



### **Global Postal & Parcel Industry News**

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#### **EU Postal Liberalization – Examination of Changes to the Rules** *(REVISED)*

In a recent article by *Hellmail* Editor, Steve Lawson, the EU Commission (EUC) defended its position that EU Postal Liberalization is not detrimental to national postal services providing Universal Service (USO). Logically, the EUC truly has no reason to change their position or stated direction on postal liberalization rules, that is, not until such time they see clear supporting evidence that the rules are detrimental or are open to logical arguments that call their position or conclusion into question. If the decision is to wait until it is obvious to everyone, the question then becomes, *Does one really have to wait and see or experience detrimental results (or disaster) first, or is there sufficient empirical evidence today to warrant consideration for changing the rules before disaster is obvious to everyone, as well as extremely difficult and expensive to alter?* An examination of EUC quotes, market conditions and historical events are sufficient to evaluate if pending disaster is probable.

The EUC stated, *"The Commission notes that while entrants may benefit from the absence of the universal service obligation, experience in a number of countries that have already liberalized their postal markets demonstrates that national operators continue to hold onto the major part of the market years after market opening. In most cases, the share is well over 90%."* In their continued statement, the EUC stated, *"Imposing universal service obligations on all postal services providers could well result in unnecessary costs."*

First, although postal markets have been open, they are not competitively equal, nor are they fully open yet. For example, most, and presumably all, of the EU national postal operators have enjoyed some form of VAT advantage for all of the years the markets have been partially open, making it less attractive for competitors to compete on an equal basis. That is, national operators enjoy a cost benefit that translates into retained market share. It is no mystery that the majority of the letters market is a low-margin, high-volume type business, so any cost advantage by an incumbent will likely result in the incumbent retaining the majority of the market (i.e., the 90% the EUC quoted). Therefore, it is incorrect for the EUC to assume, or to make, any judgments concerning market dynamics in a continually "unbalanced" market, especially when assumptions are likely skewed heavily by one or more aspects of the imbalance. Noting, if an intent exists to provide a VAT advantage to USO providers for providing USO, then so be it (there is no issue being raised with VAT itself or compensating USO providers).

Second, the postal letters market has been in decline for much, if not all, of the years the markets have been open. It is reasonable to conclude new market entrants are not willing to aggressively enter a declining market when opportunity costs and regulatory flux likely direct

them to other more attractive markets. Not one reputable business school will advocate entering a declining market when alternative markets and business opportunities exist offering potentially greater profit potential and ROI. The same basic core principle directs financial investment theory and most other business disciplines as well. Therefore, it is again incorrect for the EUC to assume or to make judgments concerning competitors, the effectiveness of existing competitors and any subsequent market share numbers for the duration postal markets have been partially open, but still "unbalanced".

Third, the EUC admits that entrants (i.e., new postal operators) may benefit from the absence of delivering USO. Clearly, new entrants benefit by not providing USO. Furthermore, non-USO postal operators also benefit by having access to the USO provider's "final-mile" service (another topic all together). However, the subsequent statement by the EUC is most troubling. The EUC stated, "*Imposing universal service obligations on all postal services providers could well result in unnecessary costs.*" If all postal operators must provide USO, then

1. It would be impossible for any niche providers to exist;
2. Supply would drastically surpass demand, creating downward market pricing pressures (in an already declining market), forcing the majority of businesses out of the market (via closure and bankruptcies);
3. Economically and environmentally the concept is an absolute waste due to repetitive overlap (that is, n different postal vehicles traveling to the furthest home address every day even with no delivery, and hoping for a pickup?); and
4. The concept of every postal provider offering USO eliminates the possibility of one service "licensing" another's service since they all must offer the same services.

It is not a matter of "could well result" in unnecessary costs, but rather, it would absolutely be a waste in every respect, and directly contradicts the objective of seeking greater competition in the market. For the EUC to make such a statement, regardless of intent or reason (recognizing it was most likely in response to a question on making all offer USO), is disturbing and could well demonstrate that the EUC has not spent sufficient time in analyzing the competitive environment and what direction it could potentially propose or take if (or when) the current rules prove detrimental to national postal services providing USO.

Continuing, the postal market is regulated and it is highly desirable to have a stable and consistent regulatory environment. During any period of change, it is expected and understandable that stability and consistency are altered, but it is detrimental to both the market and individual businesses if the regulatory framework adheres to or maintains a "wait-and-see" and "modify as needed" approach to change. That is, the EUC has implied if the new rules are seen as detrimental to national postal services providing USO, then the EUC will consider changes. There are two problems and one issue with this approach.

The first problem is that the approach is punitive towards businesses with solid, well developed and executed strategies in the current regulatory framework (ultimately capturing a significant portion of the postal market or select smaller, highly profitable segments within the overall postal market). The second problem is one of entering the market. Why enter a market when the rules can still change if there is no compelling competitive advantage that cannot be realized by entering the market sometime later. That is, wait twelve months to assure market success rather than entering today and avoid additional legal challenges against unwarranted regulatory changes or ill-conceived existing rules. (Noting, the EUC cannot see the impact to the market caused by any business that adopts the delay entry strategy.) The issue is one of adequate pre-planning given mostly unrestrictive future change. That is, if it is presumed no changes can occur at a later time, then it is expected that more planning, analysis and consideration of future implications will occur, which should produce a result that requires little to no major future changes. This is highly desirable and the best outcome for all

participants.

As stated at the beginning, it is logical for the EUC to believe no postal liberalization changes are currently required, for it would be illogical to believe changes are required, yet do nothing relative to changing the rules now. But, is there a valid argument for rule changes now, or at the very least, further consideration of the issues to determine if a better regulatory framework should be implemented now rather than later? The EUC is looking at the market, both present and recent past, and making assumptions or conclusions based only on what it sees or has seen. That is, future postal competition will not threaten national postal service providers offering USO based on what the EUC has seen to date. Just because nobody has entered the market and taken any major market share does not mean it cannot be done. It simply means nobody has done it yet. To make the point, prior to 11 September 2001, high-rise skyscraper architectural firms did not include airborne type terrorist attacks into their planning and design stages as the norm, but today it is a basic element in the overall process because such an attack was executed. That does not mean nobody considered it before 11 September; it just means in those cases where it was considered by someone, those with the final decision authority did not include the contingency. One can rarely take the position something will never occur, for the supposition itself will lead to disastrous results when it finally occurs. Another case in point is the Titanic (i.e., belief it could not sink led to slow reaction times and poor decisions).

To demonstrate one prominent argument many have put forth, including myself, let us assume we are a firm wanting to enter a particular EU country's postal services market with the intent to be competitive, profitable and grow our business over time. The EU country selected does not matter for this example. Will we select a low-margin, unprofitable segment? No, our objective is to be profitable. Will we offer USO? No, we can use the existing USO provider's network for the "final-mile" of service when needed, and at a cost-basis we cannot hope to duplicate (i.e., offer). Continuing with these types of questions, we can eliminate all unprofitable segments and offerings. In the end, our business model offers differentiation (i.e., added-value services, price, speed, et cetera, or some combination of these). It is logical to target the segment(s) offering the greatest margin on profit, and that is seldom an entire market. It is also reasonable to expect multiple high margin services of similar structure are available in the marketplace, expanding our set of services and the number of potential clients we can offer them too without expanding geographical scope in equal proportion. Based on this brief, condensed example, there exists nothing unreasonable, and the example demonstrates the selection of the most lucrative or "attractive" segments, a business practice commonly known as "cherry picking." It is unreasonable to conclude all new postal service operators will engage in "cherry picking," but it certainly is reasonable to expect many too. In reality, national postal services can be determinately impacted by as few as one well managed "cherry picking" postal operator, if that operator understood the market and what product/service mix to target and offer. To assume otherwise is unadvisable.

Because no threat is seen today for national postal operators delivering USO does not mean there is no threat. It only means it is not seen today (and considering most in the industry still consider themselves incorrectly in the communications market, it is no wonder nobody has executed such a well strategised business plan as yet). Also, if a particular "situation" is improperly considered not possible, all conclusions and results are tainted or corrupted. And, regulatory rules should never be adopted with an open-ended change-as-needed approach. Taking a regulatory position of wait-and-see and change-if-seen is problematic at best, and potentially costly to change, especially if the competitor that causes any such change mounts a valid legal challenge for cause (including seeking financial damages as a result of any change).

Is there sufficient evidence to indicate "cherry picking" will occur in the postal markets? The evidence clearly suggests the answer is, yes. I certainly would execute such a plan, so it is unreasonable to conclude nobody else would given the opportunity. Is there sufficient

evidence today to warrant consideration for changing the postal liberalization rules? The answer is only important to those with the authority to implement the change or to cause a review. Unfortunately, it is unlikely any arguments short of current evidence will alter the regulatory rules currently set by the EUC.

Having said that, there is a process that the EUC postal regulatory body can employ without admitting or agreeing to any current deficiency or rule change that ensures the best possible solution was selected, while offering a contingency plan in the event postal markets do not behave as they expect. Suppose or pretend several national postal services are under duress from one or more competitors targeting the more profitable market segments, but using the USO providers for the more costly final-mile routes, forcing USO providers to expend more resources on their USO obligations created by these new entrants for the market situation described. What proposed solutions would the EUC develop? Are any of those solutions better or significantly better than what exists today? Regardless of the answers, the exercise offers a contingency plan and an examination of existing rules, seeking and fixing any deficiencies in advance of disastrous results rather than after the fact. The only question is will the proposal be taken seriously or ignored?

**About the Author:** Timothy Nestved is founder and president of Nestved LLC, as well as a principal consultant, with expertise in turning around firms in the delivery services industry, including distressed firms facing similar challenges to those of national postal service providers like the Royal Mail and USPS. Inquiries for Timothy may be submitted through the [Contact Us](#) page at Nestved, LLC.

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