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26th Conference on Postal and Delivery Economics

Discussion of papers: Regulatory tools

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Three papers considered in this session

- *Disoriented no more: An economics compass for the cost orientation principle*, Okholm et al
- *An approach to the assessment of whether a 'commercial rate of return' is earned by an asset-light universal service network – the UK approach*, Goodman
- *Creating last-mile incentives from inside-out; A template drawn from rural telecom*, Glass

Compass for cost orientation principle

- ‘Policy implications lead to economic interpretation
  - 1. Efficiency gained by pricing flexibility
    - prices not: all at FAC
  - 2. Prevent anti-competitive pricing: avoid predatory x-subsidy
    - prices not < incremental
  - 3. Avoid excessive pricing, on bundles of (universal) services
    - revenue from bundle ~ cost of bundle plus ‘normal’ profit
  - 4. And, have flexibility for adapting cost orientation to national specificities (market circumstances)

Questions and thoughts

- Consistent and clear costing principles relevant for monopoly, dominant or universal services.
  - **But for excessive pricing of universal service bundle, what is the cost standard? SAC of universal services, but this is likely very high cost**
  - what happens when there may appear to be 'predatory' pricing by firm competing in an adjacent market, e.g. Uber offering courier handling service (ride sharing with letters)
- Dynamic efficiency is a critical issue in slow-evolving businesses (postal, utilities, etc.)
  - look more widely at the requirement for profits vs dynamic efficiency? what about firms making no profits who invest? (e.g. start-ups)

Commercial rate of return

- Lots of terms and relationships:
  - IRR = NPV (%, cashflows)
  - EBIT = Revenues - opex - depreciation in year
  - ROS = EBIT / revenues; EBIT margin (Ofcom used: 5-10%)
  - ROCE = EBIT / (debt+equity capital employed)
  - ROA = EBIT / net book value (but paper highlights intangibles / and non-valued assets such as the USO)
- Revenues are annual, steady state, a flow variable, rather than a stock variable
- What is the fundamental? **Time value of money**

Questions which may lead to further conclusions

- Identify value of intangible ‘asset’ which gives reasonable ROA
  - “brand reliability”, that Royal Mail or the universal postal provider is not going to disappear overnight, provider of last resort, government will step in
- Expand upon real investor share holding incentives rather than components of regulatory entities
- Summarise key figures for postal operator benchmarks
  - Royal Mail: relevant group vs reported business
  - Poste Italiane: Group vs ‘Mail’

Key figures for two national postal operators

Royal Mail (£m)	Plc (pension adjusted)	UKPIL (decision entity)	Reported business * *allocated*
EBIT	575	411	
Revenue	9776	7658	
Opex+Depr	9201	7247	
Dividend	**~220**		
EBIT%	**5.9%**	**5.4%**	
Equity	4998		
ROCE%	**11.5%**		
Prop, Plant, Eq	2061		
Implied tangible asset value for ROCE=ROS	**~4000**		

Poste Italiane (€m)	Group	Postal
EBIT	1123	-517
Revenue (*interseg.)	10 629	3631 **(+ 4497)***
Opex+Depr	9506 **(+4497)***	8560
Dividend	**551**	
EBIT%	**10.6%**	**-6.4%**
Equity	7550	
ROCE	**14.8%**	
Prop, plant, eq	2001	
Bonds issued	**775 @ 3.25%**	
Implied intangible value for ROCE = EBIT%	**~2500**	

Source: year ending 2017 annual reports

Last-mile incentives from the inside-out

- Looking at strategy 1, ‘Competing’ service territories with super-efficiency or super-quality
  - internal competition depends on management (and team) incentives (i.e. bonuses) – politically palatable **in principle**?
  - 0.25% or 1% effect: this may be large in aggregate $$ but I suggest this is **marginal to a unit of effort**
    - it is not noticeable to work 1% harder/easier; pay 1% more/less; pay rise expectations 2-3% regardless
  - economists take a SSNIP perspective (5% or 10% price change) to assess whether consumers would switch products
  - study situations and implications with **10% incentive bonuses**?
  - last-mile only productivity is very different from sort/transport productivity

Last-mile incentives from the inside-out

- Looking at Strategy 2: best practices simulation leading to model for subcontracting or reverse auctions for last mile
- Reverse auctions: combine this theory with learning from new Finnish model (same “good” idea, sounds like a problematic implementation)
- Complexity of private firms bidding for a 9-objective 14-factor weighting?
  - alternative: Price & Quality only. But how to ‘prove’ quality?
  - Price only: define total quality/thresholds and then auction for $ (but how to auction? multi-round? combinatorial lots?)

Questions and thoughts for further analysis

- What is the effect (in telecoms) of a consumer charge to connect to the last mile? The same *recipient benefit* exists in the postal network, but there is normally no charge to have a recipient delivery point (even with basic USO, the telecoms connection was charged, changing the economics of last-mile in rural)
- Compare and contrast with UK rail network competition – operating franchises for separate service territories, on top of a national network – in particular what are the management incentives?
  - divide and conquer the unions on working practice?
  - give up on the franchise if it gets too difficult (costly)?

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