



THE BIRTH OF THE NEW EUROPEAN POSTAL MARKET

Executive Summary



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As the debate over the next steps in European postal regulation approaches, there remains a lack of informed public analysis of sector market and regulatory development.

In this paper, David Stubbs, who has recently joined Europe Economics as a Senior Consultant and who is an experienced postal regulator formerly of the European Commission and Postcomm, sifts through the evidence of recent market and regulatory evolution.

He finds a sector in the midst of a revolutionary change, where despite remaining regulatory barriers to development, postal operators can emerge as centre players in the global economy.

The Birth of the New European Postal Sector

The European Union is currently at the vanguard of international postal reform, providing EU operators with positive incentives and with comparative regulatory advantage. This reform, combined with globalisation trends and technological advance, is creating a new type of postal sector, as operators move to take advantage of new profitable opportunities both in ancillary markets and upstream and downstream of traditional postal markets.

For postal operators, there is now no scope for standing still if they are to survive as hitherto. Globalisation offers new markets, but reciprocal deregulation threatens those operators which are passive or inefficient, as competitors build up their potential. Technological innovation creates opportunities for cost savings and new product lines, but it can also offer customers new alternatives, loosening the historic relationship between mail demand growth and the economic cycle.

Recognising this (and the potential offered by sale proceeds if privatisation becomes an option), a number of EU Member States have moved to end the postal exception, with national posts (universal service providers, or USPs) being converted into corporate organisations and with the introduction of greater private involvement in the ownership of some USPs. This “privatisation” process has been accompanied by new expectations about USP profitability and by the establishment of managements with strategic vision, including the appointment of a new round of “star CEOs”.

Spurred on by new dynamic leaderships, some USPs are moving quickly to exploit profitable opportunities, and to position themselves for future de-regulation. With a ready-made self-sustaining national distribution network, unique brand advantage, and many decades of experience, they have found themselves well placed to exploit new opportunities in the parcels, express and logistics markets. They are broadening their service offer, diversifying not only into logistics but also into enhanced product offerings, taking advantage of new technological possibilities, and pushing outwards the boundaries of the sector both vertically and horizontally.

Deutsche Post and the TPG appear to have first mover advantage. They are both highly profitable and have the greatest network penetration, following their major programmes of acquisitions from 1999 to 2002. Further, they are now learning from the experience of unifying their different businesses and preparing for the next wave of market activity following the de-



regulation of mail services. Of the other larger USPs, La Poste has built up a European parcels network that has an estimated 80 per cent coverage, and Royal Mail, even after apparently ending its major acquisition policy, still has capacity to compete in the German and Dutch postal markets and to compete for international mail, due to its “Spring” alliance with TPG and Singapore Post

Alongside these “super posts” networks, smaller USPs have built up regional networks, for example with Scandinavian USPs building up presence throughout Baltic rim markets and Swiss Post entering the Italian postal market.

This process of strategic re-positioning by market players has led to the leading USPs becoming European and global conglomerates with a diverse portfolio of operations. TPG and Deutsche Post have moved into international markets and now seek to exploit the potential for significant growth in the Chinese and Japanese markets, with Deutsche Post also targeting the US parcels market. This globalisation trend has been reflected back across the Atlantic as United Parcel Service (UPS) has aimed to expand its European networks. Further the EU enlargement process has started to move the axis of European postal operations eastwards, with operators such as DHL readjusting their structures in preparation for entering these growing markets and maybe even eyeing the Russian market, albeit nervously, for the long term.

Alongside this rapid expansion, USPs have looked inwards to improve their own business practices and have moved towards new business models, using outsourcing and more flexible working practices and exploiting new technological opportunities to automate sorting and streamline delivery round sequencing processes. They have also looked to further exploit their advantages as distributors, for example, as information handlers and as providers of end-to-end document management and delivery services. Further, they have worked with customers to create new products, such as facilitated collection arrangements and “track and trace” products. Looking beyond the traditional value chain they have also started to offer services upstream and downstream to cement key customer relationships e.g. through mail preparation and mailroom management services.

We can see, therefore, positive developments in the sector-increasing concentration, greater innovation and efficiency, and increased competition. Further, we can see that the efforts that USPs and other operators have put into innovation and marketing over the last decade have expanded revenue streams in the sector, creating a potential €100 billion of revenues for which operators may compete.¹

At This Time Of Change The Market Has Remained Strong

Despite this strong market dynamic, the birth of the new postal sector appears not yet to have begun to destroy the old. Rapid market evolution has been combined with generally benign

¹ This figure, which is indicative, includes traditional sector revenues and those where postal operators may be active in areas upstream and downstream the value chain where postal operators compete — for example mail room services and inventory management.



market headlines. Both sector and core postal revenues have continued to grow, with sector revenues at about €88 billion per annum contributing around 1 per cent of EU GDP.

Postal markets still remain predominantly national markets, with EU letter volumes largely reserved to the USPs, and relative EU market shares broadly reflecting relative national market size; for example, Deutsche Post, Royal Mail and La Poste each have about 20 per cent of the market.

That the USPs remain generally profitable is still largely due to returns from their domestic mail services, and, where they have fallen into loss, this has often reflected losses in outdated parcels products or financial services, rather than operational decline. Aggregate demand for mail, which appeared to some commentators to be slowing down, seems now to be rising again, with positive growth recorded in a number of Member States, whilst revenues in all market segments are growing. Recent trends point to an increasing profitability in USPs.

Of course, this relative structural calm, in part imposed on the letter mail market by special rights, contrasts strongly with the fierce competition and increasing concentration in the parcels and express markets, where USPs no longer dominate home markets. In this market segment, Deutsche Post, has achieved a share of over 40 per cent of volumes in the EU parcels market, largely due to its acquisition of DHL. The parcels market remains fragmented, however, with a large tail of smaller national and local parcels, courier and express companies. It is here we can really see the market dynamic at work with the leading operators building up market presence in national markets through acquisition to create European network penetration.

However, there are tensions between the new and the old postal sectors

Despite this apparent stability the movement towards the new postal sector will not be free of difficulties. Particular problems may be caused by the continued lag in regulatory change in relation to market dynamics and the incomplete national postal restructuring in some Member States.

Postal regulation has not always set positive incentives for market players. Whilst the movement towards the internal market has arguably provided positive incentives for operators, special rights in the mail market may have delayed USP adaptation. Further, asymmetric regulation between express, parcels and mail market segments has conflicted with a market development where such services are commonly provided by the same operators. This asymmetry has been reinforced by conservative regulatory choices made by some Member States which have encumbered USPs with ill-defined universal service commitments and restricted the potential for competition to develop in mail services.

This lack of competition has, in turn, allowed wide variance in the cost efficiency and structure of universal postal services in the EU to remain, potentially creating instability as the market develops. Not all USPs have been able to exploit market opportunities with some receiving mixed incentives. These tensions, combined with remaining national protectionist attitudes, could restrict sector development despite de-regulation trends.



There is now an overwhelming dynamic for change

As we have seen, the market dynamic has created a rapid change in the postal sector, with competition between market players and their expansion into new markets. In this context, the remaining lag in regulatory development threatens to limit sector development. However, global and trans-European operators have seen the opportunities as well as the costs of removing trade barriers, explicitly offsetting potential losses in their home mail markets against gains elsewhere, and this is widening the constituency for regulatory change.

We are then at the start of a new age of postal development

Presently, operators appear to be preparing to move into other EU national mail markets in three ways: by accessing the incumbent USP value chain; by setting up rival end-to-end networks, initially possibly in unaddressed mail; and in some cases by buying a stake in other USPs. The signs are that these trends will be accompanied by a further concentration in the sector and, regulatory barriers notwithstanding, the development of regional and European postal and distribution networks.

A key dimension here will be the privatisation process, which appears to be speeding up as some Member States, struggling with budget deficits see the advantages of sale proceeds. However, national attitudes may yet prevent full privatisation of some USPs.

USPs will continue to strive for greater cost efficiency with possibly some USPs benefiting from partnership with more technically efficient and larger USPs. New postal networks may also lead to the development of new efficient postal business models starting unencumbered by the legacy of monopoly. Operators will continue to innovate and move into upstream and downstream markets. Alongside this rejuvenation of post we are likely to see continued expansion of EU operators into global markets possibly shifting their focus away from mainstream universal postal products or even from their home markets.

The age of the national post office may then be drawing to a close, but the age of global postal distributors and of aggressive postal profit seekers is just beginning.

The scope of this report

This report discusses and details the developments and trends outlined above, in some [46] pages, and 24 tables and charts. Enquiries should be addressed in the first instance to the author, David Stubbs, Senior Consultant with Europe Economics, email: david.stubbs@europe-economics.com.