

# Postal Markets between Monopoly and Competition

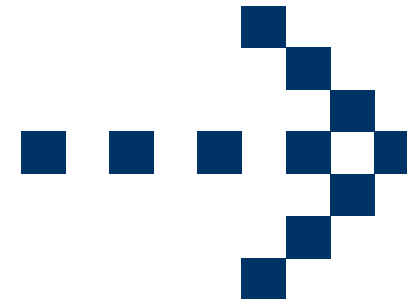
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'Access Pricing in Posts – Lessons from Other Industries'



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# Unbundling and Separation

Unbundling – disaggregating the value chain and mandatory access to parts of it.

Separation - imposing restrictions on the vertically integrated firm's structure or behaviour.

# The EC's Energy Sector Review

## Problems

- over concentration
- vertical foreclosure
- lack of transparency
- failure to build interconnectors
- limited retail competition

## The remedies

- 'full unbundling', with structural separation.
- application of competition law
- market integration

# Examples of Value Chain

<b>POSTS</b>	<b>WATER</b>	<b>GAS</b>	<b>ELECTRICITY SUPPLY</b>	<b>FIXED TELECOM</b>	<b>MOBILE TELECOMS</b>
Collection	Extraction	Extraction	Generation	Origination (local loop)	Origination (wireless)
Sorting	Processing	Transmission	HV transmission	Transit	Transit (fixed)
Tracking	Transport	Storage	LV distribution	Termination (local loop)	Termination (wireless)
Sorting		Local distribution			
Delivery					
Retailing	Retailing	Retailing	Retailing	Retailing	Retailing

## Dynamic theories of infrastructure competition: 'the ladder'

<b>Posts</b>	<b>Broadband</b>	<b>Water</b>
Delivery	Local loop	
Outward sorting	Backhaul	Delivery
Trunking	Core network	Processing
Inward sorting (‘work-sharing’)	Access to web	Extraction
Retailing	Retailing	Retailing

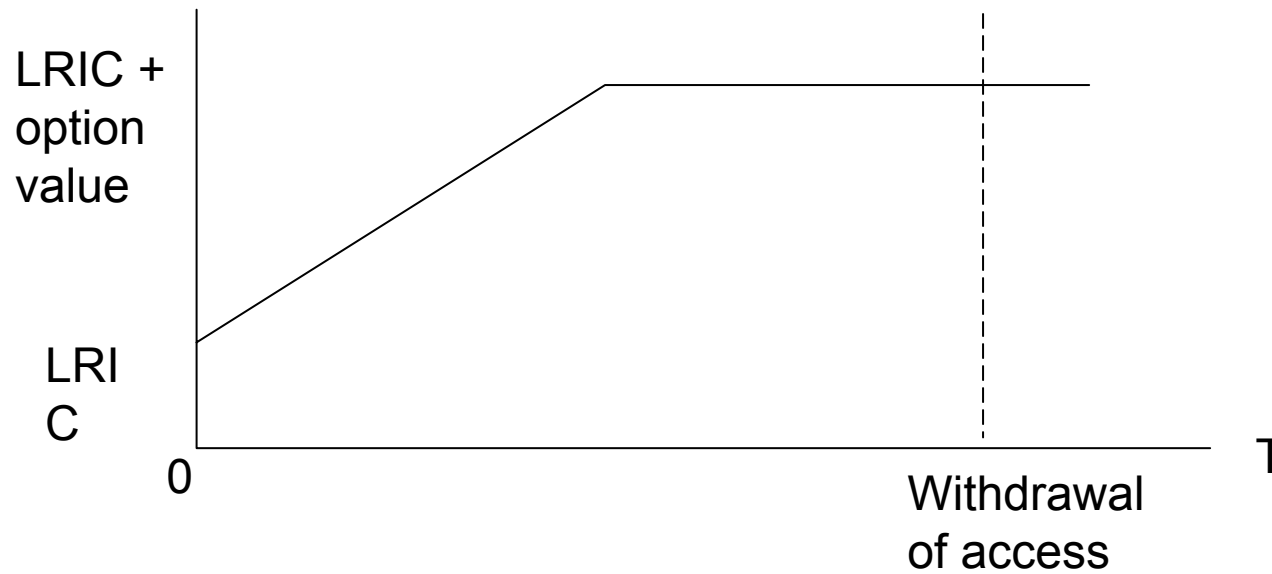
The goal is to take competition progressively into the value chain

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# Regulatory Tools for the Ladder

- Denial or withdrawal of access (based on market analyses or sunset clauses)
- Flexing access prices (low initial prices, rising as replication becomes more feasible)

# An Interpretation of Rising Prices Based on Real Options



## The Role of Separation as an Adjunct to Access Pricing

Accounting separation – should prevent price discrimination

Operational/functional separation -requires re-engineering of business processes; directed at non-price discrimination; allows co-ordination of investment across the boundary

Ownership separation: no incentive for preferential treatment.



# Elements of Operational Separation

What is separated?

- premises
- labour
- equipment
- investment strategy
- management information systems
- brand

# The Ladder of Separation

Ownership separation

Legal separation

BS + with governance change

BS with separate incentives (BS+)

Business separation (BS)

Virttual separation

Accounting separation

## Back to Access Pricing : the Regulator's Objectives

- ⌘ Efficient recovery of fixed/common costs
- ⌘ Efficient entry signal (static productive efficiency)
- ⌘ Dynamic efficiency (ladder/cost-benefit type approaches)
- ⌘ Maintaining a desired (non cost-based) retail price structure
- ⌘ Maintaining universal service objectives (same price, different costs)

# The Pricing Principles

- Marginal cost (MC)
- Long run incremental cost (LRIC)
- LRIC + equi-proportional mark-up for common costs (EPMU)
- Ramsey pricing (MC/LRIC + high mark-up for final services in inelastic demand)
- Retail-minus/efficient component pricing rule

## Comments

LRIC-based on top-down or bottom up modelling

Ramsey pricing – involves contestable demand-side estimates

LRIC + EPMU -too simple for large mark-ups?

ECPR- does it bill competition?

# Access Pricing Rules and Regulatory Objectives

	Marginal cost	Incremental cost	Ramsy pricing	ECP R
Promotion of competition	✓	✓		<b>X</b>
Promotion of efficient entry	<b>X</b>	✓		✓
Promotion of first or second best pricing efficiency	✓(1)		✓(2)	<b>X</b>
Maintaining desired retail price structure	<b>X</b>	<b>X</b>	<b>X</b>	✓
Ensuring cost recovery	<b>X</b>	✓	✓	✓

# An Interpretation of the Role of ECPR

A. Where the competitors supply considerable infrastructure

1. If retail prices are cost-based, then so should access prices be
2. If the regulated retail tariff is distorted for social reasons, then a preferable approach is to cross-subsidise losses directly, but if an alternative regulatory instrument is not available, then (possibly) ECPR

B. Where the competitor is a reseller (no infrastructure, no product differentiation), ECPR may be acceptable, since promotion of efficient entry may be the sole criterion.

## Sector Specific: Posts

2<sup>nd</sup> Postal Services Directive states:

‘... where universal service providers apply special tariffs [for access products]... the tariffs shall take account of the avoided costs, as compared to the standard service covering the complete range of features offered from the clearance, transport, sorting and delivery of the individual postal items.’

There may be room for doubt as to what this means!



## The Postal Context 1: Which Rung to Aim for?

- ▣ Some operators, such as TNT in the UK, aspire to reach the pinnacle of end-to-end competition
- ▣ This may be feasible for a) a differentiated service (eg not 6 days a week) in b) particular geographies.

## The Postal Context 2: How regulators can Deal with this Uncertainty

- ⌘ Attend to the structure of prices for access products- access providers typically want to confine access seekers to lower rungs
- ⌘ Be alert to non-price discrimination, and utilise separation options appropriately
- ⌘ Do nothing to deter end-to end competition.