 43.1 per cent of all employment. Mail processing and retail employment make up a further 27.1 per cent.

TABLE 1: AUSTRALIA POST. EMPLOYMENT 2014.

	TOTAL		FEMALE		MALE	
	NO	%	NO	%	NO	%
Delivery	14,006	43.1	3,779	29.9	10,227	51.5
Mail processing	4,971	15.3	2,238	17.7	2,733	13.8
Retail	3,827	11.8	3,180	25.2	647	3.3
Administration	3,413	10.5	1,578	12.5	1,835	9.2
Transport	2,594	8.0	230	1.8	2,364	11.9
Postal Manager	1,004	3.1	579	4.6	425	2.1
Parcels	709	2.2	257	2.0	452	2.3
Call centre	580	1.8	372	2.9	208	1.0
Executive	444	1.4	152	1.2	292	1.5
Technical	347	1.1	14	0.1	333	1.7
All other	604	1.9	265	2.1	339	1.7
Total*	32,499	100.0	12,644	100.0	19,855	100.0

Source: Australia Post, Diversity and inclusion Annual Report 2014.

Australia Post has a loyal and committed workforce. Most staff (95.3 per cent) are employed on a permanent basis with 71.6 per cent employed full time. Only 1.1 per cent of their workforce is casual. Australia Post also has a very strong

commitment to the employment of culturally and diverse groups (CALD). This group makes up 23.0 per cent of employees, while people with disabilities (PWD) constitute a further 6.9 per cent of total employment.

TABLE 2:

AUSTRALIA POST. WORKFORCE PROFILE (GENDER, ATSI, CALD, PWD) AT 30 JUNE 2014

	WORKFORCE REPRESENTATION		FEMALE		MALE		ATSI		CALD		PWD	
	NO	%	NO	%	NO	%	NO	%	NO	%	NO	%
Permanent												
Full-time	23,283	71.6	7411	58.6	15,872	79.9	323	65.5	5,719	76.4	1,698	75.5
Part-time	7,700	23.7	4,675	37.0	3,025	15.2	127	25.8	1,586	21.2	515	22.9
Total Permanent	30,983	95.3	12,086	95.6	18,897	95.2	450	91.3	7,305	97.6	2,213	98.4
Fixed term												
Full-time	504	1.6	118	0.9	386	1.9	6	1.2	58	0.8	9	0.4
Part-time	666	2.0	204	1.6	462	2.3	15	3.0	95	1.3	19	0.8
Total Fixed Term	1,170	3.6	322	2.5	848	4.3	21	4.3	153	2.0	28	1.2
Casual	0											
Full-time	51	0.2	42	0.3	9	0.0	1	0.2	4	0.1	3	0.1
Part-time	295	0.9	194	1.5	101	0.5	3	0.6	19	0.3	5	0.2
Total Casual	346	1.1	236	1.9	110	0.6	4	0.8	23	0.3	8	0.4
Indigenous Traineeships							18	3.7				
Total Employment	32,499	100.0	12,644	38.9	19,855	61.1	493	1.5	7,481	23.0	2,249	6.9

Source: Australia Post, Diversity and inclusion Annual Report 2014.



The possible end of home delivery & the future of Community Service Obligations

If Australia Post is unable to secure financial viability, there is a very real possibility that outlets will be closed and jobs will be lost. This has been the situation in Canada. Canada is the first of the Group of Seven countries to signal the abolition of mail delivery to the home, but it will almost certainly not be the last. Home delivery to the 5 million Canadian households who still receive it will be phased out completely by 2018. They will join the 3.8m households that already go to a group mailbox to collect mail and parcels. The remaining customers get their mail from boxes in building lobbies (3.8m), public and private post offices (1.8m), or from a rural mailbox (0.8m). This plan will see 8,000 postal workers lose their jobs, while consumers will see the cost of stamps increase to C\$1 each.

While ending home delivery is not currently on the policy radar for either the Government or Australia Post, it is imperative that further action is taken to strengthen the organisation's financial sustainability. This will likely include an examination of the costs associated with meeting Australia Post's Community Service Obligations (CSOs). Australia Post's CSOs govern pricing, delivery timetables, delivery frequency, and public access. The CSO requirements were last reviewed 16 years ago.

To offset the costs associated with Australia Post's CSOs, the organization has long held an exclusive right (monopoly) to carry letters within Australia. The original intention was that these exclusive rights would help ensure that the reserved letter services section of the company would operate at a healthy profit, with monopoly revenue more than covering the costs of meeting CSOs.

This was the case up until 2008-09, but since then there have been mounting losses in the mail services section of the company. In 2013-14 the

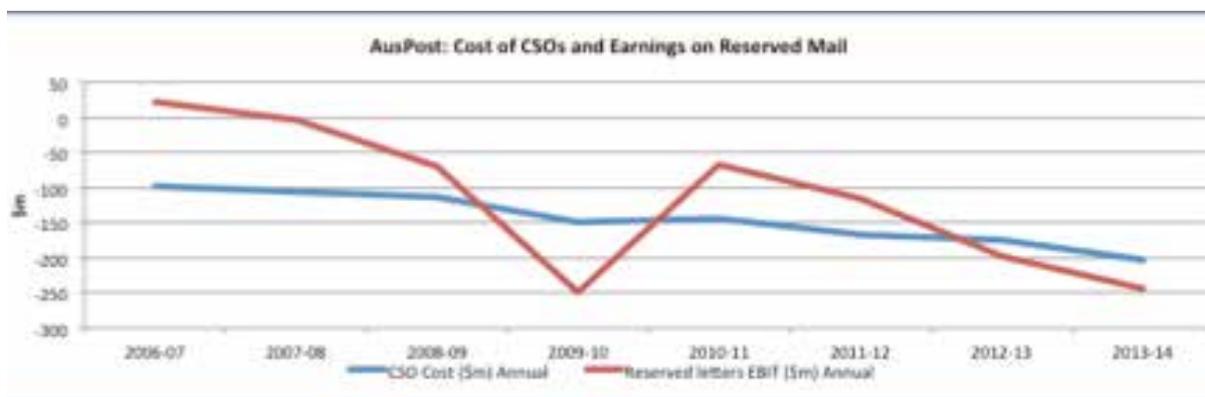


overall loss in the mail service was \$380.2 million. A substantial component of that loss can be directly attributed to the high cost of meeting CSOs, which was valued at \$203.5 million in the same year.

Nevertheless, while the cost of meeting CSOs is significant, the reality is that the reserved mail

section would still be in a loss making position even if those CSOs were abandoned altogether. Today, Australia Post is now in a position where it must cross subsidise not only its CSOs, but all of its reserved services operations from profits made in other parts of the business.

FIGURE 3:
HEADING TO COME



Following its 2014 decision on stamp pricing, the ACCC argued that Australia Post would need to further reduce operating costs by around 15 per cent below 2012-13 levels in order for its domestic reserved mail services division to break even in 2014-15. This represents a substantial challenge given that 89% of the costs associated with meeting existing performance standards are fixed and non-variable.

Further cost reductions will likely be difficult to achieve without some reform of existing CSOs and performance standards. Australia Post's existing performance standards require that it:

- Maintain at least 4,000 postal outlets of which at least 50 per cent of the total number or a minimum of 2,500 (whichever is the greater) must be located in rural or remote areas.
- Maintain at least 10,000 street posting boxes in addition to providing lodgment facilities at each of its retail outlets.
- Provide a daily weekday delivery service to 98 per cent of all delivery points and at least a twice-weekly delivery service to 99.7 per cent of all delivery points.
- Deliver 94 per cent of all reserved letters within the time specified in Australia Post's schedule of delivery times.

In order to ensure that financial sustainability is achieved, it is likely that there will need to be a wide-scale review of Australia Post's CSOs and delivery timeframes. It is also likely that some costs will need to be recovered through an increase in stamp costs.

Whilst this is likely to impose some additional burden on low income and disadvantaged groups, it should be acknowledged that those groups would be substantially more burdened by the mass closure of outlets, as has happened in Canada. It must also be acknowledged that it is actually business and government senders who account for over 90 per cent of all mail sent. Individual senders are responsible for sending only five to six per cent of total mail volumes.

In a very short time frame it is expected that letters mail, and by implication the current CSOs, will only be relevant to a very small number of people who cannot, for various reasons, send or receive digital mail.

Nevertheless, and as with the course of other technologies, digital mail will need to evolve to meet as yet unthought-of wants and uses. Australia Post will need to be flexible in adapting to new demands while maintaining a vital service for those members of the community who depend on it, particularly in regional and remote Australia.

AUSTRALIA POST. EXPECTED DELIVERY TIMEFRAMES FOR STANDARD DOMESTIC LETTERS AND PARCEL SERVICE

POSTED FOR DELIVERY	SAME STATE: BUSINESS DAYS	TO OTHER STATES: BUSINESS DAYS
Within metropolitan areas of capital cities or within the same city or town and environs	1	2
Between metropolitan areas of capital cities and country locations	2	3
Between country locations	2	4

The challenges facing Australia Post

Australia Post has already undertaken a number of reforms to improve the financial viability of its businesses. For example, The Future Ready strategy launched in 2010 has already achieved success in forestalling approximately \$1.1 billion in losses.

Nevertheless, Australia Post continues to face challenges on several fronts, including but not limited to:

- A fall in average letters per delivery point per day.
- An increase in the number of delivery points.
- Performance standards being set uniformly high.
- The price of letters being well below world average.
- A high level of fixed costs required to meet the service requirement (89 per cent of these costs are fixed).
- Acute competition in the small parcels business from couriers, logistics and road transport companies, freight forwarding businesses and global supply chain integrators.
- Small freight and parcel forwarding businesses seeking to provide an alternative to the retail outlets and parcel lockers being offered by Australia Post.
- A fall in the annual rate of growth in Australia Post's parcels and express business from 38 per cent in 2011 to 14 per cent in 2013.

This last point is of particular importance. Growth in Australia Post's parcel volumes has been almost entirely driven by the recent surge in online shopping. Approximately 70 per cent of the parcels that Australia Post handles are now generated by an online transaction. However, it needs to be emphasised that parcel delivery is a highly competitive, international marketplace and Australia Post's continued growth in this market is not guaranteed.

As competition in this space continues to intensify, the profit margins of all logistics providers will continue to come under pressure. This presents an additional challenge for Australia Post, which currently utilises its profits to offset losses in the reserved mail section of its organisation.

Increasing competition will make it more difficult to use revenue generated from the parcels business to offset declines in the reserved mail section of Australia Post. Australia Post Chairman Fahour is already predicting that growth in parcels will no longer be able to cover the growing losses in letters. For this reason, innovative new ideas must be pursued to further enhance the financial viability of the company.

Actions proposed to improve the financial sustainability of Australia Post

Australia Post has also been focusing on building new business opportunities to ensure its continuing relevance and protect or even grow jobs in business segments such as in retail and parcels. It has been very active in introducing innovations in the mail business in the area of service, including digital services and trusted identity services, developing business opportunities in the parcels business that focus on end-to-end logistics services, particularly for SMEs.

Nevertheless, Australia Post will need to take further action to ensure financial sustainability. Proposals to address the financial health of Australia Post in the letters business have so far centred on:

- The *pricing* of services – differential pricing for premium mail and ordinary mail, as is the case in relation to 'non-standard letters', such as Post Express.
- The *speed* of services – providing senders with a choice of next day (D+1) or three day (D+3) delivery options.
- The *timeliness* of services – whether households require mail delivery on a daily basis to their street addresses (bearing in mind that most



businesses have mail delivered to a PO Box or Mail Centre).

- *Service integration* – combining the mail and parcels service processing and delivery systems. Postal workers already deliver 25 per cent of parcels.
- *Leveraging the retail network* – to provide a range of trusted services centering on identity verification. This is well established in the area of passports, for example.
- *Provision of digital mail services* – including MyPost and associated e-commerce solutions.
- *Training and redevelopment* – encouraging staff to develop the skills, qualifications and experience to work in other, growing, segments of the business.
- *Reducing costs* – through centralisation and automation in a drive to achieve efficiency and productivity gains.

Reforming frequency of delivery and the impact on regional areas

Many have argued that Australia Post should continue to subsidise its loss making mail business from the profitable parcels service. This would be unsustainable in the long run. The parcels business operates in a highly contested commercial market and, in the absence of a capacity to borrow in the capital market, profits must be reinvested back into the business. Australia Post has traditionally financed all investments from cash flows.

Sorting during normal business hours and road transport would enable Australia Post to offer a two (D+2) to three-day (D+3) delivery option at a reduced rate. It would also offer greater opportunity to combine mail delivery with parcels delivery. Australia Post understands that a high proportion of senders would opt for a D+3 option, particularly for transactional mail.

Reducing frequency of delivery is sometimes advocated as a way of reducing costs. It has been adopted in other countries, together with the introduction of community mail boxes. Such an initiative would see the introduction of a greater proportion of casual or part time delivery personnel, which is at odds with Australia Post's people strategies.

With the existing availability of delayed delivery mail options for Australia Post business customers using bulk mail and direct mail services, combined with the existing performance standards relating to receivers in country areas, it is possible that letters may take up to six days to be received from time of despatch from a mail house to receipt at a country address. Reduced delivery days could extend the delay out to 10 days in rural and remote areas. Given the existing delays already built into the system for delivery to rural and remote areas, it is important that these receivers continue to have access to a five-day delivery service.

Privatisation a bad option, Australia Post should grow its synergies with government agencies

This report would also like to note that poorly considered privatisation strategies can result in a deterioration of service standards, worsening employment and labour market outcomes, and lost opportunities for building sustainable communication organisations built around technology and digital transformation.

This report argues that Australia Post should instead take on a larger role in public service delivery. License Postal Offices (LPOs) should replace declining products and services, such as basic account payments, with trusted services such as license services, and potentially representing Centrelink and Medicare.

Potential synergies in service provision could be developed between LPOs and the ATO, Centrelink, motor vehicle authorities, Medicare, Electoral Commissions, state-owned utilities, and local government.

There are other strategies currently being pursued by overseas postal companies that are also worthy of consideration by Australia Post. For example, Swiss Post has joined forces with the canton of Geneva to come up with the first nationwide electronic patient record in compliance with Switzerland's eHealth strategy. Several cantons already place their trust in the secure electronic health solutions from Swiss Post.

The Swiss Post 'vivates eHealth' service modules meet the specific requirements of the various healthcare professionals, from simple transfer and swift exchange to patient data archiving. Hospitals, physicians, pharmacies, outpatient organizations, care personnel, laboratories and other professionals can benefit from the secure, efficient and transparent handling of data.

Patients can view their data at any time and decide themselves who may access their data and to what extent. Data protection and the security of the access processes are guaranteed at all times. Swiss Post uses state-of-the-art technology and complies fully with the legal requirements for data processing.

Another notable Swiss Post innovation is SuisseID. SuisseID is a package that includes a signature service that enables electronic documents to be easily and legally signed by one or more people, and a mobile service for the use of SuisseID on mobile devices. First introduced in 2010, SuisseID is now used in 240 online applications by end customers and companies. Examples include electronic legal transactions between lawyers and courts and for business processes within companies.

A similar program exists in New Zealand. In 2013 NZ Post launched RealMe, an online identity verification system, developed in partnership with the Department of Internal Affairs. RealMe removes the need to show up in person each time to prove identity. RealMe users register online, then visit a PostShop to have a photo taken and their documents verified. Once verified online people can quickly and easily apply for services over the internet as organisations using RealMe come on board.

In the UK, the Government is now pressing ahead with a voluntary virtual identity system that will

grant ID holders access to the “panoply” of public services online through a unified portal.

In announcing the virtual identity initiatives, the UK Government noted:

Ministers are keen to embrace online services as part of an efficiency drive, mindful that transaction costs are up to 20 times lower than those conducted over the phone, 30 times cheaper than by post and 50 times less than face-to-face – netting savings of up to £1.7bn a year.

This report notes that the Australia Post MyPost platform initiative might provide the foundations for similar services in Australia. Some of the services mentioned in the UK initiative are already available through MyGov, but due to community concerns about government holding too much information about citizens, these services could potentially shift to MyPost.

By embracing innovative concepts like those outlined above, Australia Post could generate new work for its employees, helping to offset possible declines in other areas as CSOs are reviewed. This report notes that Swiss Post’s decision to engage in licensing and other online services has seen it become one of the largest IT employers in Switzerland. For Australia Post, building strength in these areas will require investment in staff development and training, including management and entrepreneurial capabilities. This report argues that such an investment would be highly worthwhile to help develop Australia Post as a leading innovative company.

The final area that should be considered for potential growth at Australia Post is in logistics. Again looking to Switzerland, SwissPost has recently introduced the YellowCube logistics solution, a highly automated storage and picking facility. The service covers the entire logistics chain, from storage and nesting to packaging and the re-storage of returns.

YellowCube fills the last gap in SwissPost’s ecommerce solution. It is designed for mail order companies who use the Internet as a sales channel and are looking for an external solution for their logistics. Businesses receive competitive logistics facilities and can achieve economies of scale. They also save on storage and personnel costs, and eliminate the worry about the processing of returns.

With SwissPost’s My Post 24 parcel terminals, customers can collect, drop off or return their parcels 24 hours a day. Receivers can specify the parcel terminal where they want to pick up as the delivery address. As soon as the parcel arrives at the terminal, the recipient receives an e-mail or text message and a code for picking up the parcel. Cashless payments can be made to settle any customs duties or shipping costs directly at the terminal.

Australia Post should consider providing similar services in Australia, which would be highly beneficial to small and medium enterprises.





Recommendations & Key

1. Reframe CSOs, service standards, and pricing to suit a contemporary digital post environment.

It is unacceptable that CSOs have not been reviewed in the last 16 years, particularly in light of rapid technological change in the online space.

CSOs, service standards, and standard letter pricing should be relevant to a contemporary digital mail environment and responsive to the changing ways that people and organisations send and receive mail. Australia Post should have greater flexibility in meeting performance standards - but standards relating to rural and remote areas should be preserved.

2. Develop and extend value added digital mail services for business and consumers.

For example, several overseas postal organisations are offering 'value added' services to their digital mail capability, including providing receivers with the option of having digital mail reformatted into text mail.

Digital MailBox services should be extended to cover a broader range of digital notification and lodgement services into a 'mail vault' and archive for household and business customers.

Identify certification services should also be

extended across a broader range of governance and regulatory institutions in a way that meets the needs of consumers and micro and small businesses. Steps should be taken to ensure that consumers and small businesses have access to letters mail services where digital options are not available.

Australia post should also examine options for enhancing its current suite of cloud services.

3. Diversify into complementary business and community service areas. Extending the range of digital communication products and services available in retail outlets.

Diversification should build on Australia Post's assets and distinctiveness as a communications business. This would involve extending the range of digital communication products and services available in retail outlets - particularly for people who cannot otherwise access digital communication services.

It would also involve making available digital capability to assist people who are financially and digitally excluded from key economic and social institutions.

Findings

4. Build capacity and capability in the e-commerce business, particularly for SMEs.

Australia Post has correctly identified that it is mainly SMEs that are the engine room of the domestic e-commerce market. To enable more effective participation by small business in global markets, Australia Post's brand and reputation should be leveraged as a credible and dependable provider of e-commerce solutions for micro and small business.

This would build on existing capability in areas such as secure payment, international logistics and supply, and extend into development of online capability and marketing.

This would assist businesses in rural and remote locations, as well as in metropolitan locations, which need to respond efficiently and effectively to orders placed on-line nationally and internationally.

5. Make a strong commitment to innovation.

Australia Post should develop and implement an innovation strategy that involves: the creation of a corporate 'innovation hub', developing an 'innovation portfolio' of ideas, initiating an internal 'innovation challenge', establishing a corporate venture fund, and developing relationships with the start-up community.

6. Build synergies with other government departments to provide greater services to our community

Australia Post should examine potential synergies in service provision that could be developed between Australia Post and the ATO, Centrelink, the DVA, Medicare, Electoral Commissions, state-owned utilities, and local government.

Australia Post should closely examine what other postal agencies around the world are doing to improve the financial sustainability of their operations. Australia Post should pay particular attention to the reforms being undertaken in places like Switzerland, where SwissPost has been transformed into a successful digital player. Identity services and other digital products should be examined as a matter of priority.

Australia Post should also examine the reforms undertaken overseas to further grow the involvement of postal agencies in logistics services.

Where possible, staff should be retained and trained to ensure that Australia Post can continue to play a role as a key employer within our community.

Detailed Summary

Over the period January to June 2014 Australia Post booked its first half-year loss since becoming a government owned enterprise in 1989. This was a direct result of the steep losses occurring in the mail business being in excess of profits generated in the rest of its operations.

Losses in the mail business flow from the costs of Australia Post's Community Service Obligations (CSOs) that govern pricing, delivery timetables, delivery frequency, and public access, in combination with declining mail volumes as people and organisations switch from traditional letters mail to digital alternatives. The CSO requirements were last reviewed 16 years ago, well before the acceleration of digital transformation across the services sector.

Australia Post has been looking to grow its business in the developing digital environment, including the opportunities presented by the growth in e-commerce and ways to make strategic use of its extensive network of retail outlets as 'digital service hubs'. It has also asked the Government for new tools to reduce the scale of the losses in the letters business, including the freedom to set more cost-reflective prices and more freedom in scheduling deliveries.

The McKell Institute is conscious of the important role Australia Post continues to play in essential service delivery and as a large employer across regional Australia. This report seeks to focus primarily on proposals to increase the financial strength of Australia Post, but at the same time take strong account the role of Australia Post as a key employer and provider of essential services, particularly in rural and regional areas. This report examines proposals currently being canvassed for change at Australia Post and identifies some alternative proposals that would enhance the financial viability of the corporation.

The specific requirements of the project brief are to provide:

- An analysis of the existing body of research surrounding the key challenges facing postal services in Australia and abroad.
- An examination of the financial health of Australia Post as recorded in annual reports over the last five years.
- A cost-benefit evaluation of the effectiveness and value of existing CSOs, with a particular focus on the impact of possible changes to regional and rural parts of Australia.
- An examination of existing and potential proposals to expand and strengthen the Australia Post business model.
- Recommendations on possible options for reform that improve the financial standing of Australia Post whilst also maintaining its core role as a provider of essential services and a core employer of Australian workers.



The Australia Post business

The Australia Post Statement of Corporate Intent 2013-14 - 2016-17, defines its business in three operating segments (Australia Post, 2013):

AUSTRALIA POST STATEMENT OF CORPORATE INTENT.

Australia Post provides low-cost and premium letters and parcels services, which are accessed through a convenient network of retail outlets supplemented with some electronic mail lodgement facilities. We extend these basic services through our main business offerings –

■ Communication and Management Services

We provide letter services to all Australians and between Australia and overseas. We add value by providing a range of services that enable mail production and the efficient handling of incoming mail. We also provide digital communication services so that our customers can integrate their physical and digital communications in a secure and low cost way.

■ Parcels and Express Services

We provide parcel and courier services to the whole Australian community and between Australia and overseas. To ensure we keep pace with customer demand, we continue to expand our capabilities, improve services and align our international activities with other high-performing postal authorities.

■ Retail services

We offer a range of retail merchandise, financial and agency services through Australia's largest and most accessible retail network. This range of products and services helps us to maintain the viability of our outlets, which are required to meet our community service obligations.

These segments are similar to the structure of national postal organisations around the world.

Under the provisions of the Australian Postal Corporation Act Australia Post is required to operate commercially, achieve a reasonable return on the assets deployed, and pay reasonable dividends to its shareholder (the Australian Government).

Australia Post, like its overseas counterparts, is also the designated postal operator for Australia for the purpose of fulfilling Australia's obligations as a member of the Universal Postal Union. Australia Post is the only body authorised to issue postage stamps for Australia.



Community service obligations

In common with national postal organisations around the world, Australia Post is required to meet specific ‘universal service’ obligations. Known in Australia as community service obligations (CSOs), they require Australia Post to provide a letters service that:

- Is *reasonably accessible* to all Australians on an equitable basis.
- Operates to *performance standards* that meet the needs of the community.
- Is provided at a *uniform price* for *standard* letters carried by ordinary post within Australia.

These obligations relate to what is known as the reserved letters service. The reserved letters service was originally intended to operate at a profit, with high returns in some areas of mail processing offsetting losses in others. However, the reserved letters service has not been profitable since 2006-07, and the mail service as a whole moved into a loss making position in 2007-08 (with a brief respite in 2010-11).

The Minister for Communications prescribes performance standards. They cover frequency, speed and accuracy of mail delivery, and the availability or accessibility of retail offices or mail lodgement points. The current standards are summarised below.

CURRENT AUSTRALIA POST PERFORMANCE STANDARDS

- At least 4,000 retail outlets and 10,000 street posting boxes will be maintained to meet reasonable levels of demand and at least 2,500 outlets in operation will be located in rural or remote areas.
- Retail outlets to be located so that in metropolitan areas, at least 90 per cent of residences are within 2.5km of an outlet, and in non-metropolitan areas, at least 85 per cent of residences are within 7.5km of an outlet.
- Specified delivery times in and between metropolitan, country interstate distribution, and at least 94 per cent of letters carried by Australia Post will be delivered by the advertised delivery times.
- At least 98 per cent of all delivery points (eg street and private post box addresses) will receive five days per week delivery, Monday to Friday (excluding public holidays) and at least 99.7 per cent of all delivery points will receive not less than two deliveries per week.

These performance standards are currently being met, or being exceeded.



Key challenges being faced by postal services in Australia and abroad

The key challenges facing Australia Post centre on declining mail volumes, increasing losses in the reserved mail business, and falling returns on assets deployed.

The nature of the challenge

The deterioration of performance in the mail business has been due in large part to the *digital transformation* of the way written communication is prepared, sent (transmitted), and received. This has come about because of:

- Advances in communications infrastructure, information technology, and mobile applications – giving business, governments and individuals a wide range of options and choices in relation to how they can prepare, convey, and receive written communication.
- The decreasing cost and increasing convenience of digital communication - leading to a rapid decline in physical (letters) mail volumes.

There are also some other contributing factors to the decline in profitability:

- The regulated price of a standard letter failing to keep pace with inflation – the standard letter price is among the lowest in the world.
- The continuing growth in delivery addresses and mail pick up points as the population grows and cities expand.
- The relatively high proportion of fixed costs in the mail processing system (collection, transport, sorting, delivery).

These financial and performance challenges are reflected in the trends shown in Table 3 below.

TABLE 3: AUSTRALIA POST. EIGHT-YEAR TRENDS

Year ended 30 June	2007	2008	2009	2010	2011	2012	2013	2014
Mail volumes (m)	5,515.8	5,609.4	5,323.4	5,145.0	5,038.2	4,843.0	4,580.2	4,484.3
Reserved letter volumes (m)	4,172.9	4,260.7	4,094.3	3,876.6	3,738.8	3,545.3	3,305.7	3,173.5
Revenue (\$m)	4,711.1	4,959.2	4,974.5	4,856.2	4,986.5	5,126.2	5,893.2	6,383.3
Profit before tax (\$m)	561.7	592.2	380.9	103.0	332.3	366.7	210.7	103.0
Profit/(loss) from reserved services (\$m) (1)	24.0	(1.7)	(69.2)	(250.1)	(66.5)	(114.4)	(198.0)	(242.6)
Return on equity (%) (2) (3)	14.2	15.4	17.2	6.2	15.0	16.8	10.5	6.7
Return on average operating assets (%)	19.6	19.4	12.2	3.8	10.9	11.5	6.2	3.4
Debt to debt plus equity			23.3	26.4	23.6	29.1	27.3	28.8
Dividends declared (\$m)	296.9	334.6	184.0	79.1	173.2	213.7	192.7	78.8
Special dividend declared (\$m)		111.6	38.4	0.0	0.0	0.0	0.0	0.0
Interest cover times)	18.4	15.6	11.0	4.6	10.9	10.8	7.7	3.6

(1) Amounts prior to 2011 included the collection, processing and distribution of international inbound letters and packets (weighing less than 2kg) in accordance with the arrangement of the Universal Postal Union. This is now included within regulated services.

(2) Return on equity is calculated as profit after tax as a percentage of equity. Equity has been normalised to remove the impact of the group's net superannuation liability/asset.

(3) Results for 2012-13 and 2013-14 include the impact of a superannuation accounting change, and also restructuring of \$90m in 2013-14. Excluding these impacts, which will then be comparable to the rest of the table, the return on equity would be: 18.5 per cent 2012-13 and 16.9 per cent in 2013-14.

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

The performance data points to:

- Mail volumes declining in overall terms and in the reserved letter business. What is now referred to as peak mail was reached in 2007-08. Mail volume has fallen by 1.1 billion items (20.1 per cent) over the period.
- The reserved services business falling into a loss position in 2007-08 – a position from which it has not recovered.
- A declared dividend to the Commonwealth of \$78.8m in 2013-14. This is a small fraction (17.7 per cent) of the total declared dividends of \$446.2m in 2007-08.
- A substantial drop in the return on (the Commonwealth's) equity.

The fall in mail volumes is expected to accelerate with further technological innovation in digital messaging and the extended availability of fast broadband. The Boston Consulting Group estimates the decline to be between eight and eleven per cent over the years to 2020 (Boston Consulting Group, 2014).

As with the switch from film to digital imaging, from analogue music players to mp3 players, and from compact discs to on-line music, the switch to digital mail formats has a strong flavour of inevitability, and will gather pace as technology advances, innovations flourish, standards become established, and end user adoption becomes embedded.

Responding to the challenge

The challenge is not unique to Australia. All postal organisations are responsible for providing universal services have been feeling the impact of declining letter volumes through digital transformation. At the same time, policy makers have also been seeking to deconstruct natural monopolies and introduce greater competition. The EU's Third Postal Directive, for example, is aimed at deregulation of postal markets and opening services to competition.

The European Union now has a fully liberalised postal market. But the promise of better services at lower prices has been elusive in some countries as postal organisations endeavour to achieve

profitability through cost reduction, automation and centralisation. New private mail competitors focus on meeting the requirements of large businesses and delivery to highly populated areas two or three times a week by a highly flexible workforce. This puts pressure on the former monopoly providers, still required to maintain a countrywide network.

In this new deregulated and competitive environment some mail arrives faster, and some takes longer to deliver. However there has been a cost in terms of reduced employment and erosion in working conditions of postal service staff. Part time employment has increased, and the use of self-employed contractors has been extended (Hermann, 2013, Hermann, 2014). But, these structural changes are not just a product of deregulation and privatisation; they are features of the disruption that is occurring across the postal services industry.

Deregulation in Europe occurred over many years, and offered postal organisations opportunities to grow, expand into new markets in adjacent countries and build scale. These opportunities are more limited in an Australian context.



The situation in Canada, for example, where Canada Post is still in public ownership, has been reported as follows.

CANADA POST ENDS HOME DELIVERY: THE POSTMAN WON'T RING AT ALL

The Economist, Dec 14th 2013.

Canada Post has been hit by a familiar story: rising electronic communication and declining volumes of letters. The decline did not start until 2007 but has picked up astonishing speed, with 1 billion fewer letters delivered in 2012 than in 2006. Canada is the first of the Group of Seven countries to signal the end of home delivery but it will almost certainly not be the last. Globally, the volume of letters posted has been sliding for a decade, dropping by 4.7% between 2011 and 2012 to 346.5bn items; a further 4% global decline is expected this year.

Parcel deliveries are still on the rise, both globally and domestically, but the gains have not been enough to offset the losses Canada Post is incurring on its letter-delivery

business. The Crown corporation faces the added disadvantage of having most of its 15m customers strung out in a 6,400km line just above the Canada-US border. The number of new customers keeps growing at a rate of well over 100,000 a year. Something had to give and with the announcement on December 11th, it did.

Home delivery to the 5m households who still receive it will be phased out over four years, beginning in 2014. They will join the 3.8m households that already go to a group mailbox to collect mail and parcels. The remaining customers get their mail from boxes in building lobbies (3.8m), public and private post offices (1.8m), or from a rural mailbox (0.8m). The plans also calls for up to 8,000 postal workers to be cut from a total staff of about 55,000, a 35% leap to C\$1 in the price of a stamp and the use of more technology and more franchise postal outlets.

<http://www.economist.com/node/21591759/print>

It is important that in an Australian context the business response by Australia Post to digital transformation, the decline in mail volumes, and the fall in profitability, is taken strategically and with decency. The response must ultimately reflect the best interests of customers, employees, the community, and the shareholder (ultimately the Australian taxpayer). Resolving and reconciling these interests will be a complex process.

Strategic repositioning

Many postal organisations have responded to the challenges of digital transformation and declining mail volumes and profitability by strategic repositioning of the business and redefining their CSOs.

At NZ Post the number of letter deliveries has

dropped from 914 million to 697.5 million in the past five years and is forecast to drop to below 500 million within the next three to four years. The Corporation has announced that it will be centralising mail processing to Auckland, Palmerston North and Christchurch, restructuring the retail network and reducing some corporate support functions. As a result, staff numbers will reduce by around 2,000 (from a current total of 10,600) over the next three years.

During that time NZ Post has committed to supporting all those affected through the 'Future Zone' initiative primarily for people whose jobs are changing or will cease to exist. Significantly, however, NZ Post has also negotiated a new CSO arrangement (Deed of Understanding) with the Government.

NZ POST: NEW DEED OF UNDERSTANDING

In October 2013 the Deed of Understanding with the Government was amended to enable NZ Post to change its standard-mail delivery schedule to fewer days per week, while meeting the universal standard of no fewer than three days a week from July 2015 for urban deliveries, and five days a week for rural deliveries. It also specified that NZ Post continue to maintain at least 880 service points, but gave more choice about what they look like.

In announcing the changes, New Zealand Post Group CEO Brian Roche said the new Deed gives the company the flexibility it needs to be able to continue to provide New Zealanders with a postal service that meets their changing requirements and expectations.

“The flexibility means while New Zealand Post is committed to providing an across the week premium mail service we have room to move in the years ahead on the frequency of standard letter delivery. The changes also recognise that technology such as self-service kiosks will form a significant part of our postal service point network, and a move towards a franchise and hosted business model.

“The previous Deed is 14 years old and is out-of-date. It constricted New Zealand Post to a business model that would have had dire economic consequences and would have threatened the viability of the postal network. The new agreement preserves a postal network for New Zealanders and takes account of the differing needs between rural and urban delivery”.

<https://www.nzpost.co.nz/about-us/media-centre/media-release/deed-changes-secure-postal-services-for-future>

Over the 2013-14 financial year NZ Post achieved a net profit after tax of \$107 million. The majority of that profit was contributed by Kiwibank (\$100 million), with the traditional mail business being just short of breaking even. For the first time in NZ Post's history, revenue from packages and parcels exceeded revenue from letters.

NZ Post is committed to leveraging its assets and capabilities, including trusted brands, its ability to offer large-scale systems and solutions, and the nationwide delivery network, through which it touches every community in New Zealand. It also has a strong commitment to innovation by working in different ways and using technology to enable customers to do business with it when, where and how they want to.

Committing to innovation

Many European postal organisations have embraced the opportunities provided for innovation. For example, Swiss Post is setting out to take a lead in service redesign. The Chairman and the CEO advised in the 2013 Annual Report that:

The challenges facing Swiss Post are many and varied. Given increasing digitization and new requirements on the part of our customers, our company needs to remain agile. In a mobile and highly networked society, people have got used to accessing information, ordering goods and using services whenever and wherever they want. By the same token, the post office network is less busy than before. With this in mind, Swiss Post's many innovations focus on the interface between the physical and digital worlds. Swiss Post today has already started shaping the universal service of tomorrow.

Swiss Post clearly differentiates in its service portfolio between the needs and wants of its private

customers and its business customers. It has positioned its communications business segment as a multi-channel specialist, safely and reliably shipping consignments of letters, promotional mailings, newspapers and confidential documents – either physically or digitally, as required. Swiss Post also digitizes documents such as incoming post for public authorities and companies, and can handle entire paper-based business processes where needed.

SWISS POST: AN EMERGING TECHNOLOGY COMPANY

In 2012-13, Swiss Post generated a Group operating profit of CHF626m. Operating profit in the communication segment amounted to CHF238m, and the Logistics segment generated a profit of CHF133m. The retail financial services sector generated earnings before tax of CHF856m. The company has 61,593 employees, representing over 100 professions and at the end of the financial year, there were 1,516 job vacancies in IT alone. Swiss Post is one the largest IT employers in Switzerland.

Deregulation and liberalisation in Europe has also encouraged postal organisations to respond to challenges with strategies for international growth and business diversification. For example, *Deutsche Post DHL* now employs about 480,000 people in 220 countries and territories. The company provides customers with both standardised products as well as innovative and tailored solutions ranging from dialogue marketing to industrial supply chains. Asia is becoming an important and profitable market for the company. At the North Asia Hub in Shanghai, DHL is the first company in the region to be permitted to offer the sorting of international transit shipments.

In its 2013-14 Annual Report *Singpost* reported

that it has achieved a significant shift in the Group's business model as it endeavoured to achieve a more balanced portfolio and reduce dependence on the domestic market and the traditional mail business. An important part of the growth strategy has been acquisitions, including freight company Famous Holdings, self-storage solutions operator General Storage Company, and online sampling platform operator EK Media.

The Group's revenue amounted to S\$821.1 million in 2013-14, an increase of 24.6 per cent from S\$658.8 million in the previous financial year. The growth was attributable to the increasing e-commerce related activities across the business segments and the consolidation of new subsidiaries, Famous Holdings and General Storage. This came as domestic mail volumes recorded a decline for the second year.

Diverse approaches

It is apparent that postal organisations are responding to challenges through a combination of:

- Service rationalisation and cost reduction in mail services.
- Shifting the focus of the business model to the parcels and logistics business.
- Diversification into digital communication services, including e-commerce and end-to-end supply chain solutions.
- Diversification into financial services, including focussing on the 'under-banked' segments of the community.

The experience of overseas postal organisations suggests that it is Innovation rather than ideological commitments to privatisation or deregulation are the major drivers for improved business performance in postal organisations. Poorly considered privatisation strategies can result in deterioration of service standards, worsening employment and labour market outcomes, and lost opportunities for building sustainable communication organisations built around technology and digital transformation.

At the same time, deregulation can provide opportunities for innovation in a new digital environment that meets the spirit of existing CSOs and provides for a more complete range of communication services for both private and business consumers.

The current Australia Post strategy focuses on its people, its trusted brand, the connections to small business, and leverages the extensive retail network in providing access to digital services (including identity validation) is well placed.

The financial health of Australia Post

The deterioration in financial performance of the mail business has been impacting adversely on the overall financial health of Australia Post. Operating earnings have declined from a peak in 2007-08 of \$584.2m to \$133.0m in 2013-14. Earnings of each segment are provided in Table 4 below.

TABLE 4: AUSTRALIA POST. OPERATING EARNINGS BEFORE INTEREST AND TAX

YEAR ENDED JUNE	2007	2008	2009	2010	2011	2012	2013	2014
Mail	160.0	148.5	52.0	(176.1)	25.5	(146.5)	(285.1)	(380.2)
Retail	86.6	86.5	94.5	78.9	80.1	182.5	177.9	165.5
Parcel services	255.9	246.4	186.8	170.8	232.3	361.5	279.3	309.4
Unallocated	52.5	102.8	51.4	32.2	(3.7)	(31.1)	51.8	38.3
Net profit (BIT)	555.0	584.2	384.5	105.8	334.2	366.4	223.9	133.0

Source: Australia Post, Annual Reports and Audited Financial Statements, 2006-07 to 2013-14.

The trends in Table 4 point to the deteriorating position in the mail business that commenced in 2007/08. This was alleviated to some extent though the impact of the Future Ready Program in 2010-11, but this has not been sufficient to reverse the longer-term trend. Earnings growth in the parcels business has slowed from 2012-13 due to growth in competition and flattening growth in demand.

The impact of the mail losses on the overall business is represented in Figure 1. Trend lines are also shown for the mail and parcels segments.

FIGURE 1: AUSTRALIA POST. OPERATING EARNINGS BY BUSINESS SEGMENT



Changes introduced by Australia Post under the Future Ready program had given an additional two-year window to manage and respond to the impact of digital transformation. But, as argued in the previous section, the current and emerging challenges are significant, far-reaching, and complex. There are many trade-offs to consider, and a need to convince the shareholder and the broader community of the decisions that are made.

Many have argued that Australia Post should continue to subsidise its loss making mail business from the profitable parcels service. But this is unsustainable. The parcels business operates in a highly contested commercial market and, in the absence of a capacity to borrow in the capital market, profits must be reinvested in the business. Australia Post has traditionally financed all investments from cash flows.

Some commentators have argued that Australia Post is not attributing sufficient revenue from its parcels business to the mail business, principally on the grounds that its retail outlet network is the foundation for this business (The Australia Institute, 2014). This issue was considered in detail in the context of Australia Post's request in January 2014 for a \$0.10 increase in the basic postage rate for ordinary small letter (BPR). In endorsing the proposed increase in February 2014, the ACCC commented:

The ACCC has recently completed a limited review of Australia Post's cost allocation methodology (CAM), which focused on the allocation of non-operational (indirect) costs to reserved services. This review did not identify any systematic bias in Australia Post's CAM that would likely lead to an inappropriate allocation of non-operational costs to reserved services (ACCC, 2014).

Proposals to address the financial health of Australia Post in the letters business have centred on:

- The *pricing* of services – differential pricing for premium mail and ordinary mail, as is the case in relation to 'non-standard letters', such as Post Express.
- The *speed* of services – providing senders with a choice of next day (D+1) or three day (D+3) delivery options.
- The *timeliness* of services – whether households require mail delivery on a daily basis to their street addresses (bearing in mind that most businesses have mail delivered to a PO Box or Mail Centre).
- *Service integration* – combining the mail and parcels service processing and delivery systems. Postal workers already deliver 25 per cent of parcels.
- *Leveraging the retail network* – to provide a range of trusted services centring in identify verification. This is well established in the area of passports, for example.
- *Provision of digital mail services* – including MyPost and associated e-commerce solutions.
- *Training and redevelopment* – encouraging staff to develop the skills, qualifications and experience to work in other, growing segments of the business.
- *Reducing costs* – through centralisation and automation in a drive to achieve efficiency and productivity gains.

Some postal organisations have taken to selling property assets to provide cash to finance operations. This can only be considered to be a short-term solution. The book value of Australia Post land and buildings is recorded in the 2013-14 balance sheet at \$879.3m – not enough to finance the recent trend in losses.

Australia Post has advised of its commitment to maximising the benefit to the community of its very valuable strategic assets "its brand, people, and reach for everyone, everywhere, everyday".

The effectiveness and value of existing Community Service Obligations

Under the *Australian Postal Corporation Act 1989* Australia Post is required to supply a letter service, available at a single uniform rate of postage, for carriage within Australia of standard letters. Australia Post is also required to meet performance standards determined by the Minister for Communications. These are considered to be particularly important for people and businesses located in rural and remote Australia.

To offset this obligation, Australia Post has the exclusive right (monopoly) to carry letters within Australia, whether the letters originated within or outside Australia. These are known as *reserved services*. The current CSOs and performance standards have not been materially altered for 16 years, well before the emergence of widespread digitisation of written communication and messaging.

An official mail service has been a key institution of democratic governance that enables government to communicate with citizens. It has provided a foundation for trade and commerce beginning with the industrial revolution. Mail provides for social, economic and political inclusion locally, nationally and internationally.

The CSO arrangements and performance standards are intended to deliver benefits to both the mail *sender and the receiver*. For the sender CSOs provide an assurance that letters will be delivered, and for receivers, an assurance that letters sent can be retrieved and read. But the service is becoming less relevant as digital alternatives become available and there is widespread adoption of these among the two major *sender* categories – business and government. Even official mail (legal notices, ballots and voting) is converting to digital formats as technology becomes available.

In 2013-14 Australia Post reported the costs of CSOs at \$203.5m, and the overall loss on

the reserved letters business at \$242.6m. The aggregate loss on the mail business was reported at \$380.2m. As indicated previously, these losses are now impacting on other parts of the Australia Post business. This is of major concern to the Board of the Corporation and its only shareholder (the Commonwealth Government).

Australia Post argues that a more comprehensive understanding of the commercial impacts of CSOs across the entire business, flowing from the need to meet all of the performance standards, would show that the real cost to the corporation is multiples of the identified CSO cost.

It follows that the initial policy intent to pay for CSOs through profits from a monopoly standard mail business is no longer valid. In a very short time frame it is expected that letters mail, and by implication, the current CSO, will only be relevant to a very small number of people who cannot, for various reasons, send or receive digital mail. Moreover, and as with the course of other technologies, digital mail will evolve to meet as yet unthought-of wants and uses.

It is important to understand that the current CSO arrangements deliver financial benefits principally to businesses and government organisations (as the major sender categories) in the form of a subsidy to offset the full cost of sending letters. Parcel senders and taxpayers, through a reduced Australia Post dividend, pay for this subsidy. Individual senders are responsible for sending only five to six per cent of mail volumes. Australia Post has adopted a strategy to further subsidise individual senders through reduced postage prices for pensioner concession cardholders.

But in the current digital environment, the level of cross-subsidy within Australia Post is still not enough to prevent business and government organisations switching mail delivery to digital alternatives.

Residual requirements for traditional letters mail will continue to exist, including delivery to rural and remote locations. However, location is not of itself a barrier to receiving digital mail services.



Digital services are now almost universally available and the cost of delivery is small and not distance related. The cost of receiving is borne by the receiver, in terms of expenditure of digital devices and connections. The associated take up of e-commerce in rural and remote locations is also high, particularly in the area of on-line shopping.

Major barriers to receiving digital mail concern *the channels* – ownership and access to digital services and devices. Some disadvantaged groups have limited access to the Internet due to low income, low digital literacy (not necessarily age related), homelessness, and various forms of physical and intellectual disability. It may be appropriate, therefore, to shift the focus of CSOs to the receiver by ensuring equitable access to Internet services and entry-level digital devices – as occurs in educational institutions.

Proposals for reform centre on the introduction of a two tier pricing structure for standard letters: a premium for overnight delivery (one day delay) and a lower price for surface delivery that would take longer (up to three days). Proposals have also been made to amend the Prescribed Performance Standards timetable and to reduce the number of deliveries to street addresses from five to three per week.

With the existing availability of delayed delivery mail options for Australia Post business customers using bulk mail and direct mail services, combined with the existing performance standards relating to receivers in country areas, it is possible that letters may take up to six days to be received from time of despatch from a mail house to receipt at a country address. Reduced delivery days could extend the delay out to 10 days in rural and remote areas. Australia Post has not advocated reducing the number of delivery days.

Given the existing delays already built into the system for delivery to rural and remote areas, it is important that these receivers continue to have access to a five-day delivery service. Under the current Performance Standards Australia Post is required to provide a five-day per week service to 98 per cent of addresses.

The potential to expand and strengthen the Australia Post business model

There is widespread concern about Australia Post's capacity to maintain its universal service and to operate as a viable business with the mounting losses in the reserved mail service. There is also concern about the viability of the thousands of small businesses that operate Licensed Post Offices in Australia Post's retail network. The continued existence of this network is essential for many other aspects of Australia Post's business and its growth strategy. The network is a strategic asset and distinctive capability available to the Australia Post business.

Australia Post has been focussing on building new business opportunities to ensure its continuing relevance and protect or even grow jobs in business segments such as in retail and parcels. It has been very active in introducing innovations in the mail business in the area of service, including digital services and trusted identity services, developing business opportunities in the parcels business that focus on end-to-end logistics services, particularly for SMEs.

Several overseas postal organisations are offering 'value added' services to their digital mail capability, including providing receivers with the option of having digital mail reformatted into text mail. There are many initiatives that have been taken in the more innovative postal organisations around the world that could be adopted and applied in an Australian context. Quite a number already have.

Australia Post has resolved to ensure that its people are prioritised as its most important stakeholder. The CEO is driving the focus around prioritising people. This is not to say that Australia Post can protect its people from the impact of reform, but it can be managed in a way that ensures the business meets its people principles – safety, good jobs, clarity and choice, future employment, diversity.

It is important, of course, for the community to be assured that new business directions will not divert commitment from the longstanding obligations that Australia Post, and its predecessor organisations, have had over a 205-year period, in supporting the institutions of democratic governance and securing basic rights to communication among citizens. These are an essential aspect of the existing universal service requirement (CSOs).

The Australia Post Board and Executive has gone through the process of considering how to expand and extend the business model. It quickly realised that there was no “win-win” and that in the end there will be some negative impacts to stakeholders.

Options and recommendations to improve financial standing and business sustainability

Australia Post has identified many opportunities for financial stability and sustaining its business model in the environment of the digital transformation of mail services. These build on its strategic assets and distinctive capabilities and are aimed at sustaining and growing the business that creates value for its many stakeholders (businesses, consumers, employees, the broader community, and the shareholder).

During the project a number of options were identified for improving the financial health and business sustainability of Australia Post. These fall into five broad areas:

1. Reframe CSOs, service standards, and pricing to suit a contemporary digital post environment

CSOs, service standards, and standard letter pricing should be relevant to a contemporary digital mail environment and responsive to the changing ways that people and organisations send and receive mail. Australia Post should have greater flexibility in meeting performance standards - but standards relating to rural and remote areas should be preserved.

2. Develop and extend value added digital mail services for business and consumers.

Digital MailBox services should be extended to cover a broader range of digital notification and lodgement services into a ‘mail vault’ and archive for household and business customers. Identify certification services should also be extended across a broader range of governance and regulatory institutions in a way that meets the needs of consumers and micro and small businesses. Steps should be taken to ensure that consumers and small businesses have access to letters mail services where digital options are not available.

3. Diversify into complementary business and community service areas.

Diversification should build on Australia Post’s assets and distinctiveness as a communications business. This would involve extending the range of digital communication products and services available in retail outlets – particularly for people who cannot otherwise access digital communication services. It would also involve making available digital capability to assist people who are financially and digitally excluded from key economic and social institutions.

4. Build capacity and capability in the e-commerce business, particularly for SMEs.

To enable more effective participation by small business in global markets, Australia Post’s brand and reputation should be leveraged as a credible and dependable provider of e-commerce solutions for micro and small business. This would build on existing capability in areas such as secure payment, international logistics and supply, and extend into development of online capability and marketing. This would assist businesses in rural and remote locations, as well as in metropolitan locations, which need to respond efficiently and effectively to orders placed on-line nationally and internationally.

5. Make a strong commitment to innovation.

Australia Post should develop and implement



an innovation strategy that involves: creation of a corporate ‘innovation hub’, developing an ‘innovation portfolio’ of ideas, initiating an internal ‘innovation challenge’, establishing a corporate venture fund, and developing relationships with the start-up community.

These matters are canvassed in further detail in Section 7.

Public policy issues

The postal market has been deregulated in many countries, including Germany, Sweden, Denmark, The Netherlands and Spain. These markets contain the three most profitable postal operators in Europe (Dutch PostNL, Deutsche Post, and PostNord).

These companies do not receive any subsidies for universal services and provide their universal services on very successful commercial terms (Dieke et al., 2011). These operators have, over the last 20 years, used their commercial flexibility to modernise their sorting and transportation networks and their post office networks.

It has been argued that deregulation has resulted in a more flexible cost structure allowing postal organisations to respond to changing market conditions with flexibility and agility. It is also argued that end-to-end competition has helped to achieve a sustainable universal service, and has improved service quality by putting pressure on incumbent operators to modernise.

Other countries, including Spain, have established compensation funds to finance their universal

service requirements. Compensation funds are legally available in the Netherlands and Germany but had not, up until 2011, been accessed.

The extent to which a letters mail communication infrastructure should be maintained, and at what standard and quality, and at what cost, is largely a public policy decision. It should not be seen as solely a business decision to be taken by the Board of Australia Post within the current regulatory framework.

Continued cross subsidy from the profitable parcels business to the lossmaking letters business does not amount to good business strategy. Steps should be taken to allow Australia Post to meet CSOs that reflect contemporary standards in a digital environment, from within the reserved mail business. The non-reserved mail business should not be encumbered with regulatory requirements.

Community Service obligations in a digital environment should address areas of digital disadvantage, including digital literacy, access to digital services, and capacity to communicate through digital channels.

It is probably too early to pronounce the letter as dead, but its demise is approaching. However it has also been observed “while the letter may be ailing, letterness is emerging phoenix-like from the flames to renewed digital life”. It is anticipated that in the longer run “new forms of epistolarity impacting on space as well as time might come into being, and so it might really be a matter of ‘watch this space’”.

Introduction

The aim of the project is to promote discussion of an appropriate future direction for Australia Post covering possible avenues for new forms of service delivery and other options for generating new revenue streams. The report examines the existing body of publicly available research and data on current and future challenges facing Australia Post and other postal entities abroad. It also makes recommendations that will help position Australia Post as a financially healthy essential service provider.

THE REPORT PROVIDES:

- An analysis of the existing body of research surrounding the key challenges facing postal services in Australia and abroad.
- An assessment of the financial health of Australia Post as recorded in annual reports over the last five years.
- An assessment of the effectiveness and value of existing Community Service Obligations (CSOs), with a particular focus on the impact of possible changes to regional and rural parts of Australia.
- An examination of existing and potential proposals to expand and strengthen the Australia Post business model.
- A number of recommendations for consideration aimed at improving the financial standing of Australia Post whilst also maintaining its core role as a provider of essential services and a core employer of Australian workers.
- Financial analysis: Assessment of the financial health of Australia Post through examination of published and audited financial reports and statements, and reports of portfolio analysts where available.
- Assessment of costs and benefits of CSOs: A high-level and strategic assessment of the effectiveness and value of existing CSOs, with a particular focus on the impact of possible changes to regional and rural parts of Australia. Time and resources did not permit extensive economic modelling. Narratives and case examples were used where appropriate.
- Meeting with key stakeholders: Conducted meetings with key stakeholders to gain insights and visions from people closely associated with the business. Stakeholders included Australia Post executive management, the Commonwealth Department of Communication, and the NSW Postal and Telecommunications Union(CEPU).
- Reference was made to the numerous submissions to the Senate Environment and Communications Legislation Committee inquiry into the Performance, importance and role of Australia Post in Australian communities and its operations in relation to licensed post offices.

THE PROJECT WAS UNDERTAKEN ON THE FOLLOWING BASIS:

- Literature review: a compilation and examination of existing research surrounding the key challenges facing postal services in Australia and overseas through examination of relevant reports, papers and articles.

1. The business of Australia Post

Australia Post provides low-cost and premium letters and parcels services, which are accessed through a network of retail outlets, supplemented with some electronic mail lodgement facilities. These basic services are extended through its main business offerings that operate in three segments.

1.1 SEGMENTS

Australia Post conducts its business in three segments.

1.1.1 Communication and Management Services

Australia Post provides a letter service to all Australians and between Australia and overseas. It adds value by providing a range of services that enable mail production and the efficient handling of incoming mail. It also provides digital communication services so that customers can integrate their physical and digital communications in a secure and low cost way.

This is essentially a *messaging business* involving communication between senders and receivers of written correspondence through physical and increasingly digital channels.

1.1.2. Parcels and Express Services

Australia Post provides parcel and courier services to the whole Australian community and between Australia and overseas. These services are being expanded to improve and align international activities with other high-performing postal authorities.

This is essentially a *transport and logistics* business, involving the collection, transport, and delivery of packages and parcels.

1.1.3. Retail Services

Australia Post offers a range of retail merchandise, financial and agency services through Australia's largest and most accessible retail network. This range of products and services helps to maintain

the viability of postal outlets, which are required to meet community service obligations.

This is a *merchandising and agency services* business, supporting the messaging business, but increasingly providing retailing and trusted agency services.

1.2 RESERVED SERVICE

Under the *Australia Postal Corporation Act*, Australia Post has the exclusive right to collect, carry and deliver letters within Australia that (subject to some exceptions) weigh less than 250 grams. This monopoly was assigned so that revenue from these reserved services could fund the cost of meeting a number of specific universal service obligations (also known as community service obligations).

1.3 UNIVERSAL SERVICE OBLIGATIONS

1.3.1. Standard letters service

Australia Post is required under the *Australian Postal Corporation Act* to provide a universal standard letters service for all Australians. These require Australia Post to:

- Carry standard postal articles anywhere within Australia for a single uniform rate.
- Ensure the letter service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or do business.
- Reasonably meet the social, industrial and commercial needs of the Australian community.



1.3.2 Performance standards

These obligations are given specific meaning under the Australian Postal Corporation (Performance Standards) Regulations, promulgated in 1998. The regulations require that Australia Post must meet the following minimum standards:

- Provide a daily weekday delivery service to 98 per cent of all delivery points in Australia and at least a twice-weekly delivery service to 99.7 per cent of all delivery points.
- Deliver 94 per cent of all reserved letters within the time specified in Australia Post’s schedule of delivery times.
- Maintain at least 10,000 street posting boxes in

addition to providing lodgement facilities at each of its retail outlets.

- Maintain at least 4,000 postal outlets of which at least 50 per cent of the total number or a minimum of 2,500 (whichever is the greater) must be located in rural or remote areas.

The schedule of delivery times for standard letters is set out in Table 3 below.

The Commonwealth Auditor General audits compliance with the standards annually. Australia Post has consistently met or exceeded the standards.

The cost of meeting these standards has been escalating to the point where Australia Post makes an overall loss on its reserved mail business.

TABLE 5: AUSTRALIA POST. EXPECTED DELIVERY TIMEFRAMES FOR STANDARD DOMESTIC LETTERS AND PARCEL SERVICE

POSTED FOR DELIVERY	SAME STATE: BUSINESS DAYS	TO OTHER STATES: BUSINESS DAYS
Within metropolitan areas of capital cities or within the same city or town and environs	1	2
Between metropolitan areas of capital cities and country locations	2	3
Between country locations	2	4



1.4 FINANCIAL PERFORMANCE

Australia Post is one of Australia's largest business enterprises. In 2013-14 the Corporation reported revenues of \$6.4 billion, and after tax profit of \$116.2m, and declared dividends of \$78.8m.

Australia Post is required to operate commercially, achieve a reasonable return on the assets used, and pay reasonable dividends to the Commonwealth. It is also required to meet Community Service Obligations (CSOs) by ensuring the letters service:

- Is reasonably accessible to all Australians on an equitable basis.
- Operates to performance standards that meet the needs of the community.
- Is provided at a uniform price for standard letters carried by ordinary post within Australia.

The letter service as a whole is intended to operate at a profit, including the cost of the CSO obligations. This was the case up until 2008-09, but since then there have been mounting losses. In 2013-14 the overall loss in the mail service was \$380.2 bringing the cumulative loss to almost \$1

billion. In 2013-14 the cost of CSOs was \$203.5m, amounting to 3.2 per cent of Australia Post revenues.

1.5 ASSETS

Australia Post has an asset base of \$4.6 billion, of which land and buildings make up \$879.5m. The largest asset item is intangibles of \$1.113m of which computer software makes up \$405m. Brand names and trademarks are valued at \$62.6m.

1.6 RETAIL NETWORK

At end June 2014, Australia Post conducted a large part of its business through a retail network of 4,417 outlets, 2,560 of which are in regional towns. There are 740 corporate post offices (16.8 per cent of outlets), 2,915 licensed post offices (66.0 per cent), 762 community postal agencies (17.3 per cent) and 29 franchises (0.7 per cent) providing postal products and services (Australia Post, 2014a).

1.7 STAFFING

Australia Post employs 32,500 people across several employment categories. These are listed in Table 1.

TABLE 6: AUSTRALIA POST. EMPLOYMENT 2014.

	TOTAL		FEMALE		MALE	
	NO	%	NO	%	NO	%
Delivery	14,006	43.1	3,779	29.9	10,227	51.5
Mail processing	4,971	15.3	2,238	17.7	2,733	13.8
Retail	3,827	11.8	3,180	25.2	647	3.3
Administration	3,413	10.5	1,578	12.5	1,835	9.2
Transport	2,594	8.0	230	1.8	2,364	11.9
Postal Manager	1,004	3.1	579	4.6	425	2.1
Parcels	709	2.2	257	2.0	452	2.3
Call centre	580	1.8	372	2.9	208	1.0
Executive	444	1.4	152	1.2	292	1.5
Technical	347	1.1	14	0.1	333	1.7
All other	604	1.9	265	2.1	339	1.7
Total*	32,499	100.0	12,644	100.0	19,855	100.0

Source: Australia Post, Diversity and inclusion Annual Report 2014.

The largest single employment category is postal delivery, comprising 43.1 per cent of employment. Mail processing and retail employment make up a further 27.1 per cent. Australia Post also contracts with a large number of contract delivery businesses.

Australia Post has a loyal and committed workforce. The greater proportion of staff are employed on a permanent basis (95.3 per cent) with 71.6 per cent employed full time. A further 3.6 per cent are employed on a fixed term basis and 1.1 per cent is casual. This is indicated in Table 5 below.

TABLE 7:

AUSTRALIA POST. WORKFORCE PROFILE (GENDER, ATSI, CALD, PWD) AT 30 JUNE 2014

	WORKFORCE REPRESENTATION		FEMALE		MALE		ATSI		CALD		PWD	
	NO	%	NO	%	NO	%	NO	%	NO	%	NO	%
Permanent												
Full-time	23,283	71.6	7411	58.6	15,872	79.9	323	65.5	5,719	76.4	1,698	75.5
Part-time	7,700	23.7	4675	37.0	3025	15.2	127	25.8	1,586	21.2	515	22.9
Total Permanent	30,983	95.3	12,086	95.6	18,897	95.2	450	91.3	7,305	97.6	2,213	98.4
Fixed term												
Full-time	504	1.6	118	0.9	386	1.9	6	1.2	58	0.8	9	0.4
Part-time	666	2.0	204	1.6	462	2.3	15	3.0	95	1.3	19	0.8
Total Fixed Term	1,170	3.6	322	2.5	848	4.3	21	4.3	153	2.0	28	1.2
Casual	0											
Full-time	51	0.2	42	0.3	9	0.0	1	0.2	4	0.1	3	0.1
Part-time	295	0.9	194	1.5	101	0.5	3	0.6	19	0.3	5	0.2
Total Casual	346	1.1	236	1.9	110	0.6	4	0.8	23	0.3	8	0.4
Indigenous Traineeships							18	3.7				
Total Employment	32,499	100.0	12,644	38.9	19,855	61.1	493	1.5	7,481	23.0	2,249	6.9

Source: Australia Post, Diversity and inclusion Annual Report 2014.

Table 5 also indicates Australia Post's very strong commitment to employment of culturally and diverse groups (CALD). This group makes up 23.0 per cent of employment and people with disabilities (PWD) constitute a further 6.9 per cent of employment.



1.8 SUBSIDIARIES AND JOINT VENTURES

Australia Post operates a number of subsidiaries and joint ventures:

- StarTrack/AUX
- Sai Cheng Logistics - International is a joint venture with China Post to provide supply chain management and logistics services between China, Australia and the rest of the world.
- Post Logistics Hong Kong - provides a freight forwarding service.
- Decipha - offer mailroom and document workflow services.
- SecurePay - online payment gateway is trusted by over 20,000 businesses to accept and manage their payments from cards and bank accounts.

Australia Post Digital MailBox.

Australia Post is the designated postal operator for Australia for the purpose of fulfilling Australia's obligations as a member of the Universal Postal Union. It is the only body authorised to issue postage stamps for Australia.

1.9 INTERNATIONAL POSTAL ARRANGEMENTS

The efficient operation of international postal services is based on treaty arrangements between postal administrations and countries. Australia is a member of the Universal Postal Union, the Asian-Pacific Postal Union and the World Trade Organization.

Universal Postal Union

The Universal Postal Union (UPU) is a specialised agency of the United Nations, which provides the basis for the exchange of international mail. It is the primary forum for international cooperation between the postal services of different countries. It develops common rules that apply to mail services between its 192 member countries and helps to ensure a universal network of up-to-date products and services.

Australia Post makes a substantial loss on the delivery of international postal articles in Australia.

Asian-Pacific Postal Union

The Asian-Pacific Postal Union (APPU) was established in 1961 with the aim of promoting cooperation between the postal services of the region and improving postal relations between member countries. It is one of sixteen regional postal unions, known as a restricted union, under the general framework of the UPU.

Currently, the APPU comprises 32 postal administrations in the Asia-Pacific region. The Acts of the APPU are given treaty status and govern the policy and operations of the Union.

World Trade Organization

World Trade Organization (WTO) members have made submissions on the postal and courier services sub-sections of the General Agreement on Trade in Services (GATS) under the Doha Development Agenda.

1.10 BUSINESS OUTLOOK

The business outlook for Australia Post is strong but there are some factors to take into consideration:

- Restructuring the mail business to place it on a viable and sustainable financial footing. Restructuring should address both cost (bottom line) and innovation (top line) issues.
- Exploiting opportunities to embrace digital technologies in communications and messaging that support traditional letter (written) messaging.
- Developing capacity and capability in e-commerce, particularly for small to medium enterprises.
- Establishing strong partnerships along the mail and parcels delivery value chain.
- Leveraging the retail network to deliver additional agency services that reflect trust and integrity of the Australia Post brand.
- Building in the synergies between the mail and parcels business – where the mail network delivers already 25 per cent of parcels.

The specific business challenges being confronted by Australia Post are addressed in the following Section.

2. The key challenges facing postal services in Australia and abroad

This Section provides an analysis of the existing body of research surrounding the key challenges facing postal services in Australia and abroad.

This Section provides an analysis of the existing body of research surrounding the key challenges facing postal services in Australia and abroad.

2.1 DIGITAL TRANSFORMATION AND DISRUPTION IN THE LETTERS BUSINESS

Digital transformation, involving the use of technology to radically improve performance or reach of enterprises, has become a major issue for companies around the world (MIT Centre for Digital Business and Consulting, 2011). It is having, and will continue to have, a major impact on the business of Australia Post.

Specifically, digital transformation refers to the use of new digital technologies (social media, mobile, analytics or embedded devices) to enable major business innovations including enhancing customer experience, streamlining operations or creating new business models (Fitzgerald et al., 2013, Westerman et al., 2014). Postal businesses, like many others, are being disrupted through digital transformation. (Turnbull, 2014).

Disruptive innovation, a term coined by Clayton Christensen (Christensen et al., 2002), describes a process by which a product or service takes root initially in simple applications at the bottom of a market and then relentlessly moves up market, eventually displacing established competitors. An innovation that is disruptive allows a whole new population of consumers at the bottom of the market pyramid access to a product or service that was historically only accessible to consumers with a lot of money or a lot of skill.

Characteristics of disruptive businesses, at least in their initial stages, can include: lower gross margins, smaller target markets, and simpler products and services that may not appear as attractive as existing solutions when compared against traditional performance metrics. Because these lower tiers of the market offer lower gross margins, they are unattractive to other firms moving upward in the market, creating space at the bottom of the market for new disruptive competitors to emerge.

Recently Australia Post Managing Director commented about digital disruption at Australia Post in the following terms:

Those of us who work in industries that traditionally delivered a service on paper – or that sell some type of physical media are unfortunately at the cutting edge of this digital disruption. Think of video and book stores or the publishers of all sorts of news, entertainment and media or photographic companies that failed to adapt – like Kodak - or paper-based cheques, Yellow Pages directory advertising and, of course, Letters.

From our perspective at Post our business model has already been severely disrupted by the community's shift to digital channels.



As Australians increasingly use the Internet and mobile devices to communicate, to shop, to access services and to pay for things it's affecting every part of our business. But our three core business areas are impacted in very different ways - some good and some bad (Fahour, 2014).

The Managing Director commented that the most dramatic impact of digital disruption has been on the letters business. The emergence of the Internet 25 years ago turned the letters business into a low margin operation with the availability of digital alternatives such as email, web based and mobile applications, and social media. Initially it was transactional information that started going online via direct debits and electronic bills and account statements.

More recently, there has been an explosion of online written communications as disruptive competitors including Facebook, Twitter, Google+ and Instagram have entered the market. Corporate blogs have also made substantial inroads into the once highly profitable letters business.

The monopoly on letters mail once enjoyed by Australia Post is no longer attractive as margins and profits tumble due to declining mail volumes and a high fixed cost structure. As Australia Post moves upward into the more profitable, but unregulated, parcels market, and seizes growth opportunities provided by on-line shopping and end-to-end e-commerce services for small business, other firms are entering. Competition in parcels has also emerged in the form of electronic downloading of e-books and music.

Competition always creates challenges, but it also drives a necessity for unrelenting innovation, particularly around the customer service experience. For example, digital transformation has had a major impact on the retail business, as fewer people need to visit a Post Office to transact business. Opportunities to leverage this very

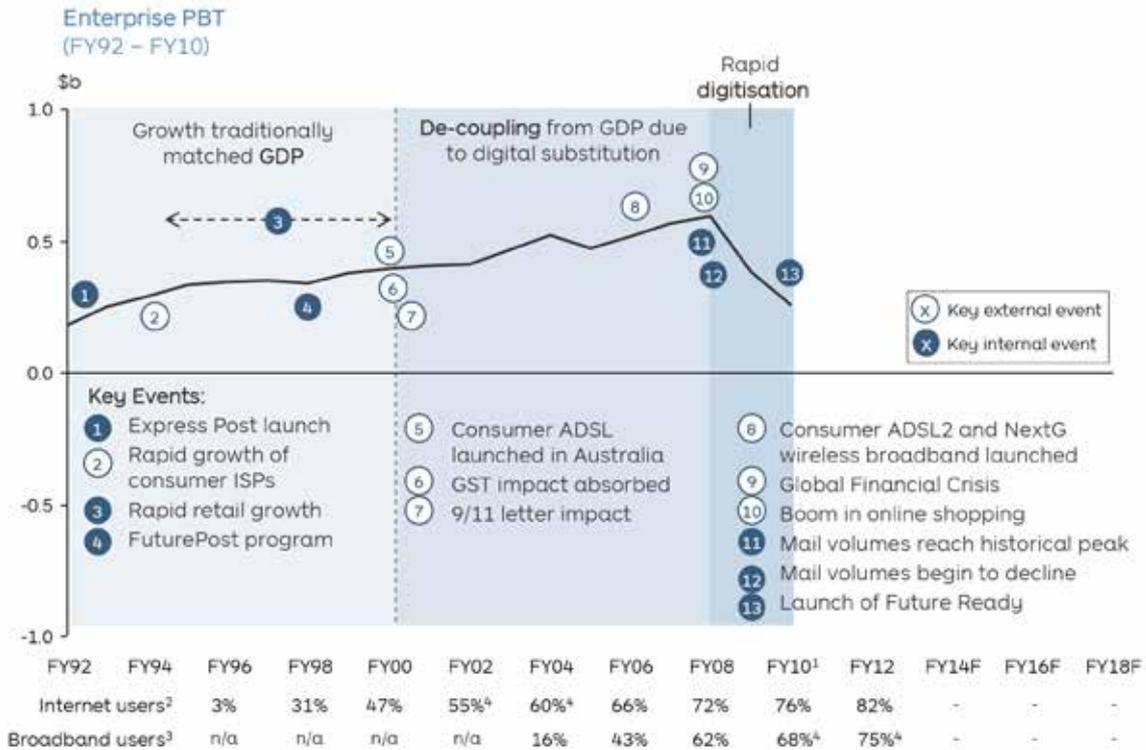
substantial asset base to provide new services for customers in new ways provide a foundation for innovation.

Post Offices are evolving with changing customer habits, but drawing on overseas experience, it is clear that the postal services that customers want must be available near their premises in order to offer a personal and flexible service. It is of course essential that new services build on the core competencies and distinctive capabilities of Australia Post. These centre on communication, and increasingly, digital communication.

The impact of digital transformation on the Australia Post business is indicated in Figure 2. Digital transformation began to impact on the Australia Post business with the widespread availability of fast broadband in 2008 and the extensive substitution of digital mail for letters mail. The immediate impact was a rapid decline in demand for letters mail and revenue. Up until then revenue growth had largely followed GDP growth.



FIGURE 2: AUSTRALIA POST: IMPACT OF DIGITAL DISRUPTION



Note: 1 FY10 PBT excludes \$150m restructuring costs; 2. Percentage of Australians with internet access; 3. Percentage of Australian households with internet access; 4. No data available for this year; interpolated Sources: AP Corporate Finance, AP Historical Annual Reports, World Bank, OECD, ABS Census
 © 2014 Australia Post

Source: Australia Post, Submission to the Senate Standing Committee On Environment And Communications Inquiry Into The Performance Of Australia Post And Licensed Post Offices, Melbourne, 2014.

The substantial decline in letters volume commenced in 2008-09, after a peak of in 2007-08 of 5.6 billion items (4.2 billion in the reserved letter business). This, in turn, contributed to a trend loss in overall business performance. By 2009-10 the reserved mail service annual loss had reached \$250m.

The decline in mail volume is directly related to the extent to which both senders and receivers embrace digital communications technology as an alternative to letters mail. As the pace of mail volume decline is influenced by the availability of high-speed broadband, the roll out of the

National Broadband Network (NBN) is likely to have a significant impact on mail volumes. Business (particularly small business), consumer and government e-commerce and e-government adoption is expected to accelerate the decline in traditional letters mail.

Australian businesses and government agencies, the predominant mail sender categories, have not tended to be early adopters of digital technologies in the letters business. This is in contrast to some European countries, particularly Scandinavia.

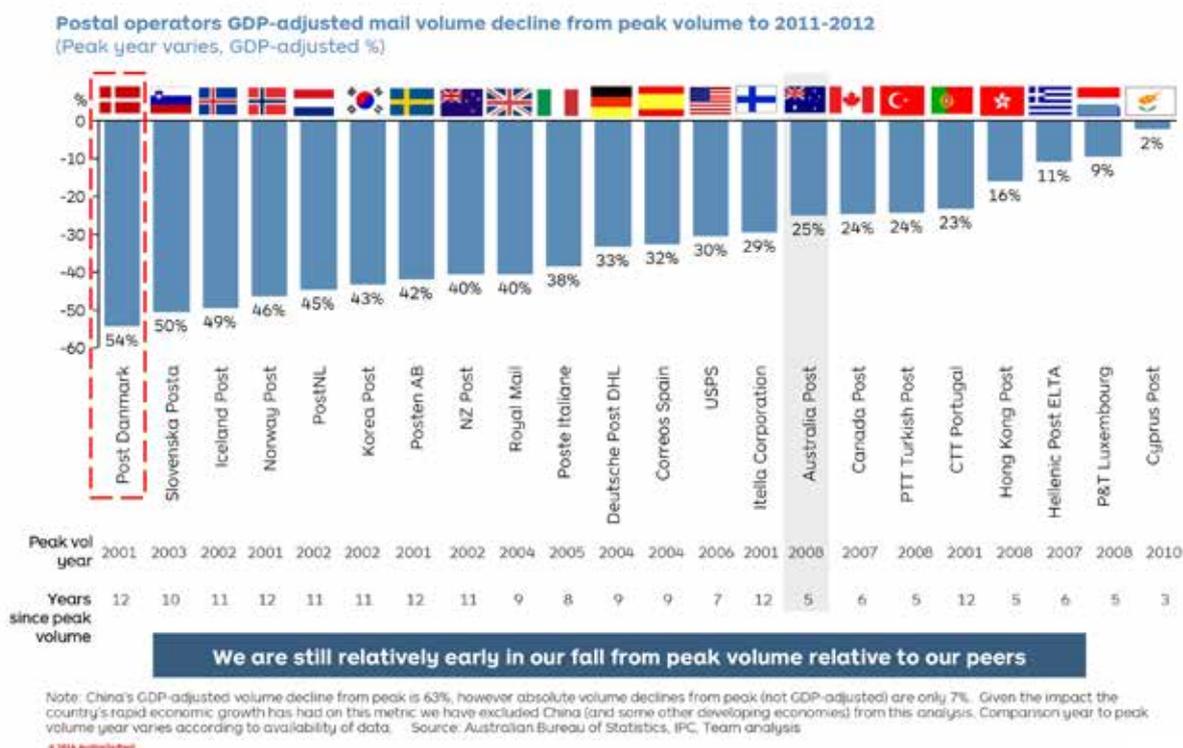
2.2 EXPERIENCE IN OTHER COUNTRIES

All countries are experiencing declines in mail volumes associated with digital transformation in the letters business. Among International Post Corporation members the greatest decline has been recorded in Denmark - a country well known for rapid technology adoption. (The decline has been 54 per cent since 'peak mail' was recorded in 2001 to 2011-12). Several other European

countries reached peak mail in 2001 or 2002, and the declines have mostly been in excess of 40 per cent.

Australia Post reached peak mail comparatively later in 2007-08 due to the slower penetration of high-speed broadband. But the GDP adjusted fall in volumes has been 25 per cent between 2007-08 and 2011-12. These trends are shown in Figure 3.

FIGURE 3:
INTERNATIONAL MAIL VOLUME DECLINE FROM YEAR OF PEAK VOLUME TO 2011-12



Source: Australia Post, Submission to the Senate Standing Committee On Environment And Communications Inquiry Into The Performance Of Australia Post And Licensed Post Offices, Melbourne, 2014.



With falling mail volumes, relatively fixed cost structures and ongoing universal service obligations, all postal organisations are facing profitability challenges in the letters mail business. One or more of the following strategic responses have been instituted:

- A commitment to cost reduction, efficiency and productivity improvement, automation and centralisation of processing functions.
- A shift in business orientation towards the parcels business, with the letters business operating in the “tail wind” of innovations in packages and e-commerce. Several have integrated their mail and parcels businesses.
- Extension of secure services and digital identification.
- Postal businesses have become more ICT enabled and orientated. Some have become significant innovators on an ICT platform. But postal organisations with restrictive charters are finding innovation to be a significant challenge.
- Several have orientated their service offerings

in the micro-SME e-tail segment as well as the SME sector more generally, offering end to end ecommerce and logistics solutions.

Several postal organisations have moved into the retail financial services business.

There is some consumer resistance to full digitisation of mail, and some postal organisations are working with business senders to offer consumers choice in the way they receive mail with the postal organisation working as an intermediary.

2.3 THE FUTURE READY STRATEGY: 2010 - 2014

With the adverse impact of digital disruption on Australia Post’s core business, Australia Post launched a business renewal program in 2010, under the title Future Ready. The program was created to guide the corporation’s strategic and operational response to the shift in customer behaviour being driven by digital transformation. The goal of Future Ready involved re-engineering Australia Post to be an enabler of the digital economy. The transformation was underpinned by three enterprise strategies relating directly

to Australia Post's three core activities – communications, retail, and parcel delivery:

1. Build a sustainable communications business – both physically and digitally.
2. Offer government, business and financial trusted services for consumers – both physically and digitally.
3. Build a world-class parcels business, with excellence in service performance.

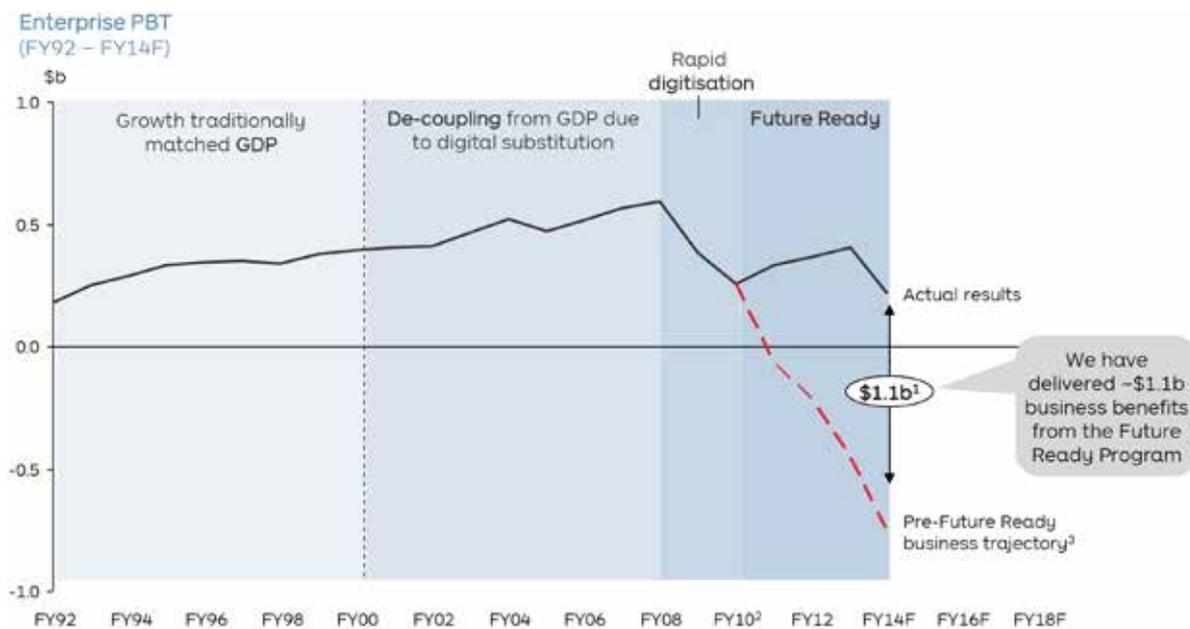
These business approaches were supported by two enabling strategies:

1. Embed the right culture and behaviours; build capabilities, and foster engagement.
2. Drive for a productive, efficient and innovative organisation.

Future Ready involved investing in Australia Post's major growth opportunities in the digital economy: digital communications; capacity and convenience initiatives, expanded parcel-processing facilities; and the addition of a broad range of new trusted services. It has also involved a range of cost containment and efficiency initiatives throughout the business, as well as a careful focus on cultural transformation.

The implementation of the *Future Ready* program has been vital to the corporation in increasing overall profitability between 2009-10 and 2013-14 and established a foundation for the future (Australia Post, 2014c). The program delivered approximately \$1.1b in benefits, offsetting a declining profit trajectory faced in 2010. This is illustrated in Figure 4.

FIGURE 4: AUSTRALIA POST. IMPACT OF THE FUTURE READY PROGRAM



Note: 1. \$1.1b represents gross business benefits and net benefits are \$0.9b. The difference is due to faster actual mail volume decline than was forecast at the time the Pre-Future Ready trajectory was developed. 2. FY10 PBT excludes \$150m restructuring costs. 3. As outlined at the time of the Future Ready strategy development, deducting the FY14 APSS a/c charge (\$176m). Sources: AP Corporate Finance, Annual reports, AP/BCG 'Future Ready, Enterprise Strategic Plan' (Sep 2010).

Source: Australia Post, Submission to the Senate Standing Committee On Environment And Communications Inquiry Into The Performance Of Australia Post And Licensed Post Offices, Melbourne, 2014.

Significant achievements of the *Future Ready* included:

- Introduction of the Australia Post Digital MailBox.
- Development of a World-class parcel network.
- Introduction of digitally enabled 24/7 parcel lockers.
- Modernisation of retail formats.
- Full acquisition of the StarTrack business.
- Extension of identity trusted services.
- Introduction of 24/7 self service access.
- Development of the Parcel send app.
- Introduction of Load&Go.
- Reduced safety incidents.
- Reached high level of employee engagement.
- Protection of the brand – Australia Post is known as the second most reputable company.

The reform processes must continue, and accelerate, in the light of the emerging business situation.

Australia Post's 2013-14 Annual Report developed the theme of *Your Post is Evolving*. The Report noted that the needs of communities are changing as a result of the digital age and that Australia Post's services must also change in order to fulfil its purpose. Four areas of change are identified in *Your Post is Evolving*:

- Building world-class delivery, supply chain and e-commerce solutions for business.
- Developing the post office and digital services to support the everyday essentials of citizens and small business owners, including a special focus on rural and regional communities.
- Enabling governments and corporations to connect with their customers online as well as through the postal network.

- Helping people and partners feel safe and supported so that they can have fulfilling jobs and businesses that serve our customers well.

2.4 OUTLOOK FOR 2014 AND BEYOND

The financial year 2013-14 has been seen as a turning point for Australia Post. For the first time since corporatisation the corporation posted an overall loss in the second half of the financial year.

Despite three months of benefit from the \$0.10 increase in the basic postage rate, the profits from the parcels business were overwhelmed by losses in the mail business, resulting in an overall loss of \$105.9 million and a trading loss of \$42.9 million before restructuring costs, in this six-month period. Profit growth in parcels has covered the growing losses in letters again in the full year but possibly for the last time (Fahour, 2014).

2.4.1. On the face of a cliff: mounting losses in the letters business

Both major political parties envisage having 80 per cent of government communications with citizens online by 2017. If this is the case Australia will reach the same level of government adoption as Denmark and Norway in the next three years. The Australia Post Managing Director has commented "If that is the case then our letter volumes will literally fall off a cliff" (Fahour, 2014).

In announcing the full year financial results for 2013-14 in September 2014, Mr Fahour pointed out that the decline in the volume of addressed letters, coupled with the fixed cost nature of the postal network, means losses will inevitably continue to grow. The losses are seen as a stark illustration of the urgent need for changes to the regulations governing the letters service. Without change, it is estimated that the corporation will incur \$12.1 billion cumulative losses in letters, and \$6.6 billion for the enterprise over the next 10 years.

The regulations used to manage the once powerful monopoly of physical letters now constrains Australia Post's ability to adapt. This results from:

- A fall in average letters per delivery point per day.
- An increase in the number of delivery points.
- Performance standards being set uniformly high.
- The price of letters being well below world average (and lagging in relation to trend CPI increases).
- A very high level of fixed costs required to meet the service requirement.

As an entity, the business looks strong, but overall performance is being impacted by the poor performance of the letters mail segment. From 2015, losses on the letters business will overwhelm the successes and profit in parcels growth and retail. These have been driven by investments in capacity expansion, StarTrack, product standardisation, last mile delivery (parcel lockers, parcel collect, delivery choices), e-commerce and expansion of trusted expansion services portfolio.

2.4.2. Competition in the parcels business

Australia Post is experiencing acute competition in its small parcels business from couriers, logistics and road transport companies, freight forwarding businesses and global supply chain integrators. These companies, including Toll, TNT, and DHL are becoming very active in the parcels business.

In addition, small freight and parcel forwarding businesses, such as Pack & Send, purchase space available with DHL, TNT and Toll and even StarTrack, and resell to small and medium businesses and consumers.

These companies are in negotiation with service outlets to provide delivery drop-off and collection points. These include retailers that are open seven days a week, such as petrol stations. They are seeking to provide an alternative to the retail outlets and parcel lockers being offered by Australia Post.

The annual rate of growth in Australia Post's parcels and express business fell from an annual growth rate of 38 per cent in 2011 to 14 per cent

in 2013. This relative flattening of growth is being experienced in other parts of the world.

Australia Post is addressing this competition and already has parcel lockers in a variety of locations, including at service stations. It has also been investing heavily in capacity, doubling the processing volume, with a Saturday delivery option recently instituted.

Clearly the competition is tough and intense. For the future, and Australia Post in particular, much will depend on the way in which the global e-tailing business plays out and the capacity to link this business with e-commerce solutions for the small business segment.

2.4.3. Integration in the e-commerce market

A growing number of retailers have set up their own e-commerce solutions in recent years and more channels are being used by retailers to reach and drive sales, which in turn puts new demands on logistics operators and their flexibility (PostNord, 2014). In this environment, e-commerce logistics becomes a source of competitive advantage. Methods of delivery, time of delivery and price of delivery have become important issues for consumers at the time of purchase.

Efficient logistics solutions drive the growth of e-commerce. Without fast deliveries and return options, e-commerce is impossible. Australia Post has some advantage in its distribution platform and has been able to leverage the combination of mail delivery and thousands of distribution points. But competitors are working their way around and through this advantage.

This provides both the challenge and the incentive for Australia Post to keep innovating in the e-commerce market around the needs and requirements of both the retailers and the purchaser. There are opportunities, particularly in the micro and small business segment, to offer integrated e-commerce solutions from the development of platforms, secure payment (through SecurePay), warehousing, delivery and returns.

2.4.4. Slow take up in the digital mail business

Australia Post introduced the Digital MailBox in the context of the *Future Ready* program. Local Governments appear to have been early adopters but there are relatively few corporate senders. This has been a common experience for postal organisations (Copenhagen Institute for Futures Studies, 2012).

The Commonwealth is moving towards its own digital mail portal with the MyGov initiative, utilising digital mail for CentreLink, Medicare, ATO and DVA mail receivers and is looking to expand the service to State and local governments. It offers a link to MyPost. The extension of MyGov may also undermine the economics of MyPost. The future of MyPost may well be with private and the small business sector and particularly financial institutions.

The slow business take up may reflect what has become known as ‘channel proliferation’ in messaging through many innovations enabled by digital technologies – emails, texts, blog posts, twitter and social networks posts.

There are certain categories of mail for which a digital option is not readily available without legislative change: this would include postal voting, ballots and exercise of proxies as well as certain official and corporate documentation.

2.4.5. LPO/franchisee viability

The Licensed Post Office (LPO) network is an important dimension of Australia Post’s business, brand and reputation. The creation of LPOs was in response to the introduction of the *Australian Postal Corporation Act* that introduced the dual obligations of community service and commercial return. Australia Post developed a retail ownership model that could provide an appropriate level of service whilst removing direct ownership of costs.

The current LPO business model is based on a commercial framework with in-built incentives to improve profitability, giving licensees greater freedom to grow their own businesses with the

benefit of Australia Post’s brand and foot traffic. The LPO Agreement is a contract with an indefinite term and no defined territory. Since the creation of the LPO model, Australia Post has issued few new licences. The majority of ownership changes occur in a secondary market.

The Australia Post income streams delivered to LPOs are based on:

- The sale of letter and parcel products, on which licensees receive a percentage-based purchasing discount from Australia Post.
- Processing and delivery fees for mail related services such as post office box servicing.
- Commissions for processing ‘trusted service’ transactions such as bill payments and banking.
- Some other subsidies, top-up payments and discounted merchandise available from Australia Post.

In addition, there are arrangements for licensees to be provided with a minimum annual payment. The majority of LPOs (94 per cent) that receive the minimum payment are in rural and remote Australia.

The Post Office network is significantly challenged by digitisation and changing customer preferences. Reduced foot traffic has had a major impact on viability. Australia Post has responded to this by investing in a number of financial and technological initiatives. In September 2014 Australia Post announced that in addition to the \$338 million in annual payments to the LPO network, new initiatives and a rural sustainability package will deliver an additional \$40 million of payments.

LPOs also generate income from a range of merchandise offered for sale in their retail outlets. The range is somewhat eclectic, covering insurance products, retail debit store vouchers, greeting cards, stationery, and digital products including cameras, books, CDs, toys, and confectionary. Some LPOs are very crowded with the volume of merchandise on display.

The viability of LPOs was the subject of a

recent inquiry by the Senate Environment and Communications Legislation Committee. (Australia. The Senate. Environment and Communications Legislation Committee, 2014). The Committee received over 200 submissions. The Report of the Committee, tabled in September 2014, made 18 recommendations, including:

- Greater commercial freedoms for Australia Post should only be considered if this provides support for the delivery of the community service obligations through a viable Licensed Post Office network.
- The Minister for Communications form a formal postal network strategy group that engages all stakeholders in the development of a comprehensive strategy to inform changes to the Australian Post network in the face of emerging challenges.
- As a matter of urgency, reassess post office box payments to licensees to ensure that they reflect the true costs borne by licensees in providing this service.
- Australia Post reviews the margins on postal products it sells to licensees with a view to ensure that margins are in line with commercial practice.

In September 2014, following the release of the Senate Inquiry Report, Australia Post announced that it would introduce a series of initiatives that in total contribute an additional \$40 million to the viability of LPOs. This is in addition to the \$338 million paid annually. These initiatives include:

- The introduction of additional payments for scanning and delivering parcels.
- A 16.7 per cent increase in payments related to the delivery function that LPOs perform.
- Bringing forward Post Office box renewal payments by 2 months to assist with licensee cash flows.
- A rural sustainability package – an increase to the minimum payment to post office

operators, new point of sale technology funded by Australia Post and removal of technology transaction fees, aimed particularly at country and rural operators.

- Increases to over the counter bill payment and banking commission rates.
- New payments such as the PO Box establishment fee and MyPost Concession Account.

2.4.6. Universal Postal Union payment arrangements for delivery of inbound parcels

As a member of the UPU, Australia Post is required to deliver parcels sent through international postal services within Australia. In return for delivering these parcels, Australia Post receives a payment from the overseas postal organisation set by the UPU. As the volume of parcels coming into Australia increases Australia Post is required to spend more on parcel delivery. There is a growing concern that UPU payments received by Australia Post do not cover the costs of delivery.

The payments that Australia Post receives under the UPU's terminal dues systems is now well below the cost of delivery within Australia. As a net importer, this means that Australia Post incurs a substantial loss on the processing of such mail. For example, in the financial years 2010-2012, Australia Post estimates that it made a loss of A\$1.06 per inbound international airmail packet (parcels less than 2 kilograms) on a volume of approximately 39.7 million articles. This amounts to more than \$42 million over two years.

This is a significant departure from the situation in 2008-09, when the costs of delivering international mail were covered. There are two reasons for the difference: the strength of the local currency, and the increase in Australians shopping online.

2.4.7. Continuing perceptions of Australia Post as a community service

Australia Post research indicates that Australians have mixed perceptions of Australia Post:

- Old-fashioned, out-dated.
- Part of the national heritage.
- Honesty, integrity, trust.
- Inefficient, confused, clunky.

Generally, people are very attached to their local post offices. But whilst they are valued as a community asset, there is probably a very poor understanding of the business and commercial imperatives that are required for their efficient operation.

Post Offices in regional, rural and remote locations also serve as ‘beacons’ for government presence. Australia Post is committed, through its *Reconciliation Action Plan*, to “being a part of Indigenous communities through the services we provide, particularly in remote Australia”.

Australia Post staff also perform important community work particularly in times of crisis and natural disaster.

The differential branding of Australia Post (mail) and StarTrack (parcels and logistics) goes a long way to addressing differences in business scope and mission. It reflects a similar differentiation in Germany with Deutsche Post (mail) and DHL (parcels, logistics and transport).

2.4.8. The policy environment

Political and newspaper commentary has canvassed options for privatisation of Australia Post. It was also canvassed by the National Commission of Audit (Australia. National Commission of Audit, 2013). This can be a diversion from the real task at hand, which is to ensure that the mail business delivers a commercial return *and value* for both mail senders and receivers. European experience indicates that change of ownership does not necessarily improve performance.

The Government has indicated that privatisation is not on the policy agenda for Australia Post.

2.5 CONCLUDING COMMENT

The availability of digital technologies promises much more than transformation of business processes and capturing efficiency and productivity improvements. Digital technologies can drive the transformation of the *business*. After some initial stumbles, leading global businesses have worked out ways of linking business strategy with technology strategy.

A 2013 *MIT Sloan Management Review* and Capgemini Consulting survey of 1,559 executives and managers in a wide range of industries indicated:

- Managers believe in the ability of technology to bring transformative change to business. But they also feel frustrated with how hard it is to get great results from new technology.
- 78 per cent of respondents believe that achieving digital transformation will become critical to their organizations within the next two years.
- 63 per cent said the pace of technology change in their organization is too slow.
- The most frequently cited obstacle to digital transformation was lack of urgency - Only 38 per cent of respondents said that digital transformation was a permanent fixture on their CEO’s agenda.
- Where CEOs have shared their vision for digital transformation, 93 per cent of employees feel that it is the right thing for the organization. But, a mere 36 per cent of CEOs have shared such a vision. (Fitzgerald et al., 2013)

It is of interest that the research shows that *frontline employees* believe they face a strategic imperative to successfully adopt emerging new technologies. Almost no organization is sheltered from the competitive disruption wrought by the widespread adoption of digital technologies.

These observations provide an important backdrop to considering the financial health of Australia Post. They also underscore the importance of placing value on the contribution of employees in approaching the tasks of change and innovation.

AUSTRALIA
POST



3. The financial health of Australia Post

The project brief required an examination of the financial health of Australia Post as recorded in annual reports over the last five years. In order to provide a more complete picture of trends, annual reports were analysed for a further three years – from 2006-07.

TABLE 8: AUSTRALIA POST. PERFORMANCE SUMMARY

Year ended 30 June	2007	2008	2009	2010	2011	2012	2013	2014
Mail volumes (m)	5,515.8	5,609.4	5,323.4	5,145.0	5,038.2	4,843.0	4,580.2	4,484.3
Reserved letter volumes (m)	4,172.9	4,260.7	4,094.3	3,876.6	3,738.8	3,545.3	3,305.7	3,173.5
Revenue (\$m)	4,711.1	4,959.2	4,974.5	4,856.2	4,986.5	5,126.2	5,893.2	6,383.3
Profit before tax (\$m)	561.7	592.2	380.9	103.0	332.3	366.7	210.7	103.0
Profit/(loss) from reserved services (\$m)(1)	24.0	(1.7)	(69.2)	(250.1)	(66.5)	(114.4)	(198.0)	(242.6)
Return on equity (%) (2) (3)	14.2	15.4	17.2	6.2	15.0	16.8	10.5	6.7
Return on average operating assets (%)	19.6	19.4	12.2	3.8	10.9	11.5	6.2	3.4
Debt to debt plus equity			23.3	26.4	23.6	29.1	27.3	28.8
Dividends declared (\$m)	296.9	334.6	184.0	79.1	173.2	213.7	192.7	78.8
Special dividend declared (\$m)		111.6	38.4	0.0	0.0	0.0	0.0	0.0
Interest cover times)	18.4	15.6	11.0	4.6	10.9	10.8	7.7	3.6

(1) Amounts prior to 2011 included the collection, processing and distribution of international inbound letters and packets (weighing less than 2kg) in accordance with the arrangement of the Universal Postal Union. This is now included within regulated services.

(2) Return on equity is calculated as profit after tax as a percentage of equity. Equity has been normalised to remove the impact of the group's net superannuation liability/asset.

(3) Results for 2012-13 and 2013-14 include the impact of a superannuation accounting change, and also restructuring of \$90m in 2013-14. Excluding these impacts, which will then be comparable to the rest of the table, the return on equity would be: 18.5 per cent 2012-13 and 16.9 per cent in 2013-14.

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

The performance data points to:

- Mail volumes declining both in overall terms and in the reserved letter business. What is now referred to as peak mail was reached in 2007-08 with 5.6 billion items (4.5 billion reserved items) to 4.5 billion items in 2013-14 (3.2 billion reserved items).
- The reserved services business falling into a loss position in 2007-08 and steadily increasing loss to \$242.6m in 2013-14.
- A declared dividend to the Commonwealth of \$78.8m in 2013-14. This is a small fraction (17.7 per cent) of the total dividend of \$446.2m declared in 2007-08.
- A substantial drop in the return on (the Commonwealth's) equity.

The continued decline in mail volumes pushed the enterprise into an overall second-half loss for 2013-14. Whilst the financial health of the reserved letters business is not strong, other segments of the business, particularly the parcels business, are performing well.

Further analysis of the financial health of Australia Post is provided in the remainder of this Section.

3.2 OPERATING PERFORMANCE

Information drawn from Australia Post Annual Reports over the period 2007-08 to 2013-14 provides insights into the operating performance trends of the three business segments. For the purposes of reporting, the segments are (Australia Post, 2014a):

- Mail - the collection, processing and distribution of mail items, digital communications and associated services. This covers both reserved and non-reserved mail.
- Retail - provision of postal products and services, agency services, mail boxes and bags, financial services and other retail merchandise, principally philatelic, stationery, telephony, greeting cards, gifts and souvenirs.
- Parcel Services - the processing and distribution of parcel and express products along with freight forwarding operations.

Operating earnings of each segment are set out in Table 9.

TABLE 9:

AUSTRALIA POST. OPERATING EARNINGS BEFORE INTEREST AND TAX (YEARS ENDED JUNE) \$M

YEAR ENDED JUNE	2007	2008	2009	2010	2011	2012	2013	2014
Mail	160.0	148.5	52.0	(176.1)	25.5	(146.5)	(285.1)	(380.2)
Retail	86.6	86.5	94.5	78.9	80.1	182.5	177.9	165.5
Parcel services	255.9	246.4	186.8	170.8	232.3	361.5	279.3	309.4
Unallocated	52.5	102.8	51.4	32.2	(3.7)	(31.1)	51.8	38.3
Net profit (BIT)	555.0	584.2	384.5	105.8	334.2	366.4	223.9	133.0

Source: Australia Post, Annual Reports and Audited Financial Statements, 2006-07 to 2013-14.

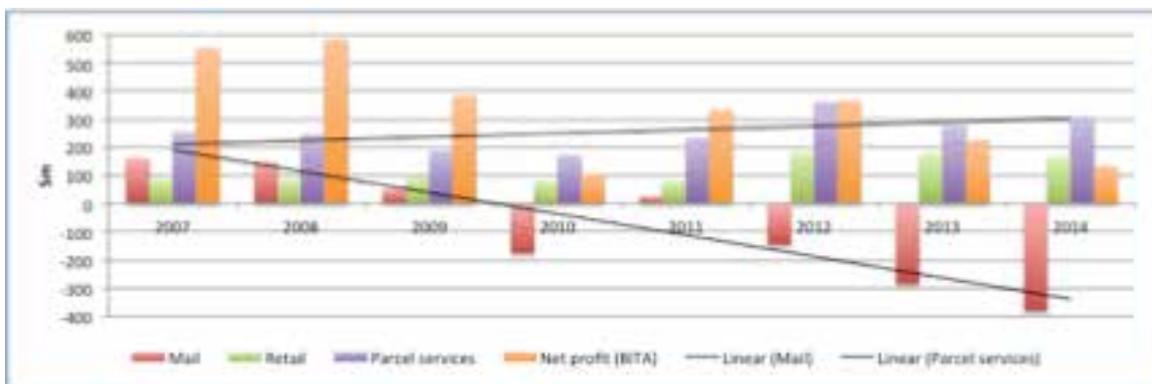


The information in Table 9 points to the deteriorating position in the mail business, particularly since 2011-12. The deterioration that became apparent in 2007-08 was alleviated though the impact of the Future Ready Program, but this has not been sufficient to reverse the longer-term trend.

a peak in 2007-08 of \$584.2m to \$133.0m in 2013-14. The decline in profitability is due in large measure to losses being made in the mail segment. The impact of these losses is represented in Figure 5. The data does not include earnings in the 'unallocated' business segment. Trend lines are also shown for the mail and parcels segments.

The net profit of Australia Post has declined from

FIGURE 5: AUSTRALIA POST. OPERATING EARNINGS BY BUSINESS SEGMENT





As indicated in Section 3, the losses made in the mail business are due to a combination of:

- A universal price for standard letters, set by Government, that does not cover the cost of the service. The price applies whether delivery is in a metropolitan area or in a rural or remote town.
- A high fixed cost base - including the need to process mail overnight, associated with the CSO commitment for next day delivery in capital cities.
- Declining letter volumes due to an increasing range of digital alternatives to letters mail.

Mail volumes have fallen by 22 per cent between 'peak mail' of 5.2 billion items in 2007-08 to 4.1 billion in 2013-14. Mail volumes are expected to decrease by between eight and 11 per cent annually to 2020 (Boston Consulting Group, 2014).

These factors are having a flow through impact to the Australia Post business as a whole. This is addressed below.

3.3 INVESTMENT IN THE BUSINESS

Despite the deteriorating overall operational performance, Australia Post has continued to invest in the business, and has increased investment substantially over the last two years. Investment has been financed from cash flows and retained earnings. As a Government Business Enterprise (GBE), Australia Post is limited in its ability to borrow in the capital markets. Capital investment over the 2006-07 to 2013-14 period is shown in Table 10.

Table 10: Australia Post. Segment capital expenditure (years ended June) \$m

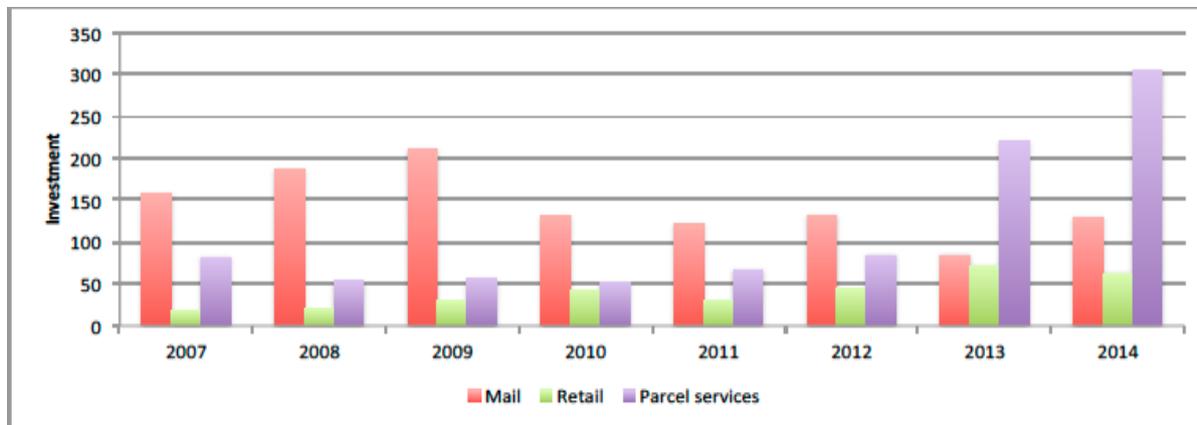
TABLE 10: AUSTRALIA POST. SEGMENT CAPITAL EXPENDITURE (YEARS ENDED JUNE) \$M

POSTAL SERVICES	2007	2008	2009	2010	2011	2012	2013	2014
Mail	156.7	187.2	210.9	130.8	122.2	132.2	84.3	130.0
Retail	18.8	21.1	29.5	43.1	31.1	45.1	71.4	62.6
Parcel services	81.2	54.0	57.5	53.0	66.7	84.0	220.5	304.2
Unallocated	28.5	32.5	13.3	5.7	2.2	0.9	-	35.0
	285.2	294.8	311.2	232.6	222.2	262.2	376.2	531.8

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

Over the eight years covered by this analysis it would appear that Australia Post has shifted investment priority from the mail to the parcels business. There was an increased commitment to mail investment in 2013-14. This is illustrated in Figure 6.

FIGURE 6: AUSTRALIA POST. CAPITAL EXPENDITURE IN EACH BUSINESS SEGMENT



Continued investment in the Australia Post business is constrained due to the declining cash flows and rundown in retained earnings.

3.4 FINANCIAL ANALYSIS OF THE AUSTRALIA POST BUSINESS

This Section provides information and brief analysis of Australia Post financial reporting statements for the years 2006-07 to 2013-14.

3.4.1. Income statement

Information provided in the Australia Post annual reports provides an insight into Australia Post's income and expenditure trends. Table 11 provides summary information for the main categories included in the income statement.

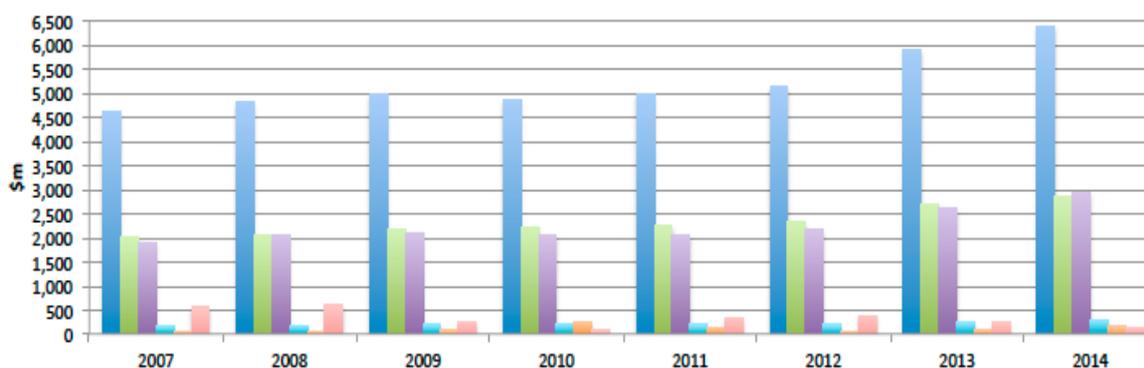
TABLE 11: AUSTRALIA POST. SUMMARY INCOME STATEMENT (YEARS ENDED JUNE) \$M

	2007	2008	2009	2010	2011	2012	2013	2014
Income	4,607.4	4,936.9	4,974.5	4,856.2	4,986.4	5,126.2	5,893.2	6,383.3
Expenses								
Employees	1,998.6	2,044.2	2,173.5	2,225.3	2,254.0	2,322.9	2,700.2	2,865.1
Suppliers	1,904.5	2,041.9	2,100.4	2,054.6	2,047.1	2,162.2	2,605.4	2,926.4
Depreciation	174.3	186.1	207.4	213.5	198.4	201.6	246.3	295.6
Other	39.8	54.2	85.1	245.7	141.1	52.3	98.8	153.0
Total expenses	4,117.2	4,326.4	4,566.4	4,739.1	4,640.6	4,739.0	5,650.7	6,240.1
Profit before tax, finance and share of net profit on joint ventures	561.2	610.5	408.1	117.1	345.8	387.2	242.5	143.2
Gross margin	12.2%	12.4%	8.2%	2.4%	6.9%	7.6%	4.1%	2.2%

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

Table 11 clearly indicates that Australia Post's profitability has declined markedly since 2008. Profitability increased in 2011 and 2012 with the impact of the Future Ready program, but slid backwards in 2013 and 2014. These trends are indicated in Figure 7.

FIGURE 7: AUSTRALIA POST. INCOME, EXPENSES, PROFIT - 2006-07-2013-14



Whilst Australia Post revenues have been growing, they have been growing in the parcels business. As indicated, losses in the mail business have eaten away at profits in other segments of the business that will potentially give rise to an overall operating loss in 2015.

Employee costs reached a high of 45.8 per cent of revenue in 2012-13, but fell to 44.9 per cent in 2013-14. This points to a high level of cooperation between Australia Post management and the postal unions in addressing the financial situation and their support in the implementation of the Future Ready program.

Of potential concern is the increase in supplier costs from 41.3 per cent of revenue in 2006-07 to 45.78 per cent in 2013-14. This would reflect the impact of acquisitions, but suggests a need to look closely at supply chain management across the business.

3.4.2 Asset base

Asset portfolio

Movements in the Australia Post asset portfolio are summarised in Table 12. It reflects a decline from a peak of \$5.48 billion in 2007-08 to \$3.92 billion in 2009-10, recovering to \$4.66 billion in 2013-14.

TABLE 12: AUSTRALIA POST. TOTAL ASSETS BY SEGMENT (YEARS ENDED JUNE) \$M

	2007	2008	2009	2010	2011	2012	2013	2014
Postal services								
Mail	1,257.8	1,375.9	1,290.0	1,231.2	1,208.7	1,236.1	978.0	1,012.7
Retail	463.4	464.2	406.2	395.2	422.0	470.8	493.6	492.4
Parcel services	1,064.7	1,037.3	1,043.0	1,040.9	1,126.4	622.5	1,935.2	1,874.7
Unallocated	2,704.6	2,599.6	1,531.0	1,247.9	1,378.0	1,846.4	994.4	1,271.4
Total assets	5,490.5	5,477.0	4,270.2	3,915.2	4,135.1	4,175.8	4,401.5	4,651.2

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

Retail assets represent a significant investment and make up ten per cent of the total asset base.

Changed accounting for superannuation assets impacts the reported total assets and net assets in 2006-07 and 2007-08. In 2012-13 there was also a substantial increase in intangible assets – predominantly goodwill as a consequence of the accounting treatment of the acquisitions of AUX investments (Startrack), SecurePay and Messenger Post. Movements in the asset portfolio are contained in Table 13.

TABLE 13 AUSTRALIA POST. ASSET PORTFOLIO (YEARS ENDED JUNE) \$M

	2007	2008	2009	2010	2011	2012	2013	2014
Current assets	1,295.8	1,307.4	1,170.0	1,129.5	1,326.5	1,536.0	1,239.9	1,237.4
Non current assets								
Investments in joint entities	308.7	309.7	298.3	295.6	292.1	284.7	2.7	1.8
Superannuation asset	1,777.8	1,594.7	468.0	172.6	287.4	-	-	47.8
Land and buildings	773.1	777.0	815.5	795.4	739.6	736.4	796.5	879.3
Plant and equipment	534.2	534.2	541.0	509.6	474.7	481.3	647.0	727.9
Intangible assets	192.6	218.4	223.8	234.8	317.2	351.9	1,123.1*	1,112.7*
Investment property	127.1	238.4	219.5	224.9	183.3	195.7	172.5	192.1
Deferred tax assets	249.6	264.5	292.0	315.0	279.1	343.6	303.7	333.2
Other non current	231.6	232.7	242.1	237.8	235.4	246.2	116.1	119.0
Total non current	4,194.7	4,169.6	3,100.2	2,785.7	2,808.8	2,639.8	3,161.6	3,413.8
Total assets	5,490.5	5,477.0	4,208.9	3,848.4	4,132.3	4,175.8	4,401.5	4,651.2

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14. *Includes goodwill acquired through acquisitions of AUX investments (Startrack), SecurePay and Messenger Post.

Liabilities

A summary of Australia Post liabilities is set out in Table 14. The major categories of current liabilities are trade creditors and provisions, particularly for annual and long service leave. Non-current liabilities reflect short-term securities, provisions and deferred tax.

TABLE 14 AUSTRALIA POST. LIABILITIES (YEARS ENDED JUNE) \$M

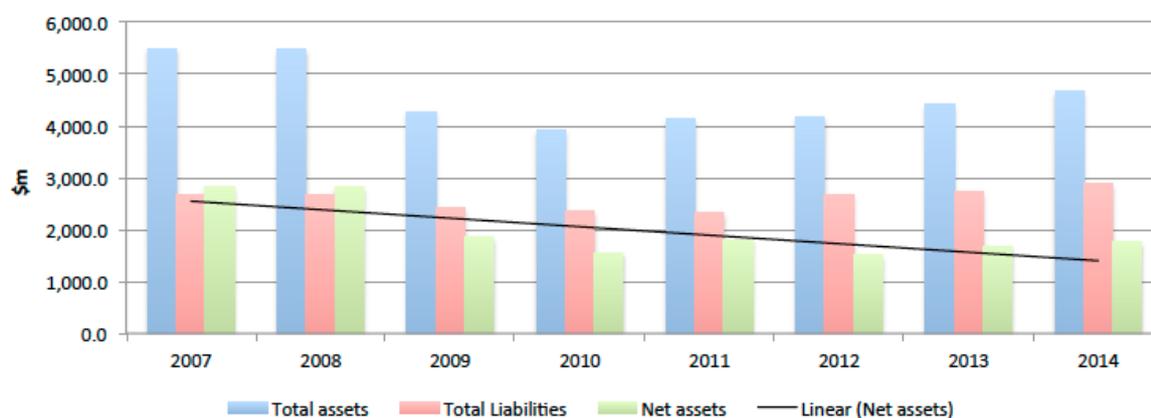
	2007	2008	2009	2010	2011	2012	2013	2014
Current liabilities	1340.6	1673.4	1405.4	1439.1	1595.2	1454.7	1935.4	1670.0
Non current liabilities								
Interest bearing liabilities	530.4	229.5	560.6	558.4	323.6	617.5	290.5	713.9
Provisions	165.5	167.2	170.2	167.6	164.8	188.9	232.9	231.0
Net superannuation liability	-	-	-	-	-	233.9	1.6	-
Deferred tax	635.2	586.9	227.5	171.1	224.5	147.0	228.0	225.3
Other	6.4	10.1	11.4	19.9	23.1	27.8	31.1	48.3
Total non current	1337.5	993.7	1019.7	917.0	736.0	1215.1	784.1	1218.5
Total liabilities	2,678.1	2,667.1	2,425.1	2,356.1	2,331.2	2,669.8	2,719.5	2,888.5

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

Net assets

The Australia Post Annual Report 2013-14 indicates a net asset position of \$1.76 billion. The position has deteriorated from a peak position of \$1.85 billion in 2008-09. The movement in net assets is illustrated in Figure 8.

FIGURE 8: AUSTRALIA POST. NET ASSET POSITION 2007-2014



The overall trend, depicted in Figure 8, indicates a deteriorating net asset position.

3.4.3 Cash flows

Australia Post has been able to generate substantial cash flows from its businesses. Investments in the business have been financed almost entirely from cash flows. Cash flow information is provided in Table 15.

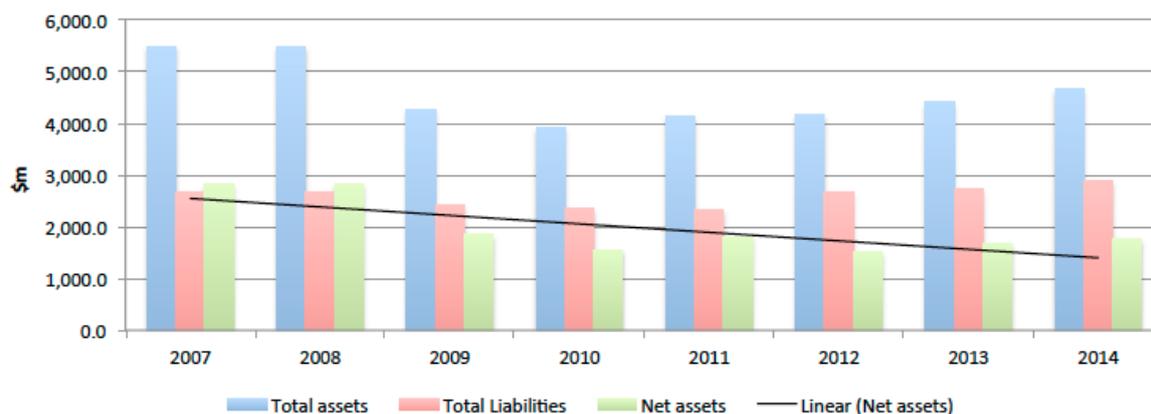
TABLE 15 AUSTRALIA POST. CASH FLOWS (YEARS ENDED JUNE) \$M

	2007	2008	2009	2010	2011	2012	2013	2014
Operating cash received	5,093.6	5,244.8	5,336.7	5,378.9	5,549.4	5,597.4	6,330.4	6,895.3
Cash used								
Employees	1,978.0	2,020.7	2,101.4	2,315.3	2,361.3	2,361.3	2,566.5	2,746.0
Suppliers	2,078.1	2,258.7	2,411.1	2,343.9	2,372.2	2,372.2	2,993.4	3,335.8
Financing costs	32.3	36.6	39.1	32.5	34.9	34.9	33.7	41.3
Income tax	125.3	186.0	142.4	54.1	-1.4	46.6	51.3	59.7
GST	208.2	215.6	208.4	225.7	230.2	230.2	236.0	250.8
Total cash used	4,421.9	4,717.6	4,902.4	4,971.5	4,997.2	5,046.2	5,880.9	6,433.6
Net cash flows from operations	671.7	527.2	434.3	370.9	407.4	551.2	449.5	461.7
Net cash flows from investing	-268.8	-275.7	-234.7	-205.3	-222.1	-233.9	-703.5	-278.7
Net cash used by financing activities	-279.4	-306.3	-402.8	-171.9	-83.8	-143.9	-228.7	-57.3
Net increase/decrease in cash/cash equivalents	123.5	-54.8	507.0	500.7	101.5	173.4	-482.7	125.7

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

The Corporation has had positive cash flows for all years between 2007 and 2014, except in 2013, where an above average allocation of cash was made into investment. Table 9 also points to a decline in the level of income tax paid to the Commonwealth – from a peak of \$186.0m in 2007-08 to \$46.56m in 2011-12. Trends in the use of cash are indicated in Figure 9.

FIGURE 9: AUSTRALIA POST. USE OF CASH



3.4.4 Equity position

The Commonwealth has a contributed equity (shareholding) in Australia Post of \$400m. The other major component of equity is reserves and retained profits. In 2007 reserves stood at \$4.6m and retained profits stood at \$2.41 billion. At 30 June 2014, reserves were recorded in the balance sheet at \$7.7m and retained profits at \$1.36 billion. Changes in the equity position are provided in Table 16.

Since 2007, the value of the Commonwealth's interest in Australia Post has fallen by \$1.05 billion - from \$2.81 billion to \$1.76 billion. It has, however received \$1.84 billion in dividends over the period, in addition to \$694.0m in income tax (see Table 15).

TABLE 16 AUSTRALIA POST. CHANGES TO EQUITY POSITION (YEARS ENDED JUNE) \$M

	2007	2008	2009	2010	2011	2012	2013	2014
Comprehensive income								
Profit	400.6	432.1	260.5	89.5	241.2	281.2	177.4	116.2
Other	303.6	-128.3	-1,127.2	-288.6	116.0	-543.0	347.0	152.7
Tax on comprehensive income	n/a	n/a	338.2	86.4	-34.5	162.8	-104.1	-45.7
Share of joint venture items	n/a	n/a	-10.2	-2.0	0.9	-7.8	-0.9	-0.2
Tax on share of joint venture items	n/a	n/a	3.1	-0.6	-0.3	2.8	0.3	-
Total comprehensive income	704.2	303.8	-535.6	-114.1	323.3	-104.0	419.7	223.0
Dividends paid	-279.4	-306.3	-427.8	-171.9	-78.5	-193.9	-243.7	-142.3
Balance of equity at 30 June	2,812.4	2,809.9	1,845.1	1,559.1	1,803.9	1,506.0	1,682.0	1,762.7

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.



3.4.5 Commitments

The 2013-14 Annual Report records \$2.94 billion in net commitments, an increase from \$1.84 billion in 2006-07.

TABLE 17 AUSTRALIA POST. COMMITMENTS (YEARS ENDED JUNE) \$M

	2007	2008	2009	2010	2011	2012	2013	2014
Commitments receivable	6.0	5.8	335.1	355.6	331.0	358.2	415.4	406.2
Commitments payable								
Land and buildings	32.6	13.7	14.2	10.3	3.7	7.1	74.6	93.4
Plant and equipment	64.3	61.0	91.1	75.4	40.2	53.9	61.7	29.2
Operating leases	765.7	969.0	1,011.9	1,059.9	564.0	513.9	677.6	779.4
Other	988.2	1,065.1	1,247.10	1,526.20	1,613.2	1,880.4	2,712.7	2,440.8
Total commitments payable	1,850.8	2,108.8	2,364.3	2,671.8	2,221.1	2,455.3	3,526.6	3,342.8
Net commitments	1,844.8	2,103.0	2,029.2	2,316.2	1,890.1	2,097.1	3,111.2	2,936.6

Source: Australia Post, Annual Reports and Financial Statements, 2006-07 to 2013-14.

The majority of other commitments relate to the carriage and delivery of letters and parcels by contractors. Commitments are recognised for these items when it is considered likely that payments will occur.

3.4.6 Credit rating

In November 2014 Standard and Poors lowered the Australia Post credit rating to AA-. The Standard and Poors update noted that the challenges of the core mail business are increasing the financial risk of the organisation, but also acknowledged the strong performance of the parcel business and the benefit to the organisation of “its scale and unique integrated business-to-business and business to consumer parcel delivery offering to its commercial customers”.

3.5 STEPS TAKEN TO STEM THE LOSSES

Australia Post has sought to stem the losses in the letters business through a strategy that involves:

- Offering greater product choice in letters, including express, priority and regular service standards.
- Pricing to ensure that prices cover the costs of delivery.
- Operational changes, including centralisation of support services and automation.
- Building and growing ‘trusted services’ through retail outlets.
- Extending access to parcel and postal services in store and on-line.
- Developing a world class parcels business.
- Continuing to engage employees, customers and the community.

These strategies are discussed further in Section 6.

3.6 TOWARDS A SUSTAINABLE FUTURE

A sustainable future for Australia Post will require transformational strategies. These strategies must place Australia Post as a major player and in a critical position in the parcels and e-commerce value chain. Particularly important in this value chain are SMEs and start-ups. Value chain

positioning also means working effectively with multi-channel retailers.

Transformation of the Australia Post business will require significant investment, particularly in technology. But as profits fall, funds available for investment will be constrained. To address this problem, funds could be sought from borrowing and through joint venture partners.

Transformation will also require review of current community service obligations and removal of regulatory and other impediments that stand in the way of opportunities to grow and diversify with agility, flexibility, and responsiveness to market and commercial signals. It is understood that various interpretations of the APC Act have caused the shelving of a number of potential opportunities that are complementary to Australia Post’s core business.

This situation is in contrast to other international postal organisations, which have been able to grow substantial commercial operations in the areas of financial services and telcos, generating revenue and profit streams that have overtaken legacy businesses.

Australia Post has, however, been successful in growing a successful parcels business. Parcels revenue exceeded revenue from the letters business for the first time in 2012-13. Future growth requires the development of international capacity and capability that will, in turn, require strong in-country partnership relationships. It will also involve leveraging the substantial asset base in the retail network and in the well-established delivery systems.





4. The effectiveness & value of existing Community Service Obligations (CSOs)

The project brief required that a cost-benefit evaluation be undertaken of the effectiveness and value of existing CSOs, with a particular focus on the impact of possible changes to regional and rural parts of Australia.

4.1 BACKGROUND: THE CASE FOR CSOS

In 1989 Australia Post was one of the first Commonwealth government businesses to be corporatised. The most significant aspect of this reform was the provision of an independent board and a commercial charter, but with ongoing obligations to meet community service obligations.

In a submission to the National Competition Council review of the *Australian Postal Corporation Act* 1989 in 1997, the Commonwealth Treasury pointed out that postal policy in Australia and internationally has traditionally been based on the premise that an unregulated postal market would not provide a universal letter service. To address this 'market failure' a universal service obligation is imposed on postal operators as a condition for a monopoly in relation to letters services to enable it to generate sufficient revenues to cover the costs of supplying the universal service.

Treasury argued that the most significant policy issue in this case becomes the determination of the scope of the monopoly (i.e., the range of postal services 'reserved' to the monopolist) rather than whether there are alternatives to the monopoly provider model. Nonetheless, some countries (Sweden, and Finland, for example) have recently rejected this postal policy paradigm and completely deregulated their postal markets while maintaining

USOs on their public postal operators.

Back then Treasury saw strong merit in this alternative approach and considered that a key issue for the NCC review was to examine the way Australia Post's USO is currently defined and costed and then assess whether it can be preserved in the face of competition, either through Australia Post competing effectively (including through improving efficiencies) or by some funding arrangement (for example, a universal service fund) which 'insulates' the USO from competition.

Over the ensuing years Australia Post was generating sufficient revenues through the reserved letter service to cover the costs of its USOs referred to as Community Service Obligations. This situation ceased to exist in 2007-08, when Australia Post began to incur losses in its reserved letters service. From 2007-08 losses in the letters business were being offset by profits in the parcels business and the opportunities associated with ecommerce and delivery of packages ordered through on-line technologies.

The parcels business is continuing to grow, but is now constrained by a highly contested competitive environment and a blockage in the business take up of digital e-commerce, particularly among small businesses. Sustaining a position in the parcels business will require ongoing strategic investments and strategic initiatives.

Losses in the letters business have now reached the stage where in the second half of 2013-14 Australia Post made a loss on its overall business operations. Given that Australia Post has financed all of its growth through cash flows, this lack of earning capacity severely impedes the capacity to sustain the business over the medium to longer term.

The time is now opportune for a close look at the requirements for the present structure of CSOs, to look at alternatives in a digital environment, and to ensure that Australia Post is in a position to leverage its substantial asset base into a viable and sustainable business.

4.2 CURRENT CSO REQUIREMENTS UNDER THE POSTAL CORPORATION ACT

4.2.1 Requirements of the Australian Postal Corporation Act

Under the *Australian Postal Corporation Act* 1989 Australia Post is required to supply a letter service, available at a single uniform rate of postage, for carriage within Australia of standard letters. To offset this obligation, Australia Post has the exclusive right (monopoly) to carry letters within Australia, whether the letters originated within or outside Australia. These are known as *reserved services*.

Under the APC Act, a letter is defined as:

Any form of written communication that is directed to a particular person or address, and includes: any standard postal article; any envelope, packet, parcel, container or wrapper containing such a communication; and any unenclosed written communication that is directed to a particular person or address.

The value of this monopoly status in letters mail is being substantially diminished by the emergence of digital alternatives to letters mail.

There are a number of exceptions to the scope of reserved services, including the carriage of:

- A letter weighing more than 250 grams unless the letter consists of an envelope, packet, parcel, container or wrapper containing two or more separate letters.
- A letter within Australia for a charge or fee that is at least four times the rate of postage for the carriage within Australia of a standard postal article by ordinary post.
- A newspaper, magazine, book, catalogue or leaflet, whether or not directed to a particular person or address and whether or not enclosed in any sort of cover.
- A letter from an office of the individual or organisation to another office of that individual or organisation.
- A letter to an office of Australia Post where it is then lodged for delivery under a bulk interconnection service.
- A letter, in the course of a document exchange service.

All non-reserved services provided by Australia Post are open to competition.

Under the *Australian Postal Corporation Act* Australia Post is under a commercial obligation to perform its functions in a manner consistent with sound commercial practice. In application, this means setting prices that reflect the efficient costs of production and include profit margins reflecting a return commensurate with the risks.

In the light of the expected continuing decline in letter volumes Australia Post's ability to continue to meet its current CSOs and performance standards on an ongoing basis also requires prices to be set to recover efficient costs and include profit margins that reflect a return commensurate with the risks.

4.2.2 The scope of existing CSOs

The Community Service Obligations, defined in Section 27 of the *Australian Postal Corporation Act*, require Australia Post to supply a letter service that:

- Carries reserved service mail.
- Carries mail between Australia and other countries.
- Carries standard postal articles anywhere within Australia for a *single uniform rate*.
- Ensures the letter service is *reasonably accessible* to all people in Australia on an equitable basis, wherever they reside or do business.
- Reasonably meets the social, industrial and commercial needs of the Australian community.

In addition to CSOs, Australia Post must also meet a range of specific performance standards.

4.2.3 Performance standards

Under Section 28C of the *Australian Postal Corporation Act*, regulations may be made to prescribe performance standards in relation to the frequency, speed or accuracy of delivery or in relation to availability and access to mail services. In 1998, *Australian Postal Corporation (Performance Standards) Regulations 1998* regulations were promulgated to prescribe the following minimum standards:

- Provide a daily weekday delivery service to 98 per cent of all delivery points in Australia and at least a twice-weekly delivery service to 99.7 per cent of all delivery points.
- Deliver 94 per cent of all reserved letters within the time specified in Australia Post's schedule of delivery times.
- Maintain at least 10,000 street posting boxes in addition to providing lodgement facilities at each of its retail outlets.
- Maintain at least 4,000 postal outlets of which at least 50 per cent of the total number or a minimum of 2,500 (whichever is the greater) must be located in rural or remote areas.

These standards reflect the outcome of the 1997 National Competition Council review of the *Australian Postal Corporation Act*. The Council was





specifically requested to provide advice on practical courses of action to improve competition, efficiency and consumer welfare in the postal services sector. The digital revolution across the services industry had not at that stage commenced.

The Council had concluded that there was no effective alternative means of providing those social benefits (Fahour, 2014). This was, of course, well before the widespread adoption and application of digital technologies, particularly in relation to digital alternatives to letters mail. There has not, however, been a full-scale competition review of

the Australian Postal Corporation Act. Competition issues have arisen in ACCC examination of Australia Post requests for increases in the standard letter rate.

The Australian National Audit Office is required to report annually to the Minister on the extent to which Australia Post has complied with these regulations. These are included in the Annual Report (Australia Post, 2014b). The results for 2012-13 are set out in Table 18.

Quite clearly Australia Post is exceeding performance standards in all areas of requirement.

TABLE 18 AUSTRALIA POST. PERFORMANCE STANDARD

REQUIREMENT	2013-14 RESULT
98% of delivery points to receive deliveries five days/week	98.8%
99.7% of delivery points to receive deliveries no less than twice/week	99.9%
94% of reserved letters delivered on time	94.5%
10 000 street posting boxes	15, 805
4 000 postal outlets (2500 in rural or remote areas)	4,417 (2,560 in rural and remote areas)

4.2.4. Regulatory oversight

Australia Post's 'ordinary' letter services have been declared by the Minister (Treasurer) to be 'notified services' and Australia Post to be a 'declared person' in relation to those notified services under the provisions of the *Competition and Consumer Act*.

Before increasing the prices of 'ordinary' letters (the basic postal rate, or BPR), Australia Post must provide the ACCC with a 'locality notice'. The ACCC will then assess the proposed increases and decide whether to object or not object to the proposed charges. It may invite submissions from interested or affected parties, but must respond within 21 days.

The ACCC customarily adopts a cost-based approach to assessing prices notifications. The appropriateness of proposed prices is considered by assessing the extent to which they are forecast to recover efficient costs, including an appropriate rate of return.

Australia Post has sought increases in the basic postage rate on only five occasions: 1992: 2003, 2008, 2010, and 2014. Whilst the CPI has increased by more 70 per cent over the period, the basic

postage rate has increased by only 56 per cent.

Australia Post must also notify the Minister for Communications of its intention to increase the BPR, and the Minister has the power, under the Australian Postal Corporate Act, to disapprove any such increase.

4.3 THE COSTS OF CSOS

Australia Post provides information in its *Annual Report* and accompanying Financial Statements about the cost of CSOs. Costs reached an estimated \$203.5m in 2013-14.

CSO costs are calculated on an avoidable cost methodology. This involves an estimation of costs that would *not* be incurred if CSOs had not been provided. Avoidable costs generally refer to *variable* costs that can be avoided (unlike most fixed costs, which are typically unavoidable). It is accepted practice in GBEs that whilst avoidable costs are often viewed as negative costs, they may be necessary to achieve certain public policy goals or thresholds.

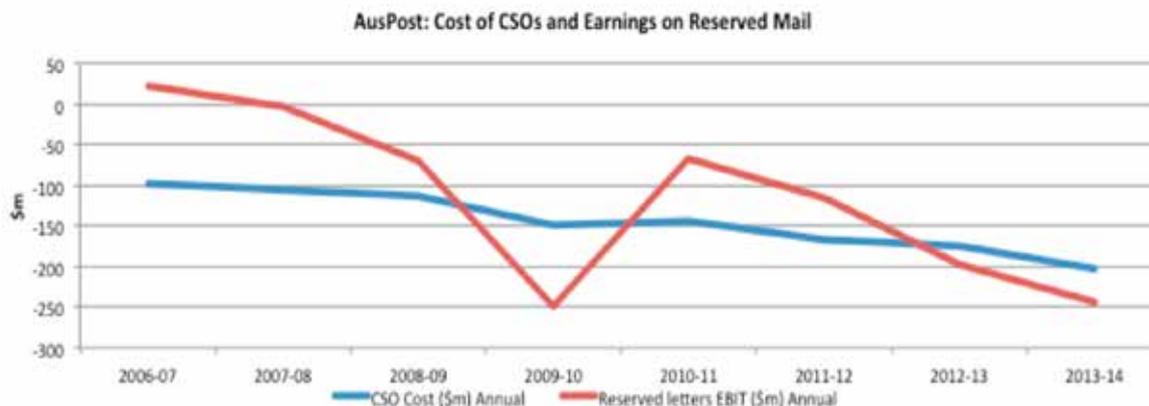
Information on estimated and audited cost of CSOs and the financial performance of the reserved letters business is provided in Table 19.

TABLE 19 AUSTRALIA POST. ESTIMATED COST OF CSO OBLIGATIONS AND FINANCIAL PERFORMANCE OF THE RESERVED LETTERS BUSINESS

	CSO COST (\$M)	RESERVED LETTERS EBIT (\$M)	RESERVED LETTERS VOLUME	
Year	Annual	Annual	Millions	Decline (%)
2006-07	97.3	24.0	4,172.9	..
2007-08 (peak)	104.3	-1.7	4,260.7	+2.1
2008-09	113.8	-69.2	4,094.3	-3.9
2009-10	147.7	-250.1	3,876.6	-5.3
2010-11	144.7	-66.5	3,738.8	-3.6
2011-12	165.9	-114.4	3,545.3	-5.2
2012-13	173.9	-198.0	3,305.7	-6.8
2013-14	203.5	-242.6	3,173.5	-4.0

Source: Australia Post, Australia Post and Community Service Obligations (CSOs), Annual Reports.

FIGURE 10: AUSTRALIA POST. COST OF CSOS AND EARNINGS ON RESERVED MAIL



As indicated earlier in this report, Australia Post mail volumes peaked in 2007-08. This was also the year the reserved letters business entered into a loss making situation – a position from which it has not recovered. The decline in earnings loss was stemmed, to some extent, in 2010-11 with the impact of the Future Ready Program. Future Ready is estimated by Australia Post to have delivered \$1.1 billion in business benefits. This is apparent in Figure 10.

Contrary to the policy objective that the cost of CSOs could be met from earnings in the monopoly letters business, the information in Table 19 and Figure 10 clearly indicates that earnings on the reserved letters business do not offset the costs of the CSOs, and have not done so for seven years. The gap between earnings and CSO costs has progressively widened since 2010-11.

While there has been an overall decline in letters volume, the reserved letters volume has declined from 75.6 per cent of the total letters volume in 2009-10 to 73.0 per cent in 2013-2014. Volumes are expected to decline further at an average rate of between eight and eleven per cent over the period to 2020 (Boston Consulting Group, 2014). Volumes in the direct mail category are holding up quite well, particularly as marketing techniques become more sophisticated and targeted. For many businesses, direct mail is an important element in the marketing mix.

Somewhat ironically, several years ago there was a concern that Australia Post was cross subsidising its non-reserved business from reserved operations. From 2004-05 the ACCC was required to examine Australia Post's accounts to check for elements of cross subsidy. In the assessment for 2006-07 the ACCC reported:

Revenue from Australia Post's non-reserved services is greater than the fully distributed costs and is also greater than the upper bound of the stand-alone cost of providing the non-reserved services, even when taking a conservative approach. This means that the non-reserved services (as a whole) do not receive a subsidy; rather they appear to be a possible source of subsidy (ACCC, 2007).

In 2007-08 the position was reached where Australia Post was no longer in a position to cross subsidise loss-making responsibilities in its reserved letters business from profit making activities in that category. Australia Post is now in a position where it must cross subsidise not only CSOs but all reserved services operations from other parts of the business.

4.4 THE VALUE OF CSOS

Value can have different meanings in different contexts. It is important therefore that there is some clarity about value in relation to the existing framework of CSOs. Value also has different meanings in economics and public finance.

In economics the value of a service is determined by people's preferences and the trade-offs they choose to make given the resources and the alternatives available, or the value the market places on an item. There are two dimensions to this: economic value is represented by the maximum amount a consumer is willing to pay for an item in a free market economy; *market value* represents the minimum amount a consumer will pay. Economic value thus often exceeds market value.

In messaging and communication through letters mail, value must be considered in terms of preferences relating to the sender, the *receiver*, and the *channel provider*. It is a fundamental principle that *communication has not been achieved unless a message has been delivered, understood and acted upon* (Drucker, 1994). Posting a standard letter, even to a 'correct' address does not assure it will be received. Thus, value to a sender must be reciprocated in terms of value to a receiver.

In public finance, the following dimensions usually encompass consideration of value for money:

- Economy – which relates to the prudential use of resources, having regard to availability and scarcity, and the avoidance of waste and misallocation.
- Efficiency – which relates to considerations of unit cost, cycle time and productivity (cost in relation to output).
- Effectiveness – which relates to considerations of overall cost in relation to outcomes and results, quality (whether services meet needs without faults or defects), and overall customer satisfaction.

Value for money considerations have assumed greater importance in both management and policy terms as the cost of CSOs is no longer

funded within the reserved mail monopoly but involves a direct impost of \$203.5m on other parts of the Australia Post business. That cross-subsidy redirects revenues from pursuing strategic investment opportunities or, perhaps more significantly, reducing the amount that Australia Post would pay to the shareholder (the Commonwealth Government) in dividends.

From a public policy point of view the value and effectiveness of CSOs concerns the extent to which taxpayers would be prepared to support an annual payment from the budget of \$200m, or more, to support the current Australia Post CSO requirements.

4.4.1. Value to senders

In financial terms, the value of CSOs accrues predominantly to senders in that senders do not pay the full cost of sending letters mail items. The benefit is reflected in an estimated loss of \$242.6m in the reserved letters business in 2013-14 (see Table 19). The letters business became loss making in 2007-08. Since that time the cross subsidy to senders from other parts of the Australia Post business has approached \$1 billion.

Segments

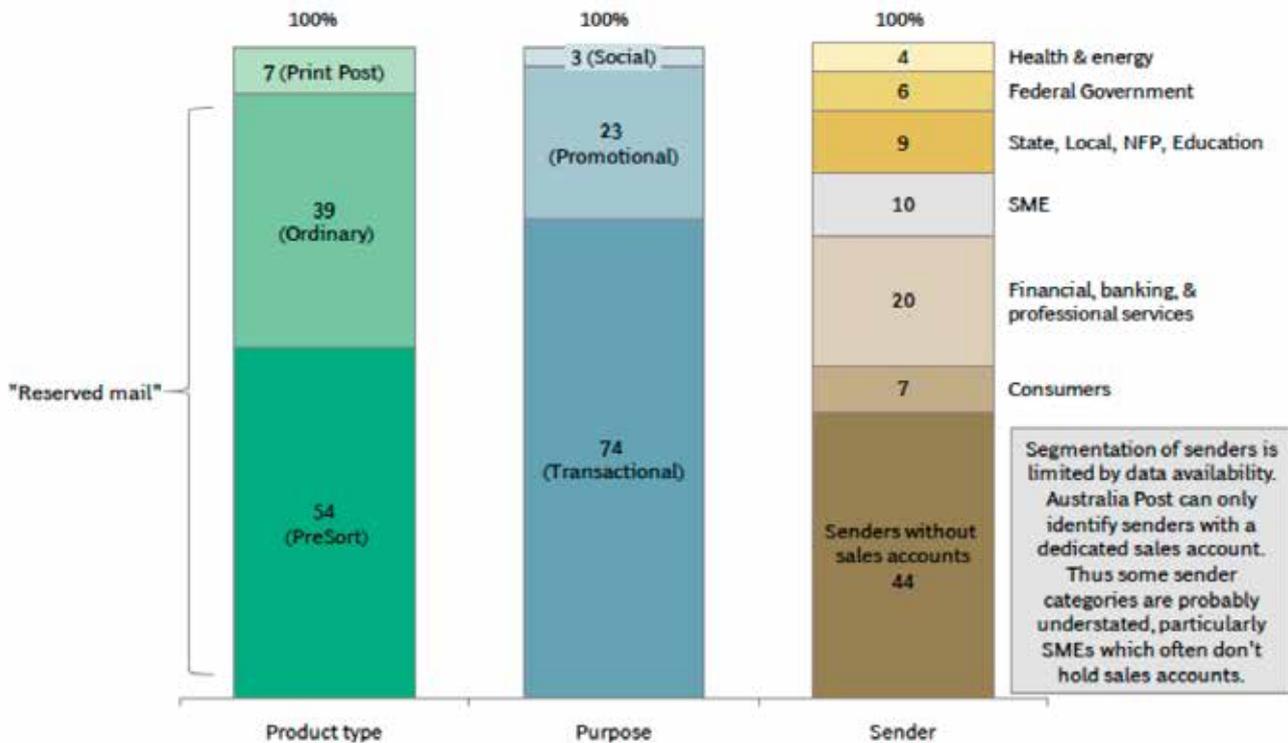
Australia Post has segmented sender categories into consumers, financial, banking and professional services, SME, government, and 'health and energy'. These sender categories are identified in Figure 11. Although SMEs are only identified as comprising 20 per cent of senders, Australia Post is of the view that this proportion is probably understated, as not all SMEs would hold a dedicated sales account.





Figure 11 also identifies the addressed letter product type and the purpose. Almost three quarters is considered to be of a transactional nature and just under a quarter is promotional material. Three per cent is categorised as 'social' mail.

FIGURE 11: THE AUSTRALIA POST ADDRESSED LETTER MAILBAG



Note: Data refers to 2012/13.
 Source: All data sourced from Australia Post, with the exception of the share of mail sent by consumers, which is a BCG estimate.

Source: The Boston Consulting Group 2014. Australian and International; Postal Services Overview: Background Report, Sydney, The Boston Consulting Group.

In the European Union, it is estimated that 85 per cent of total letters are sent by businesses. About 60 per cent is correspondence (transactional), 30 per cent direct mail, and more than 10 per cent is publications. More than 60 per cent of business mail is sent to individuals, and in some countries it is 80 per cent. Business to consumer mail is dominated by industrially produced transactional mail (bank statements, invoices, etc.) and direct mail (Copenhagen Institute for Futures Studies, 2012).

Even with the benefit of a subsidy, letters mail is still seen as expensive compared with the digital alternatives that have become progressively available with technological innovations. Cost reduction strategies within business environments are encouraging corporations to look for alternatives to letters mail.

In Australia it is expected that businesses will increasingly shift to digital mail for correspondence and transactional mail, but so far they have been slow to adopt, particularly among small to medium businesses. The shift is likely to accelerate with the availability of reliable high speed broadband through the NBN.

It has been found that the business community is generally unwilling to pay for a premium letters service; they are happy with a standard, longer delivery time option. Urgent mail messaging is already conveyed through Express Post, which also has a capacity for tracking. Receivers have indicated through surveys that they are not willing to pay for mail delivery.

For senders (and receivers with digital devices), digital mail is not only cheaper, it is also instantaneous – locally, nationally and globally – and is being increasingly preferred by business and government. At the same time, however, Australia Post surveys indicate that 52 per cent of Australians prefer to receive messages about government policy and legislative changes by letters mail (Skocic, 2013). Thirty-two per cent prefer to receive information from political parties in the lead up to an election by mail.

Private mail senders, whilst small in number, will continue to rely, to some extent on traditional mail services. Private senders have limited ability to pass on the cost of sending to others, such as

customers, in the case of businesses, or taxpayers, in the case of government. They also do not have access to lower pricing structures available for bulk mail senders. In some areas consumers may have limited alternatives to digital alternatives.

It is therefore important that the interests of consumers be secured as both senders and receivers of mail.

Innovation adoption and the pace of digital transformation

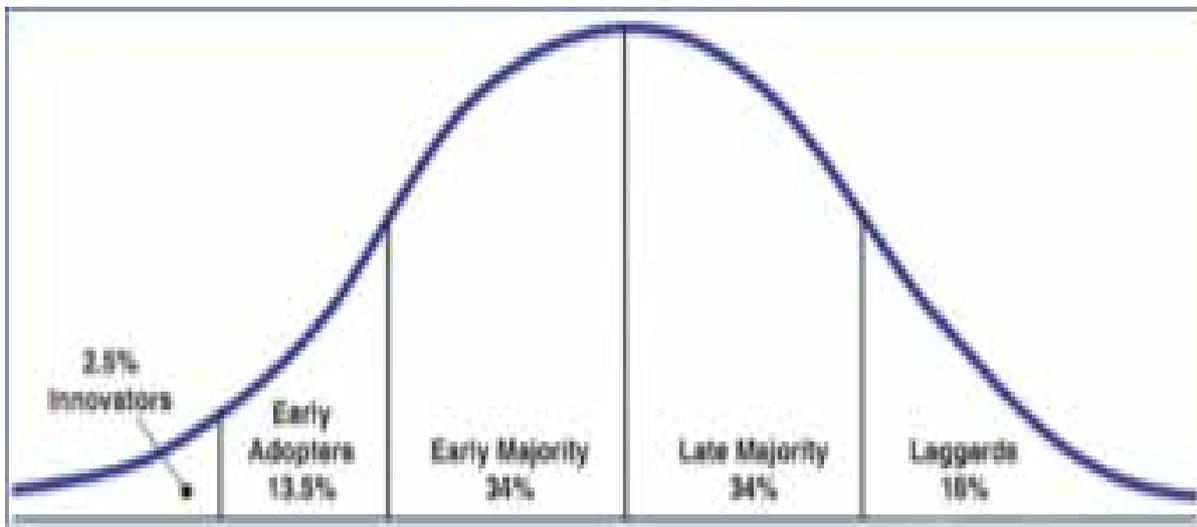
There is a view that Australian businesses are at the early stage of the Everett Rogers innovation diffusion adoption curve (Rogers, 2003). We are seeing the earlier adopters in countries such as Denmark which has high broadband penetration, but the rest of the world will follow when they become comfortable with the technologies and their application. It is not clear where Australia would be on the curve in relation to digital post. However, the Australia Post Managing Director has commented that:

Australia lags behind much of the developed world in the rate of letter volume decline – and the adoption of eGovernment and there is clearly a correlation between the two. As soon as a government starts communicating and transacting with citizens online then total letter volumes in that nation start to plummet.

At the top end of this scale are the Nordic countries, Denmark, Finland, and Norway. They all have superfast Broadband and they all have eGovernment adoption rates of roughly 80 per cent. As a result, total letter volumes in those nations have already halved from the peak as governments have transitioned to online communications with their citizens (Fahour, 2014).

The innovation adoption curve is usually represented as in Figure 12.

FIGURE 12: INNOVATION ADOPTION CURVE



Source: <http://inknowvations.com/does-the-innovation-adoption-curve-apply-to-innovation-process-adoption/>

There are certain mail items that are difficult to digitise due to legal, cultural or ethical requirements. This includes certain legal documentation where original signatures are required and voting material in political, corporate, and union elections, which are governed by statutory requirements. These legacy requirements are currently being considered.

Electronic voting has been adopted in the Australian Capital Territory.

Social mail

Consumer to consumer letters communication has, for the most part been largely replaced by electronic mail insofar as it concerns regular correspondence (Instagram, iMessages, WhatsApp, and Facebook), although emotional mail such as greeting cards and postcards has been slower to change and remains relatively stable (Copenhagen Institute for Futures Studies, 2012). Glossy, over-saturated post cards still seem to sell well in newsagencies and tourist shops.

Time sensitivity

Research indicates that many senders do not

require overnight mail delivery and would be comfortable to have mail delivered over a three-day timeframe. This option would reduce costs in Australia as a large proportion of inter capital city mail could be delivered by road rather than air. Overnight delivery is not available to senders in rural and remote areas.

There is a view that senders requiring overnight delivery should pay a premium. This is currently the case for Australia Post Express delivery, where the charge is three to four times the standard letter price. Many senders also use this service due to tracking capability.

The changing direct mail market

The direct mail market is changing, and is likely to remain a strong sector for postal corporations over the next decade. Direct mail is improving in format and presentation due to printing technologies and ability to write copy. There are new forms of analogue-digital advertising, and perhaps more significantly, direct mail can get around digital (spam) filters.

Direct mail has greater ability to communicate directly with consumers through targeted mailings that make use of increasingly sophisticated databases to conduct lower volume targeted mailings or higher quality mass mailings that are less costly to produce and distribute.

With the telephone service being the subject of increasing levels of spam calling by telemarketers, many businesses prefer to have uninvited solicitations delivered by letters mail.

Direct mail can also satisfy needs to “relax and unwind” (reading glossy catalogues, for example) and stay in touch with what’s happening in particular fields of interest. Innovations such as augmented reality, interaction with tablets and smart phones, and 3D rendering are being applied in the direct mail business.

4.4.2 Value to receivers

Receivers engage in communication in multiple ways and they now have multiple choices in the way they receive messages. Therefore, the value of received or delivered mail over digital mail must now be considered in relation to the alternatives and other considerations of value.

Research undertaken by Australia Post indicates the letterbox as a channel has greater potential when the message needs to stand out from the clutter (Skocic, 2013). The survey findings indicated:

- The average Australian receives 8.2 items of mail addressed to them personally each week and 11.1 unaddressed items.
- Households read 72 per cent of addressed mail they receive. For banks and financial institutions, readership is 91 per cent.
- Mail only is the most preferred channel from utility senders (43 per cent), supermarkets (42 per cent), government (40 per cent) and banks (40 per cent).
- Email is preferred for newsletters and invitations when the message is brief, suggesting that

email only holds attention for a short time.

- is the preferred channel for receiving advertising and promotional messages when the receiver is an existing customer.

The Boston Consulting Group reported that the current model of service delivery exceeds the demand of most customers, suggesting that two thirds of people rely on their mail only one or two days a week. BCG analysis of a 2014 survey of 8,000 customers indicated that half of respondents were prepared to accept a move to three day a week delivery.

Only five per cent of customers indicated that they would be prepared to pay an annual charge (of \$25) to retain current standards. It is the case, however, that a substantial proportion of businesses already pay to have letters mail delivered to a Post Office Box or a post bag held at a mail distribution centre.

There are some continuing advantages with letters mail for the receiver: it is more difficult to ignore or ‘lose’ than electronic formats and there are many receivers who still prefer to read documents in physical formats. There is a view that either senders or receivers will increasingly have to pay for the service (Copenhagen Institute for Futures Studies, 2012). In some countries, receivers are being offered a choice whether they want to continue receiving physical mail. Postal organisations are providing an intermediary role and delivering digital mail items as letters.

Thus, a significant proportion of the population will continue to need and want physical mail services – those who prefer reading print formats as well as those who have limited access to digital facilities, who are elderly (and suffering from degenerative diseases), or are disabled, non English speaking, and some people in rural and remote areas where the mail service itself provides contact with the external environment.

While there is a strong case to retain the requirement to deliver mail to every delivery address, the question moving forward will be the



extent to which receivers require a delivery service at the currently defined performance standards. This issue relates to the speed of delivery, rather than the intensity of delivery. Slowing down both the speed of delivery together with the intensity of delivery may impose unacceptable delays for mail receivers in rural and remote areas of Australia.

4.4.3 Value to channel providers

Australia Post relies on message delivery through its own corporately owned Post Offices and delivery staff and a network of Licensed Post Offices (LPOs). LPOs are small business operators with an unlimited license term and income derived from Australia Post for mail services provided.

LPOs are an essential element in meeting the CSO requirement that the postal service is reasonably accessible to all Australians wherever they reside. To do this it is critical that LPOs can replace declining

products and services, such as basic account payments, with trusted services such as licenses and potentially representing Centrelink and Medicare.

Australia Post has supported the LPO network through a number of initiatives amounting to an annual payment of \$338m, although LPOs claim that this has been insufficient. In September 2014 Australia Post announced that it would introduce a series of initiatives that in total will contribute an additional \$40 million to the viability of LPOs (see Section 2.4.5 above). This is in addition to the fact that the Government is not in the mood to pay subsidies for failing businesses (Australia. Department of Industry, 2014).

There is, at the same time, pressure to expand the network in response to demographic change. New suburbs require basic community services, which includes a Post Office. However greenfield developments offer opportunities for innovation in service delivery LPOs are also particularly important



for SMEs engaged in online merchandising. Whilst they receive orders electronically, they rely on LPOs to despatch parcels. If LPOs did not exist, many small online e-tailers would not be viable in remote locations.

The introduction of 24/7 parcel lockers and Saturday trading, extension of parcel and Express Post delivery also support the viability of Australia Post's retail network (Turnbull, 2014).

4.4.4 Other dimensions of value

Value to shareholders and taxpayers

Australia Post is a Government Business Enterprise (GBE), wholly owned by the Australia Government. The Ministers for Communication and Finance are the nominated shareholders.

Australia Post is required to deliver a commercial return and meet corporate income tax obligations, which in turn, delivers value to both shareholders and taxpayers.

Over the last eight years Australia Post has delivered a significant dividend flow and income tax revenues. However, those flows are now drying up as the profitability of the business declines. It is understood that Australia Post will not declare a dividend in 2015.

Value to employees

Australia Post employs 32,500 people who rely on wages and salaries to finance their expenditure on goods and services and support their families. Australia Post is a highly regarded employer, known to give priority to the well being of staff and culturally diverse groups. Many employees have worked with Australia Post for their whole career.

Value to the community

The community sees value in having a Post Office as a community resource. As indicated earlier, a Post Office is often a beacon for government presence and representation of democratic institutions in rural and remote communities.

4.5 EFFECTIVENESS

Effectiveness is an important dimension of ‘value for money’. The other dimensions are economy and efficiency. Effectiveness involves considerations of cost (cost effectiveness), quality, and customer satisfaction.

4.5.1 Cost effectiveness

The key considerations in cost effectiveness concern the extent to which the resources allocated could achieve greater impact, or alternatively, whether the same impact could be achieved with fewer resources or other and cheaper strategies.

Cost to Australia Post

Australia Post incurs significant costs in meeting CSO obligations and they are becoming an increasing proportion of postal corporation revenues. Australia Post has pursued price increases for some of its services to offset the cost of CSOs and to better reflect the cost of providing this universal service.

The operating environment tends to make existing CSOs less cost effective in doing what they were set up to do and achieve. It is likely that Australia Post could achieve similar outcomes to those currently being achieved through alternative strategies and at lower cost.

Cost to senders

Australia Post mail costs in relation to outcomes are seen as high in comparison to digital alternatives. Senders are responding to this situation by switching to digital options.

Costs in the competitive parcels space reflect prices determined through competitive pressures. Senders may expect a superior outcome in relation to cost when looking at competitor offerings.

Cost to receivers

At the moment, receivers incur no cost to receiving mail delivered to a street address. This differs from other forms of messaging where receivers generally need to invest in devices such as computers, tablets, smart phones, broadband and wireless

connections in order to receive messages.

Receivers do pay to receive mail if delivered to a Post Office Box, or have mail diverted from one address to another.

Research by Australia Post indicates that receivers would be not prepared to pay, or contribute to the cost of mail delivery services.

Cost to LPOs

LPOs have been doing it tough as letter volumes and traffic through Post Offices declines as people not only send fewer letters but also pay their bills online. Australia Post has responded by increasing annual payments to LPOs. Increasing postage rates is also helpful.

Australia Post wants to keep Post Offices open to meet its community service obligations and build its parcels business and trusted adviser services portfolio. It does not want LPOs to close. The failure rate among LPOs is much lower than for other small businesses.

4.5.2 Service quality and satisfaction

Surveys and internal metrics point to high levels of service quality. Key quality indicators of timeliness and lost mail rate highly on performance scales

Surveys report high levels of satisfaction among both senders and receivers.

4.6 OTHER ASPECTS OF VALUE

4.6.1 Appropriateness

There are questions of the appropriateness of the current regime of CSOs given the alternatives available. Many customers cannot receive mail communication digitally due to limited availability of technology, and the ‘digital divide’.

It follows that the objectives that surround CSOs could be more appropriately achieved through enhancing access to digital services. This includes not only physical access, but also financial access as the cost of digital mail is largely borne by the receiver whereas the cost of letters mail is born by the sender and the channel provider (Australia Post).

4.6.2 Relevance

Some may argue that existing CSOs have limited relevance in the overall communication mix. This is indicated by the decline in addressed mail volumes over the last five years.

Governments and financial services firms are turning to digital delivery, and some charge additional fees for paper copies to be sent. But there are some areas where addressed mail will continue

4.7 THE FUTURE OF CSOS

The CSO that Australia Post is required to administer is declining in value to both senders and receivers as they switch to digital alternatives. Limited access to digital services is not a case for the preservation of letters mail: it is a case for assistance and support to provide better access to the digital services that are replacing letters mail.

Many see a future where letters do not exist at all. With capability for messaging through digital channels, it is most unlikely that a postal service would have been invented, or at least in its present institutional form.

Australia, like many other countries, has a postal service built around sending and receiving letters mail which is being confronted with rapidly declining mail volumes and an associated rapid decline in financial viability.

There are some legacy requirements, currently covered in a range of statutes that necessitate written message notification by governments, incorporated entities, unions or charities. Many do not envision a digital alternative. But a range of innovative digital alternatives to official forms of communication is now emerging. Both government and business are actively exploring these.

Government cannot rescue the postal services situation by mandating, through a community service obligation that business organisations or government agencies must continue to communicate with their customers, clients or stakeholders/shareholders through letters,

particularly where the cost of the digital alternative is significantly lower.

According to some observers, both senders and receivers have taken a decision that letters are no longer a priority form of communication. The number of letters per delivery point has fallen from 1.7 in 2008, to 1.2 in 2014 and is expected to be less than 0.5 per delivery point in 2020. The price of the standard letter, universally applied across Australia is \$0.70, well below the cost of delivery.

There is a clear relationship between the decline in mail volumes and the need to increase prices to cover the higher unit costs of declining service utilisation. The alternative would be an ever-expanding government subsidy, as is the case in the USA with the USPS. Potentially, costs can also be reduced by offering differing service levels with longer delivery times, as is already occurring with Australia Post with some categories of business mail.

Retaining present performance standards for letters delivery will inevitably stifle innovation and prevent Australia Post from exploiting messaging opportunities in a competitive market by having to retain a commitment of scarce resources to a high cost service option. These innovation opportunities include leveraging the Corporation's substantial assets in the retail network, its brand, technology, its people and synergies with the parcels business. If, as some have pronounced, the letters business is dead, the parcels business is alive and kicking vigorously. Some have argued that the letters business will survive in the "tail wind" of the parcels business.

Whilst the Internet is expected to continue the trend decline in the letters business, it has enabled a boom in e-commerce, and particularly in on-line shopping, which has in turn created a massive demand for parcels delivery. Up until quite recently, the parcels business has grown on the back of the letters business. The situation is now in reverse trend where letters delivery can be an enhancement to the scope of parcels delivery services.

The letters business continues to have some

viability in the direct mail business. Direct mail is being used by businesses to target particular message receivers, on the basis of data and analytics, but it is generally part of a larger business marketing strategy.

The pace of change in the letters business is, however, difficult to foreshadow: notwithstanding the 25 per cent decline in letters volumes since 2007-08, Australia Post still carried 3.4 billion letters in 2013-14. But with higher levels of innovation adoption in digital communication by government, business and consumers, many see acceleration in the rate at which both senders and receivers switch to digital mail options.

4.8 CONCLUDING COMMENT: SECURING ESSENTIAL MAIL

A range of digital alternatives is substituting for letters mail. Digital mail is accessible irrespective of location. The cost effectiveness of current CSOs has diminished due to alternatives to letters mail.

Regulatory frameworks can be established to ensure that providers continue to provide what are considered, in public policy terms, to be appropriate and relevant universal service obligation that meets community expectations. CSOs and universal service obligations must be looked at in terms of the extent to which they are achieving the results intended, and whether there are other more 'cost effective' ways of doing this.

The capacity to receive and respond to written communication from government, business and the broader community is an important institution for an informed and participative democracy. It is a well-accepted principle that communication has not occurred until messages are received, understood and acted upon. It is the "receiver" who communicates. In a modern society, it is not acceptable for people to be excluded from the means of communication.

It is therefore important that people in the community who cannot, for various reasons, have access to digital communication are in a position to communicate through traditional channels until their essential communication needs are secured.



5. The potential to expand & strengthen the Australia Post business model

The project brief required an examination of existing and potential proposals to expand and strengthen the Australia Post business model. This Section looks at the current Australia Post business model and makes reference to developments and initiatives occurring in other postal organisations that may have relevance to the Australian situation and circumstances.

The Australia Post business model, as defined in the Corporation's financial statements, is built around three separate, but interrelated segments:

1. Mail. The collection, processing and distribution of mail items, digital communications and associated services.
2. Retail. Provision of postal products and services, agency services, mail boxes and bags, financial services and other retail merchandise, principally philatelic, stationery, telephony, greeting cards, gifts and souvenirs.
3. Parcel Services. The processing and distribution of parcel and express products along with freight forwarding operations.

In the 2013-14 Annual Report Australia Post advises that it is *evolving and strengthening* its business in four areas:

- Building world-class delivery, supply chain and ecommerce solutions for businesses.
- Developing the post office and digital services to support the everyday essentials of citizens and small business owners, including a special focus on rural and regional communities.
- Enabling governments and corporations to connect with their customers online as well as through our postal network.

- Helping our people and partners be safe and supported so that they can have fulfilling jobs and businesses that serve our customers well.

These initiatives have application across all business segments.

As outlined in previous sections, the mail business is currently a dead weight financial burden on the overall financial performance of Australia Post. Much of this stems from the decline in mail volumes and the need to work within the current regime of community service obligations and performance standards.

In addition to proposals to minimise losses in the mail business, there are also many proposals to expand and strengthen the retail and parcels businesses. These proposals are in many respects interconnected with the mail business.

5.1 MAIL: TRANSFORMING FROM THE PHYSICAL TO THE DIGITAL

Current proposals to minimise losses in the mail business can be grouped into three broad categories:

- Pricing.
- Service.
- Operations.

These proposals centre on increasing revenue, reducing costs, or increasing productivity. They will have impacts on both mail senders and receivers. They are reflected in a number of initiatives already announced by Australia Post. Each will be examined in turn, followed by other initiatives that may be adopted to build the mail business from the existing platform.

5.1.1 Pricing

Under current arrangements, the Australia Post Board sets the price of a standard letter. Australia Post notifies the ACCC, which in turn undertakes an analysis of the case for adjustment. The price of a standard letter is currently \$0.70 for a letter weighing up to 250g.

In November 2013 Australia Post argued in its submission to the Senate Inquiry into Licensed Post Offices that there was a \$0.20 gap between postage price movements and the CPI movements between 1992 and 2012. In March 2014 Australia Post increased the price of a standard letter by \$0.10, following a review by the ACCC. The Minister for Communications did not object to the increase.

The 10-cent increase has enabled Australia Post to partially offset the growing losses in its letters business. At \$0.70 the Australian domestic stamp price is still among one of the lowest in the OECD. At the same time, Australia Post introduced a concession rate stamp to maintain \$0.60 postage available for 5.7 million eligible Australians, who register with Australia Post, until 2017. It is understood that one million people have taken up the offer.

Mail utilisation information suggests that changes in the pricing of mail to recover Australia Post losses will impact more on costs to business and government rather than consumers. Without information on price elasticity it is not easy to discern what impact changes in price will have in accelerating the decline in letter volumes if businesses use price signals to shift their mail requirements to digital alternatives.

In its assessment of Australia Post applications for price increases on standard letters the ACCC

undertakes extensive modelling of the impact on the business. In its 2014 decision the ACCC reported that after the price increase, Australia Post would still need to reduce operating costs by around 15 per cent between 2012-13 and 2014-15 for domestic reserved mail services to break even (ACCC, 2014).

There is some resistance for greater pricing flexibility among mail houses, printers, trade unions and franchisees. They are calling for a new strategic blueprint and pricing oversight by the Australian Competition and Consumer Commission (Bajkowski, 2014). It is, of course, not the job of the ACCC to develop or redirect strategy, but it has an important role in securing transparency and accountability in those elements of the business that exhibit characteristics of monopoly behaviours.

The direct financial impact of price changes on letters mail receivers is limited as it is the sender, predominantly business or government, who pays for mail. However, some businesses are beginning to charge receivers for sending letters mail in place of the digital alternative. In the UK, Royal Mail is a partner in *Keep Me Posted* campaign, a coalition of 56 charities, trade unions and business groups that aim to protect the consumer's right to choose, without penalty, how they receive important financial information from competitors.

Internationally, the price of a standard letter, calculated at purchasing power parity, is \$0.73 in the USA, \$1.21 in Canada (for a single stamp only), \$0.80 in New Zealand, \$1.62 in the UK. In Denmark, where the decline in letters mail from peak volume (2001) has been most profound (54 per cent) the price is \$1.88. Australia Post must be allowed to increase the price of letters, particularly in business and government senders, to reflect overall movements in costs.

In the switch from letters mail to digital mail there is a financial impact on mail receivers: it is the receiver who bears the cost of the technology required to receive (as well as send) mail. This can generate disadvantage for people who for various reasons are not able to acquire the necessary technologies and knowledge necessary to receive digital mail.

5.1.2 Service

Mail service covers the elements of speed, frequency and collection points.

Delivery speed

Australia Post is keen to extend arrangements currently available to business that would provide all senders with the option of delivery times outside the times set out in the performance standards. Overnight delivery times between capital cities requires that mail be sent by air, which is expensive in terms of transport costs and overtime and night time penalty rates paid to Australia Post staff.

If the performance standards were amended to allow Australia Post to offer a slower service (i.e. D+2 or D+3) then it would be able to undertake a higher proportion of sorting and transport during normal business hours. It would also offer greater opportunity to combine mail delivery with parcels delivery. Australia Post understands that a high proportion of senders would opt for a D+3 option, particularly for transactional mail.

Delivery frequency

Reducing frequency of delivery is sometimes advocated as a way of reducing costs. It has been adopted in other countries, together with the introduction of community mail boxes. Such an initiative would see the introduction of a greater proportion of casual or part time delivery personnel, which is at odds with Australia Post's people strategies.

Reductions in delivery frequency, combined with reduced speed of delivery may give rise to unacceptable delays in receiving mail. Australia Post has indicated that there will continue to be a five-day-a-week delivery commitment.

Collection points

In 2013-14 Australia Post maintained 15,805 street posting boxes. This is well above (almost 60 per cent) the performance standard of 10,000. This growth has been driven by suburban expansion and population growth.

Whilst the cost of serving street posting boxes

may be high, they are a very significant brand recognition icon.

5.1.3 Operations

Australia Post has been looking at opportunities to streamline and innovate in its operating environment. These include centralisation of mail processing, automation of tasks, changes in the mode of mail delivery (vans, motorbikes), integrating mail and parcels deliveries and staffing arrangements, including opportunities to relocate to the growing parts of the business.

Australia Post is constrained in reducing costs due to the regulatory framework and CSO related performance standards. It is important that these be reviewed to align with community needs and requirements, having regard to the availability, practicality and feasibility of digital alternatives.

Most postal organisations, including Australia Post, have continued to develop new mailing products such as Drop & Go (in the UK) and Self-service Kiosks. In the UK, the branch network currently has over 230 Post & Go machines that allow customers to undertake transactions without the need to go to a counter

5.1.4 Digital services and integrated solutions

Australia Post has made substantial progress in the introduction of digital services through the Post Digital MailBox and is looking at other possibilities made possible through advances in information and communication technologies. This is an important aspect of expanding the Australia Post business model into providing access to trusted services – by offering secure and convenient digital formats

Opportunities exist for the planning and delivery of integrated business solutions for Australia Post customers. Many initiatives have been taken and applied, and are referred to in earlier parts of this report. Innovations and initiatives taken in overseas postal organisations that may be relevant to Australia Post are canvassed in the following paragraphs.



New Zealand

For corporate clients, New Zealand Post assists with the management of communications through both physical and digital channels, in document printing and mail-processing services and direct marketing delivery. Recent initiatives and strategic decisions have included:

- Reachmedia, an unaddressed circular and mailer joint venture, has formed a closer operating relationship with the courier business, ECL, with the latter's transport division now collecting and moving promotional materials from the printer to the distribution centre, and between distribution centres to distributors across the country.
- Formation of a Digital Platforms team to grow new digital revenue streams, to provide a seamless customer experience that spans channels, and to unify our digital platforms and processes to provide ubiquitous, nationwide services.
- Launch of the Digital Hub, which enables organisations to digitise large parts of their business processes including invoice management and archiving.

NZ Post is aiming to develop its depth of knowledge in how to effectively communicate with audiences. This includes planning campaigns, producing collateral like flyers and brochures, and delivering messages to the targeted demographic appropriate for the product or service, through addressed mail (delivered by New Zealand Post) or unaddressed 'direct' mail (delivered by Reachmedia). According to the Annual Report -

This ability to reach the right audience has been leveraged not only by businesses, but also by government departments and charities. This expertise is also a key reason behind certain government functions with a heavy focus on information and contact management being nested inside New Zealand Post – including the Electoral Enrolment Centre and the administrative and technical support function for the National Cervical Screening Programme.

Scandinavia

PostNord sees its future in value added delivery of communication services that are being increasingly outsourced: stock-keeping, logistics management, supply of goods, and communication with customers. The group intends to build this capacity on a robust structure of thousands of mail carriers and drivers as well as logistics and mail terminals throughout the region. It notes that:

Demand for PostNord's services is based on the fundamental needs of society and the business sector for transport and communication. But, due to the current and extremely rapid change in customer needs, the contents of mailbags and postal trucks are changing. Increasing e-commerce is driving demand for goods distribution and logistics services. New ways of communicating have reduced demand for letters as a mode of communication.

The business has introduced sweeping changes without any contribution from the owners while maintaining a high quality service level. It has made an explicit promise for the future to the Nordic business sector and society. "You will be able to reach your recipients on time, securely and cost-effectively. PostNord is your reliable, accessible and sustainable business partner for communication and logistics."

Swiss Post

In Switzerland the letter is still seen as an important means of communication, with letter volumes declining more slowly in comparison with other countries. Swiss Post is also expanding its digital services through ePostOffice, an online platform, which enables receivers to use an online platform to specify the mail they want to receive digitally and the mail they want to receive physically.

HYBRID AND DIGITAL

We want to accommodate customer needs at an early stage. That's why we're continuously developing our range of hybrid and digital solutions, says Frank Marthaler, Head of Swiss Post Solutions. These include solutions for printing and sending digitally processed data from major customers and automated integration of secure electronic mailings. Digitization solutions for receiving physical postal consignments are available to business customers. For years, Swiss Post has been one of the leading companies in the field of digital document solutions for business customers. With IncaMail, Swiss Post has developed a solution for sending e-mails securely, and with SuisseID has laid the foundation for secure identification on the Internet and electronic signing of legally valid contracts. As Frank Marthaler notes: These solutions don't just keep us at the cutting edge – we are also creating growth opportunities around Swiss Post's core business.

SwissPost. Annual Report, p. 13.

The online platform is currently being tested internally and will be gradually developed to full capacity at Swiss Post.

The company is of the view that the logistics of physical letters, newspapers and promotional mailings has a future. In the light of their appeal to receivers, it is argued that physical consignments will remain an important pillar of Swiss Post's business in future. In the Annual Report of 2013, the Chairman and the CEO advised:

The challenges facing Swiss Post are many and varied. Given increasing digitization and new requirements on the part of our customers, our company needs to remain agile. In a

mobile and highly networked society, people have got used to accessing information, ordering goods and using services whenever and wherever they want. By the same token, the post office network is less busy than before. With this in mind, Swiss Post's many innovations focus on the interface between the physical and digital worlds. Swiss Post today has already started shaping the universal service of tomorrow.

Swiss Post's *IncaMail* allows companies to send confidential items such as payroll documents directly to the private e-mail addresses of their employees. They can skip printing, filling envelopes and franking, save time and money, and reduce the demand for paper. With patented SAFE technology, sensitive e-mails are encrypted and transmitted verifiably.

Swiss Post is also positioning itself with Swiss banks and insurance companies to expand its range of digital document solutions for large customers with high performance scanning platforms and software solutions for document processing. It has recently extended the service into the health services sector.

In an Australia context there would be privacy issues that would need to be addressed in an IncaMail type initiative.

Germany

Deutsch Post provides a range of value added services through Deutsche Post Solutions. These include:

- A service that allows companies to design and print advertising mail themselves and send it at reasonable rates via the network. The company provides customers with online tools and services to ensure the quality of their addresses and the efficient identification of target groups. Companies may rent the addresses of these identified target groups for their own advertising campaigns as needed.
- A broad range of digital solutions, which customers can use for cross-media and targeted advertising. The German dialogue market comprises advertising mail along with telephone and e-mail marketing. The mail-order industry, in particular, considerably reduced advertising expenditure.
- Partnerships with publishers to sell subscriptions to more than 500 press products both online and offline as part of the Deutsche Post Leserservice, a service that has seen much success.

VIVATES EHEALTH

Swiss Post has joined forces with the canton of Geneva to come up with the first nationwide electronic patient record in compliance with Switzerland's eHealth strategy. Several cantons already place their trust in the secure electronic health solutions from Swiss Post.

The vivates eHealth service modules meet the specific requirements of the various healthcare professionals, from simple transfer and swift exchange to patient data archiving. Hospitals, physicians, pharmacies, outpatient organizations, care personnel, laboratories

and other professionals can benefit from the secure, efficient and transparent handling of data. Patients can view their data at any time and decide themselves who may access their data and to what extent.

Data protection and the security of the access processes are guaranteed at all times. Swiss Post uses state-of-the-art technology and complies fully with the legal requirements for data processing.

Source: <http://www.swisspost.ch/post-startseite/post-geschaefskunden/post-dokumente-dialog-loesungen/post-vivates.htm>

- International physical, hybrid and electronic written communications for international business customers, giving them the flexibility to decide what best suits their needs. Foreign customers tap into German expertise and experience in order to do business successfully in the German market.

5.1.5 Disadvantaged and vulnerable groups

Australia Post is mindful of its roles and responsibilities to provide accessible and convenient services to disadvantaged and vulnerable groups. The CSO requirements have particular application for people in rural and remote communities. There are 2650 Australia Post retail outlets in rural and remote communities.

A recent study has pointed out that In Australia the nearly universal access to banking draws attention away from a growing underbanked population, and technology-enabled financial inclusion is not yet on the policy radar. Remote Indigenous communities are the most financially and digitally excluded group in Australia (Godinho and Sing, 2013). Though many indigenous people have access to mobile phones (half of which are smart phones), mobile phone banking is not yet popular.

Research suggests that the general lack of banking infrastructure in regional and remote Australia translates to greater financial exclusion in these locations. Indigenous people are 2.5 times more likely to be 'severely excluded' than the average Australian. The underbanked also lack opportunities to save small amounts, and access insurance (Godinho and Sing, 2013).

Research has tended to concentrate on greater use of mobile technologies to address underbanking issues and problems, particularly in third world contexts. But the availability of Australia Post's retail network, together with its Australia-wide digital connections, can also provide an important means for designing culturally appropriate financial products, services and education programs, which could be followed to address financial exclusion of other underbanked communities in Australia.

5.2 RETAIL: CREATING VALUE FROM A STRATEGIC ASSET BASE

Australia Post's nation wide network of 4,417 retail outlets (2,560 in rural and remote areas) has been feeling the impact of digital disruption. Customer visits to stores has been steadily declining since 2003 as a result of declining stamp sales, related to declining letter volumes and digital alternatives, and the trend towards online bill payment and banking.

The network continues to provide value added services, particularly for people living in rural and remote areas. To that end, the network is an important strategic asset and distinctive capability that would be difficult to re-create or replicate. It offers many advantages over other networked retail outlets such as convenience stores, pharmacies and newsagencies. Many licensed post offices are in fact located in these entities, which creates considerable value for the business as a whole.

A number of proposals for expanding and strengthening the business are canvassed below.

5.2.1 Leverage the network in the provision of trusted services for government

The retail network has a critical role is expanding access to trusted services. Already Australia Post provides a wide range of products and services on behalf of government and business enterprises. It performs the role of a trusted intermediary, often in the transfer of information or payments from customers to government and business.

Services include financial services and payments, foreign exchange, identity services, insurance and travel services. Australia Post has indicated that it wants to take on claims and payments processing for Medicare and the Pharmaceutical Benefits Scheme.

These services have enabled the retail business to improve profit, albeit incrementally, despite the decline in customer numbers.

5.2.2 Virtual identity initiatives

Many postal organisations have taken initiatives

in the area of virtual identity services and identity verification:

- SuisselD is a package that includes a signature service that enables electronic documents to be easily and legally signed by one or more people, and a mobile service for the use of SuisselD on mobile devices. First introduced in 2010, SuisselD is now used in 240 online applications by end customers and companies. Examples include electronic legal transactions between lawyers and courts, for business processes within companies, and by customers of the Ticketcorner and Swisslos platforms. SuisselD is enjoying growing popularity among users.
- In 2013 NZ Post launched RealMe, an online identity verification system, developed in partnership with the Department of Internal Affairs. RealMe removes the need to show up in person each time to prove identity. RealMe users register online, then visit a PostShop to have a photo taken and their documents verified. Once verified online people can quickly and easily apply for services over the internet as organisations using RealMe come on board.
- In the UK the Government is to press ahead with a voluntary virtual identity system that will grant ID holders access to the “panoply” of public services online through a unified portal.

In announcing the virtual identity initiatives, the UK Government noted:

Ministers are keen to embrace online services as part of an efficiency drive, mindful that transaction costs are up to 20 times lower than those conducted over the phone, 30 times cheaper than by post and 50 times less than face-to-face – netting savings of up to £1.7bn a year.

To reduce ever-present worries over the security of online data the government has pledged not to

host a unified database but instead contract out the work to five private companies; including Experian, Verizon and the Post Office.

The Australia Post MyPost platform initiative might provide the foundations for this service in Australia. However, some of the services mentioned in the UK initiative are already available through MyGov, but due to community concerns about government holding too much information about citizens, could potentially shift to MyPost. Whilst the Australian Government wholly owns Australia Post, there is a perception of an “arms length” relationship that follows from its statutory and independent status.

5.2.3 Link to the parcels business

Retail postal outlets provide an important resource for the parcels and logistics business. It is important that staff in these outlets are fully knowledgeable about the business, and are able to sell services, market capabilities, and engage with SME customers both in store and externally through business networks.

5.2.4 Merchandising strategies

Australia Post has recently opened a number of superstores in metropolitan centres. The superstores sell stamps, different types of packaging from vending machines, and a facility to weigh, pay for and post parcels from an automatic checkout. Their merchandise is much more focussed on the communication business. The superstores also include new Parcel Lockers that can be accessed 24 hours a day.

5.2.5 Viability of Licensed Post Offices

The viability of Licensed Post Offices has been a matter of concern to owners, Australia Post and the Government. It has been addressed in other parts of the Report, but it is also an issue internationally.



UK COMMUNITY POST OFFICE BRANCH FUND

In the UK, as part of the Securing the Future strategy, the Post Office announced a £20 million Community Branch Fund to support around 3,400 Post Office branches that are effectively the 'last shop in the village'. In addition to providing Post Office services, these branches operate the only retail outlet in a community.

The fund is regarded as a significant investment in subpostmasters' businesses and their local communities. These branches will continue as they currently operate to ensure the network reach is maintained and they will be able to access funding to improve their service for customers.

5.3 PARCELS: DISTRIBUTION, LOGISTICS, AND E-COMMERCE

The parcels business has been a major success story for Australia Post. It has been at the forefront of business development through StarTrack and other initiatives related to ecommerce.

5.3.1 Distribution and logistics

The demand for integrated product and service logistics is increasing. Integrated supply chain solutions is an important area of value add particularly for small to medium businesses entering the export market. Services range from inbound-to-manufacturing services and warehouse and transport services to integrated packaging solutions, returns management and technical services.

Australia Post has performed well in this area with StarTrack building an extensive suite of business and consumer solutions within Australia and internationally. In addition to parcels distribution it is also building a business in warehousing (with 3PL) and international freight forwarding with 3PL Asia and Sai Cheng (a joint venture with China Post). StarTrack maintains a bonded warehouse in Shenzhen which serves as a hub for many centres in China.

Australia Post will need to continue to invest in its parcels infrastructure and capabilities to ensure that, as volumes grow, its services continue to represent good value, efficiency and reliability.

Initiatives and developments in overseas postal organisations are canvassed briefly below.

Germany

Deutsche Post DHL offers a number of innovative products in the international parcels market; for example, developing international shipping solutions for private consumers (B2C) in the growing e-commerce sector. This now includes a returns solution for 24 European countries. The offer also comprises consulting and related services for all physical and digital dialogue marketing needs.

In the Supply Chain business unit, DHL provides logistics solutions along the entire supply chain for customers in a wide variety of sectors. From planning, sourcing, production, storage and distribution to returns and recycling, customers rely on assurance of a smooth logistics flow. In the technology sector particularly, customers require fast, flexible and efficient supply chains.

These services are being introduced and delivered by StarTrack in Australia.

Scandinavia

Post Nord sees a strong future in the logistics business. It has a strategy to create end-to-end solutions and cross border capacity. This has involved complementary acquisitions of a mixed cargo, consignment goods and thermal transport business, capacity within parcel and pallet handling and building a new state-of-the-art logistics terminal, and responding to the demand for outsourcing services.

Singapore

SingPost has a regional logistics strategy of offering end-to-end e-commerce logistics solutions in the Asia Pacific. E-commerce logistics revenue accounted for 31 per cent of Quantum Solutions', the regional entity set up a joint venture in Indonesia and a representative office in China, bringing its network in Asia Pacific to 13 markets. The Group aims to strengthen its new businesses and operations, and extend its reach into the regional markets.

Switzerland

SwissPost has recently introduced the YellowCube logistics solution, a highly automated storage

and picking facility. The service covers the entire logistics chain, from storage and nesting to packaging and the re-storage of returns.

YELLOWCUBE

YellowCube fills the last gap in Swiss Post's ecommerce solution: it is designed for mail order companies who use the Internet as a sales channel and are looking for an external solution for their logistics. Businesses receive competitive logistics facilities and can achieve economies of scale. They also save on storage and personnel costs, and eliminate the worry about the processing of returns.

With the My Post 24 parcel terminals, similar to those being implemented in Australia, customers can collect, drop off or return their parcels 24 hours a day. Receivers can specify the parcel terminal where they want to pick up as the delivery address. As soon as the parcel arrives at the terminal, the recipient receives an e-mail or text message and a code for picking up the parcel. Cashless payments can be made to settle any customs duties or shipping costs directly at the terminal.

5.3.2 E-commerce

Digital disruption has presented Australia Post with significant growth opportunities, particularly as the delivery partner of retailers with the growth in online shopping. Australia Post has reported that although the Australian e-commerce market was initially slow by international standards, it is now growing rapidly. All of the research is predicting double-digit annual growth in Australian online spending through to 2020 (Australia Post, 2014c).

Over the past three years, Australia Post's parcel volumes have been growing by around eight to 10 per cent a year. This growth is entirely driven by online shopping. Approximately 70 per cent of the parcels that Australia Post handles are now generated by an online transaction (Australia Post, 2014c). Australia Post has also noticed that it

is mainly SMEs that are the engine room of the domestic e-commerce market (e.g. companies like Catch of the Day, Ozsale, Booktopia, and The Iconic).

In the UK, approximately three quarters of the Royal Mail's domestic parcel revenue is derived from micro-SMEs and SMEs. The engine for parcels growth is recognised as B2C through e-retail and carriers are increasingly focussing on this market. The UK has one of the most developed e-retail markets in the world, with ten per cent of all retail sales conducted online.

Australia Post has initiated an ongoing enterprise engagement program and an Australia Post Business Forum.

Small businesses also purchase services and office supplies online rather than go into freestanding office stores such as Officeworks. Australia Post/StarTrack provides a next day delivery service for Officeworks online purchases.

Australia Post's nationwide logistics network underpins the growth of thousands of small businesses by providing them with a fast and reliable way of getting their product to their customers. For this reason, Australia Post has a vested interest in expanding digital marketplaces and supporting Australian business to get online.

Other e-commerce initiatives include myshopinabox, PostPay, Farmhouse direct and SecurePay. Australia Post and StarTrack are developing a stronger consumer and small business focus through a range of StarTrack products and services, Express Post, six-day parcel delivery.

It must be emphasised that parcel delivery is a highly competitive, international marketplace and Australia Post's continued growth in this market is not guaranteed – and, with intensifying competition the profit margins of all logistics providers will continue to come under pressure.

For example, in November 2014 a new start-up, Sendle, was launched “gunning for Australia Post by offering door-to-door parcel delivery services

for consumers through an online service that lets users choose who'll pay for delivery”. The service is designed for users of sites like eBay and Gumtree.

Sendle uses a network of delivery providers based around Australia to pick up and deliver packages, utilising courier services and making use of idle resources. Sendle said its partners are “trusted delivery providers who already ship more than 30 million packages each year”. The company currently operates within and between Adelaide, Brisbane, Canberra, Gold Coast, Gosford, Melbourne, Newcastle, Sunshine Coast, and Sydney.

Most postal corporations see a strong future in e-commerce. On occasions they invest in promising start-ups to grow capacity and capability.

Some initiatives being explored and implemented in overseas postal organisations are canvassed briefly below.

New Zealand

In 2012 New Zealand Post launched YouShop, a digitally enabled international inbound shipping service for consumers, which enables online shoppers to purchase products from the websites of overseas companies that do not ship to New Zealand. Shoppers direct their purchase to an international address, from which agents then ship it to New Zealand.

In November 2014 Australia Post launched ShopMate, which provides a convenient and secure delivery service for Australian online shoppers to buy from US retailers who do not ship to Australia. Many major US online retailers restrict sales to US-based customers.

Scandinavia

Post Nord has a strategy is to respond to the trend among large retail companies for increasing their investments in e-commerce, and the “always on Internet access” among consumers who are increasingly able to look at products in physical stores before comparing prices and making their purchases online. Both mail and logistics volumes benefit from this trend. B2C parcel volumes, which are closely linked to e-commerce, rose 12 per cent

during the year. During 2013 nearly one in three Nordic residents shopped online each month. All indications are that this trend will continue.

PostNord is the strongest e-commerce partner in the Nordic region. With a coordinated distribution network and solutions for logistics outsourcing and customer communication, it aims to decrease the distance between e-retailers and end consumers. PostNord aims to

“improve its customers’ competitiveness by solving their communication and logistics needs on time, securely and cost-effectively. Our offer spans the entire commercial chain – from business generation to fulfilment and follow-up”.

5.3.3 Partner strategies

Effective and lasting partnerships are the basis for business development. Partnerships along all dimensions of the value chain are important for Australia Post as it moves towards offering integrated supply chain solutions for micro, small and large businesses.

Australia Post is also exploring partner strategies for global expansion and integration of the business. With limited access to capital, working with other businesses in joint ventures and strategic alliances makes for sound business strategy. Partners also bring access to networks, contacts and capabilities.

5.4 COMMUNITY SERVICE

In rural and remote communities, the Post Office is often the only public service icon. Communities rely on the Post Office, and postal staff, for support and assistance in a wide variety of activities, including assistance in natural disaster situations.

In the aftermath of Hurricane Sandy, which devastated many areas along the coast in New York and New Jersey, Postal employees played a vital role in the quick return to normalcy by ensuring that needed mail, packages, and basic relief

services were being delivered almost immediately. Employees contended with floods and forest fires, and all manner of severe weather, and consistently performed at a high level in meeting the needs of America’s communities.

It is upon this foundation of innovation and service that the future of the Postal Service is being built. If given additional flexibility and authority under the law to fully meet America’s evolving mailing and shipping needs, the Postal Service can have a bright future for the coming decades.

5.5 CONCLUDING COMMENT

The potential for Australia Post to expand and strengthen its business model is strong. But to do so requires sorting out the financial burden of the existing structure of CSOs, many of which are no longer relevant to a postal organisation operating in the digital age.

The future of Australia Post is tied to riding the wave of digital transformation in creating new business opportunities and around new and emerging technologies. The future is also tied to leveraging the strategic assets in the retail and delivery network and the distinctive capabilities that concern the knowledge, skills and experience in running a communications business.

Australia Post has made many important strides in the transformation journey. But change has been disruptive and challenges will continue. The corporation has achieved success in adapting innovations from overseas postal corporations and this should continue. However, a sustainable future will require Australia Post developing its own capacity for innovation that suits the particular situation and circumstances relating to physical and digital mail in Australia.

For the future, Australia Post must leverage its tangible and intangible asset base and its distinctive capabilities to secure its future as a viable business enterprise. It must continue and build up its commitment to innovation. These assets include the physical assets of the retail network and the intangible knowledge assets of employees. These strategies will, inevitably, involve multichannel



messaging and parcels solutions and an *integration* of these businesses.

Due to constraints of time and resources it has not been possible to test the operational practicality and financial feasibility of the options and initiatives identified in earlier parts of this Section of the report. Some may have potential for adoption and application in an Australian context, whilst others may fail in developing sound and robust business cases.

It is important however, that the potential and the success being achieved in the parcels and retail businesses are not used to delay important reforms that are needed in the mail business, including the current regime of community service obligations and performance standards. Unless these are addressed losses will continue and eventually overwhelm the business.

These matters are addressed in the next Section of this Report.

6. Facing the future: Options & recommendations to improve financial standing and sustainability

The project brief requires development of a set of recommendations on possible options for reform that improve the financial standing of Australia Post whilst also maintaining its core role as a provider of essential services and a core employer of Australian workers.

As noted earlier in the Report, Australia Post is facing a challenging future with declining mail volumes, a rapidly deteriorating financial position in its mail business, and a restrictive regulatory framework for determining pricing and service issues. From a business that recorded operating earnings of \$584m (before interest, tax and adjustments) in 2007/08 to one that is expected to deliver a financial loss in 2014-15 Australia Post requires a fundamental turnaround in its business fortunes.

The *Future Ready* strategy launched in 2010 achieved success in forestalling approximately \$1.1 billion in losses. But Australia Post has now reached a position where it must fundamentally transform its business to face the challenges and capture the opportunities in the digital age. It must become a digital business. It must also disengage from costly legacy obligations instituted well before the advent of the Internet and digital communications. Community Service Obligations that can be justified on the basis of demonstrated need should be retained.

To date turnaround strategies have been built around product and process change and innovation. These are worthwhile, but strategies must embrace the disruptive forces that have impacted on the postal services industry on a

worldwide basis. Other postal businesses have redirected their businesses into 'trusted' government services, logistics, and secure service. Some have been privatised, including the Royal Mail in the UK, or partially privatised.

Several broad areas of strategy are outlined below.

6.1 REFRAME CSOS, SERVICE STANDARDS, AND PRICING STRUCTURES TO SUIT A CONTEMPORARY DIGITAL POST FRAMEWORK

The cost and the earnings drain of the present structure of Australia Post's CSOs and performance standards has been a major theme of this report. It is vital that these obligations reflect contemporary community needs and expectations in a digital environment. This environment provides a range of options and alternatives to traditional letters mail.

A strategy for consideration would involve:

- Increasing the price of a standard letter in line with increases in the CPI. Consideration be given to an additional 'catch up' price increase to narrow the gap between CPI movements and standard letter prices since the time that the reserved mail service moved into a loss making position.

- Requiring the ACCC to undertake pricing reviews on an annual basis to determine if prices above the CPI should be granted.
- Relaxing the mail delivery timeframes – to allow a greater proportion of mail processing to occur during normal business hours.
- Integrating, to the greatest extent possible mail delivery services with parcel delivery arrangements. It is noted that already 25 per cent of the work of posties relates to parcels delivery.
- Retaining the current five-day per week delivery commitment to households and businesses.

As the letters business continues to be a distinct operating segment within the Australia Post enterprise, it should be a requirement that it deliver a commercial return in its own right. From a commercial perspective, a cross subsidy from the competitive parcels business is not appropriate and a public subsidy for reserved mail services should not be sought (and is unlikely to be provided).

It is therefore important that the reserved services business is put on a financial footing that will enable its continuing viability to be maintained - whilst acknowledging that the scope for generating monopoly profits is much more limited than it was before the advent of digital mail.

Financial stability will require business and government senders, who account for over 90 per cent of mail sent, to pay postage prices that reflect the cost of delivery. The current internal cross subsidy from the parcels business that subsidises businesses and reduces dividends to the shareholder is, in effect, a payment by taxpayers, in the same way as a direct subsidy from the Commonwealth Budget. Australia Post has already introduced concessional prices for holders of pensioner benefit cards.

Whilst acknowledging the decline in transactional mail, there is scope for growth in direct mail and for this service to be developed as retail businesses appreciate its role in their overall marketing mix. Direct mail is used extensively to generate on-line

orders. Many postal corporations are developing this segment quite aggressively.

It is also important that the communication needs and requirements of disadvantaged groups are met. These requirements relate not only to access to the means to send and receive written communication (letters mail) through postal delivery, but also access to the means to send and receive digital communication. People in some groups may not own or have access to channels for digital communication as a result of:

- Limited access to the Internet, due to location and/or affordability of connections and digital devices.
- Poor digital literacy.
- Homelessness.
- People unable, for various reasons, to establish a digital identity.

These areas of communication disadvantage raise important public policy issues that are a matter for government to address in the broader context of digital and on-line strategies.

6.2 VALUE ADDED SERVICES FOR BUSINESS AND CONSUMERS

Businesses and government, the major users of the mail service, have been, and are continuing to pull out of traditional letters mail. Some legacy requirements for written documentation, notifications in writing remain, but they are being progressively superseded with the introduction of technology and greater security.

Digital disruption in the mail business provides many opportunities to develop customer and business solutions.

6.3 DIGITAL MAIL SERVICES

The digital mail service currently offered by Australia Post has not been an overwhelming success. It may well be the case that the Post Digital MailBox has to develop further from being simply a mail repository to a facility that provides value added

communication services in order to be attractive to business and consumers. Technology has the potential to offer value added services in areas such as:

- Information vault – a virtual ‘safe’ for digital mail, giving customers the ability to access mail, respond to mail, and pay accounts on line.
- Identity verification – document certification services for government agencies, financial institutions, and business services organisations.
- e-documents – document scanning service that digitises paper documents for electronic lodgement for government.
- Information intermediary services – provision of security on electronic messaging, including digital signatures, digital time stamps, and registered mail
- e-box – single postal portal for digital and physical communication allowing all incoming mail to be sorted and accessed anywhere and at any time through a computer or mobile device.

These services are being offered by several overseas postal organisations. Building strength in these areas will require investment in staff development and training, including management and entrepreneurial capabilities.

Electronic notification and lodgement is already well established in the ATO, Centrelink, the DVA, Medicare, government tender processes, financial services, utilities and local government (particularly in relation to development applications). It is less well established in ASIC, the Australian Bureau of Statistics, the Australian and State Electoral Commissions, and state/territory based social welfare and community services organisations.

Digital technology creates opportunities for closer working arrangements with these and other organisations that rely on the mail system, including the Australian Electoral Office and the Australian Bureau of Statistics.

6.2.2 Trusted identity services

The development of digitised government services requires the application of credible identification systems. Australia Post can facilitate these changes in its role as trusted intermediary for people and organisations that are finding it difficult to make the shift.

Australia Post already performs an important role in relation to Passports, which has the potential to extend to international visas and other official documentation.

6.3 DIVERSIFICATION INTO COMPLEMENTARY BUSINESS AREAS

Australia Post has been quite strategic in considering its diversification initiatives. These have concentrated on building core competencies and distinctive capabilities in the communication business. Entry into areas beyond core capacities is always risky and very difficult to grow organically without substantial investments. Diversification opportunities that have been raised in the course of this project are canvassed below.

6.3.1 Banking and financial services

Australia Post already offers a range of agency services on behalf of banks and insurance companies. Some have advocated entry into retail banking.

Further entry into the banking and financial services business would impose a considerable cost and risk for Australia Post, with a high degree of uncertainty about return. Recently announced prudential and capital adequacy requirements would make such a venture very expensive.

6.3.2 Digital communication hubs

One of the strengths of Australia Post is its retail network of over 4,417 retail outlets, 2560 of which are in rural or remote areas. The Post Offices are more than service points: most are small business entities owned and operated by independent business people engaged in the sale of goods and services.

It is important that the Australia Post retail outlets reflect the strategic direction that is being taken by Australia Post in the digital environment. As retail outlets, often in community shopping centres or strips, it is important that they are differentiated from other stores selling a range of general merchandise. A focus on digital communication would assist in developing this distinctiveness.

As indicated elsewhere in this Report, there are opportunities for LPOs to develop as “digital communication hubs”, specialising in the marketing and sale of digitally enabled and enhanced services and products and providing digital services and access to people who for various reasons cannot access digital communication devices and services.

Initiatives in these areas would link with other proposals in the Communications Portfolio concerning access to digital products and services and that address digital connectivity.

6.3.3 Services for the disadvantaged and vulnerable

Consistent with Australia Post’s interest in working with the Department of Human Services (Medicare and Centrelink) there are also opportunities to develop products and services around technology-enabled financial inclusion for the ‘under banked population’. Whilst financial inclusion has received a great deal of attention internationally, it is not established on the policy radar in Australia.

As indicated earlier in the Report, remote Indigenous communities are the most financially and digitally excluded group in Australia. Indigenous people are 2.5 times more likely to be ‘severely excluded’ than the average Australian. The underbanked also lack opportunities to save small amounts, and access insurance (Godinho and Sing, 2013).

The availability of Australia Post’s retail network, together with its Australia-wide digital connections, could provide the means for designing culturally appropriate financial products, services and education programs for the financially excluded members of society.

6.4 BUILD CAPACITY AND CAPABILITY IN THE E-COMMERCE BUSINESS, PARTICULARLY FOR SMES

The progress of digital transformation and developments in purchasing and procurement has meant that e-commerce is increasingly global in its orientation. Effective business participation in the growing e-commerce market will demand an international focus. Businesses in rural and remote locations, as well as in metropolitan locations need to respond efficiently and effectively to orders placed on-line nationally and internationally.

Small business is a natural market and target for Australia Post. It is a trusted brand and has a high degree of credibility in the small business community. However, only a small number of small businesses have an account with Australia Post. At a recent presentation Australia Post’s head of Customer Research and Insights commented our future ‘best’ customers are today’s unknown customers (Fanthorpe, 2012).

Australia Post has been positioned predominantly as a consumer oriented business. This is reflective of Australia Post’s traditional orientation as a delivery business with the majority of its capital invested in the receiver. Australia Post must now also be positioned as a business built around e-commerce. This follows from its investment and success in the parcels business through StarTrack and its emerging capability in global e-commerce supply chains.

The primary focus of the business has now shifted to the sender, who is most likely to be a business or government organisation. However, its public face does not present as an organisation oriented to business needs. This is being addressed by the separate branding of Star Track as a business service, albeit closely aligned with the trusted Australia Post brand.

Australia Post can leverage this trusted supply reputation by assisting SMEs with development of related online capability. Through SecurePay it already assists entrepreneurs setting up an online business.

The growth in trade and commerce with China suggests a very strong postal orientation and opportunities for Australia Post. The strategy is already unfolding in partnerships with Chinese providers, but the opportunities abound, particularly with the free trade agreement

6.5 DEVELOP A CORPORATE WIDE INNOVATION STRATEGY

The term innovation is used only three times in the Australia Post 2013-14 Annual Report. These were in the context of the 2014 AMR Corporate Reputation Index; the CV of board member Michael D'Ascenzo; and a profile of SME customer Farmhouse Direct in the context of Australia Post e-commerce initiatives. In 2013-14 and in the previous year Australia Post had allocated \$500,000 to a research and development fund to investigate and test new energy efficiency solutions in the transport network.

This is not to say that Australia Post lacks a focus on innovation. It just does not come out as a corporate strategy or a strategic priority. Since the introduction of *Future Ready*, Australia Post has seen the adoption of substantial innovations involving the application and use of technology, in retailing, and in customer service. Many of these have been adapted from developments in postal organisations overseas. This reduces risk, but may not be enough to mark out the future of Australia Post building on its strategic assets and distinctive capabilities.

As mentioned earlier in this Report digital transformation and disruptive innovation go hand in glove. Postal organisations that have not innovated, such as Canada Post face uncertain and challenging futures as equity disappears and they are forced to sell assets. On the other hand, Swiss Post, that has a strong commitment to innovation, has introduced many new products and services to leverage opportunities in the digital environment.





The following initiatives are proposed:

6.5.1 Create an Australia Post innovation hub

An innovation hub provides a nucleus for the formation, development and experimentation of new ideas and piloting them for adoption and application. A hub should have both an internal and external focus, engaging with staff and with universities and the broader start-up community. These communities are expanding with the support of universities, businesses and governments.

An Australia Post Innovation Hub would also provide a locus for networking, innovation workshops, and events relating to innovation. It would also promote Australia Post's interest in innovation to the start-up community, and where appropriate, partner with start-ups in exploring technology opportunities.

6.5.2 Establish a corporate venture fund

Developing relationships with start-ups progresses logically into consideration of opportunities for corporate venture investment. In Germany, Deutsche Post has initiated its own corporate venture fund to invest in start-ups that have relevant technology requiring early stage investment. Deutsche Post Ventures GmbH specializes in start-up companies within the Internet and logistics sectors. The fund seeks to invest between \$250,000 and \$5 million.

Corporate venturing has also become a new model for corporate research and development in large organisations. In particular, it allows for expanded corporate R&D effort, complementing internal efforts with external investments in innovative companies. A portfolio of investments in technology relevant areas can be an efficient alternative to in-house development and testing, maximising entrepreneurship while reducing management overhead and P&L expenses.

Telstra has established Telstra Ventures to invest in breakthrough companies that are strategically important to Telstra.

6.5.3 Develop an innovation portfolio

Australia Post's chances of creating new products and services are directly proportional to the number of ideas it fosters and the number of trials, or experiments it starts. Following from the logic first put forward by Gary Hamel (Hamel, 2000) Australia Post should consider developing an *innovation portfolio*. This would consist of

- A portfolio of ideas of credible, but untested new business concepts
- A portfolio of experiments – ideas that have particular merit where they are validated through low cost market incursions
- A portfolio of new ventures – experiments that look promising that advance to the venture stage.

Many organisations have adopted this approach in their innovation strategies.

6.5.4 Initiate internal innovation challenges and competitions

Many companies have put in place arrangements for regular innovation challenges and business plan competitions that encourage staff to put forward ideas for innovation into practice.

Swiss Post established PostVenture, a group-wide business plan competition, where the best business ideas are sought out and rewarded. PostVenture commenced in early 2012 under the motto *Take a Step Forward*. Everyone who participates in the competition receives professional guidance and training while developing the business plan.

POSTVENTURE

In 2012 Swiss Post invited employees from the entire group to take part in the PostVenture competition. It supported the employees taking part with external professional training and coaching. In the course of the competition, they were able to increase their know-how and entrepreneurial thinking and receive a certificate for their achievements.

Swiss Post employees in Switzerland and abroad were able to submit their ideas in spring 2012. Countless good new ideas were received from employees from all group units. After several development phases and selection processes, 13 ideas were developed into convincing business plans. Four of these qualified for the final. On 20 February 2013 the day had finally arrived: the jury, consisting of a group management committee, chose the winner from the four finalists. As a reward for their personal commitment and good ideas, the authors of the four best business plans are invited on an educational trip to Silicon Valley.

Work is now continuing on the best business plans. In the coming months, the business plan authors will assess the feasibility of their business ideas together with internal experts.

<http://www1.post.ch/en/post-k-innovation-postventure.htm>

Several Australian Universities organise annual business plan competitions for their students, which involve external mentoring assistance from corporations with a strong commitment to innovation. They provide important forums for spotting innovative ideas.

6.5.5 Introduce an innovation sourcing strategy on the principles of open innovation and crowdsourcing

It is well acknowledged that ideas for innovation often emerge from outside the business. There are several ideas exchanges that offer connections between companies and innovators. Many large corporations have well-developed strategies for sourcing ideas externally and for resolving problems and capturing opportunities through crowd sourcing.

Australia Post should consider these innovation elements with a view to developing an innovation strategy that is integrated with the Your Post is Evolving direction.

Evolution and improvement are important strategies, but may not be enough to manage life at the cliff face – even with a significant restructuring of the mail business.

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