

Public Procurement of Universal Services: Practical Considerations

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“Competition in Postal Services: A Return to Senders?”

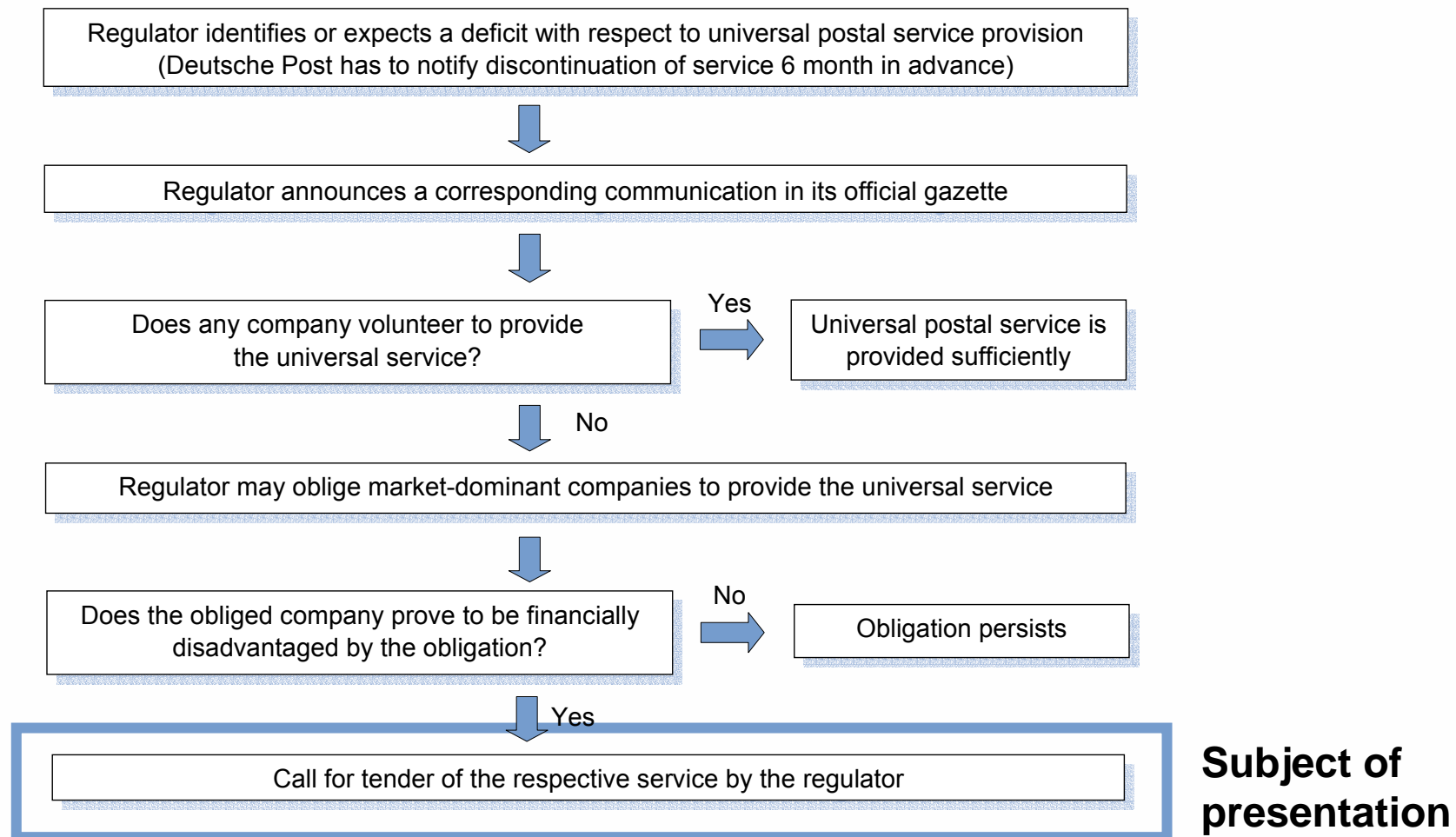
Königswinter, 26 November 2008

Background and Objective of Presentation

- Germany:
 - No obligation on a company to provide universal postal service
 - Regulator (BNetzA) can procure service(s) if universal service is not supplied adequately by the market
- Postal Directive explicitly allows for the possibility of ensuring universal services by public procurement
- Background of the study:
 - No practical experience
 - Practical implementation is expected to be difficult
- Objective of the study:
 - Discuss practical matters related to the procurement of universal services, or parts of the universal service

1. USO Mechanism of the German Postal Law
2. List of Relevant Questions for Procurement
3. Procurement of “Regional Acceptance” (1st example)
4. Procurement of “Regional Delivery” (2nd example)
5. Conclusions

1. USO Mechanism of the German Postal Law



2. List of relevant Questions for Procurement

General recommendation for *all* procurement procedures:

- Use open procedure (standard procedure by European law)
 - Maximising bidder's competition
 - minimising compensation payment

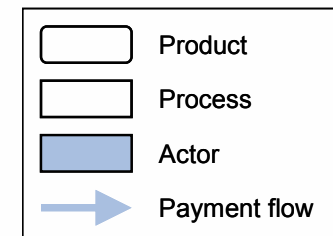
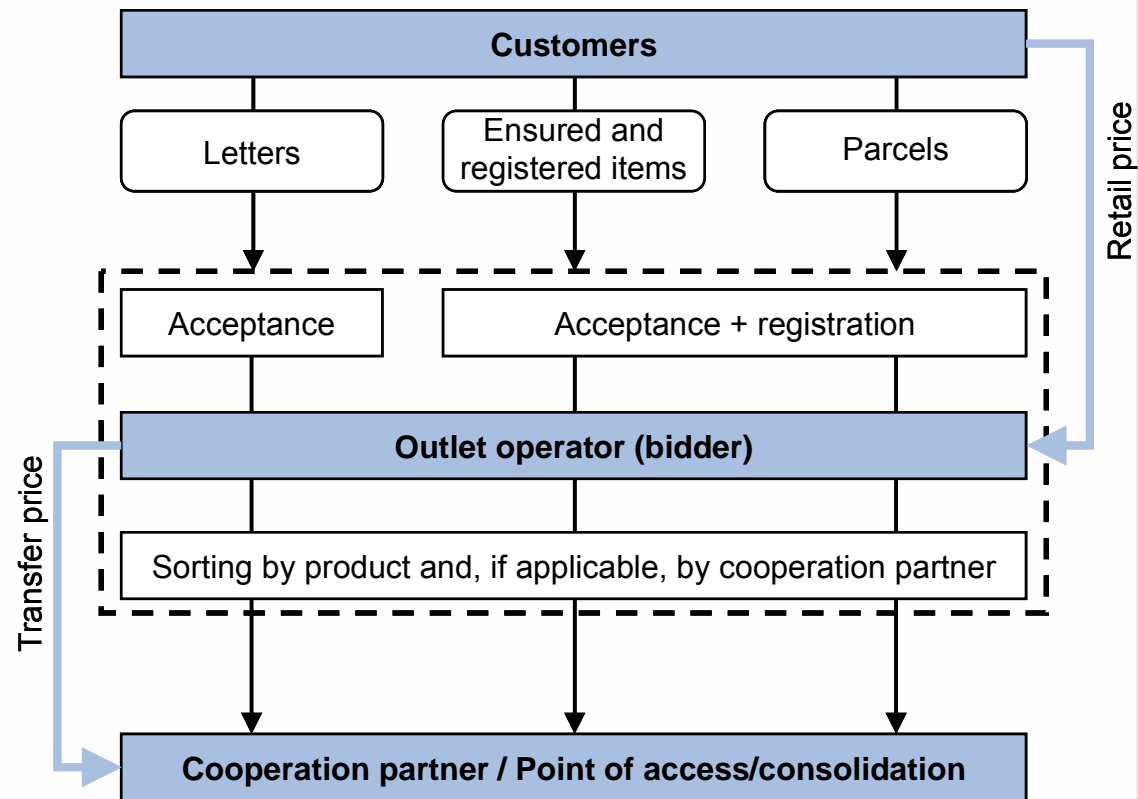
List of relevant questions:

Description of subjects of contracts	<ol style="list-style-type: none">1. For which service should the regulator solicit bids?2. For which period should the regulator procure the service?
Financial aspects	<ol style="list-style-type: none">1. Should the bidder keep the sales revenues?2. Should the regulator prescribe prices on all bidders?

3. Procurement of Regional Acceptance Processes and Payment Flows

Assumptions:

- Bidder accepts postal items against retail price (right payment flow)
- Bidder cooperates with at least one postal operator for transport and delivery
- Bidder pays a transfer price to the cooperation partner (left payment flow)
- Two conceivable models :
 - Sales agent
 - For own account

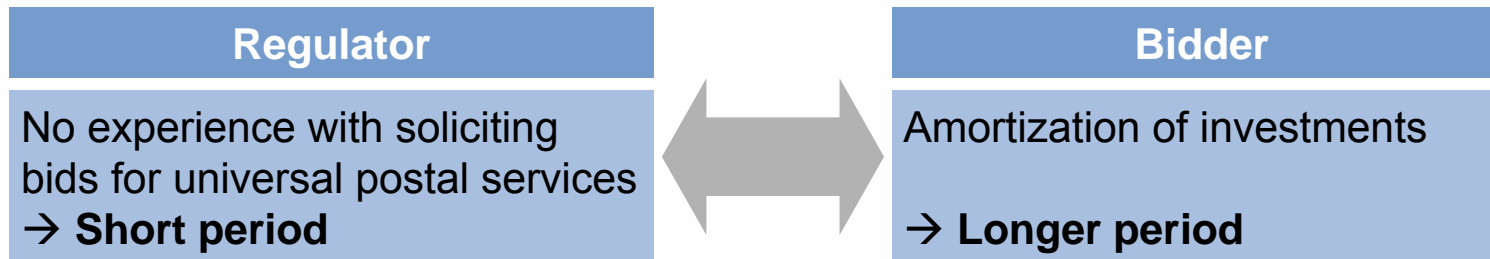


3. Procurement of Regional Acceptance Description of Subjects of Contract

1. For which service should the regulator solicit bids?

- Solicit bids only for services which are not provided by the market (here: acceptance of US in a specific area, e.g. a municipality)
- Use functional service descriptions rather than prescribing detailed production processes: innovative concepts of bidders can lead to more economic solutions for providing universal service

2. For which period should the regulator procure the service?



- We expect bids from existing stores – only marginal need of additional investments
→ **Short period** (e.g. one year)

3. Procurement of Regional Acceptance

Financial Aspects: Who keeps sales revenues?

1. Should the bidder keep the sales revenues?

Option 1: Bidder keeps sales revenues
→ Bidder takes the risk



Option 2: Bidder transfers sales revenues to the regulator
→ Regulator takes the risk

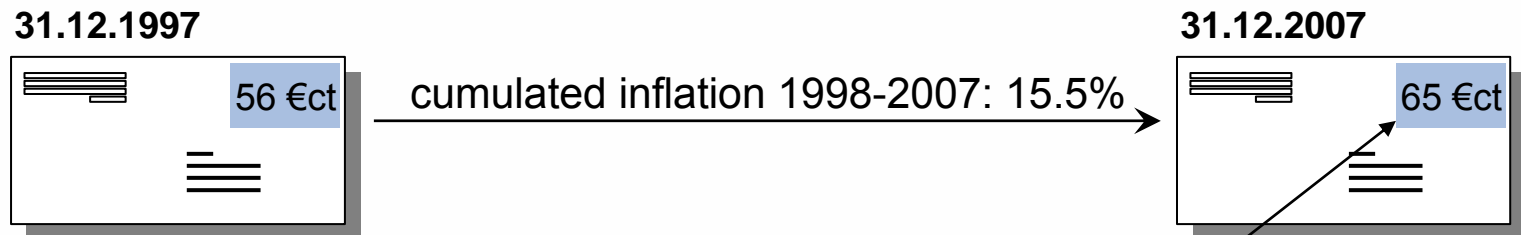
- Objective: Bidders should take the risk of revenues only if they can influence the revenues
- Bidder's revenues seem relatively certain
- Bidder can influence revenues (+/-): attract more items (+) by providing good service – or scare off customers (-)
- Recommendation: bidder should keep all revenues, e.g. generated by sale of stamps (bidder covers his costs by revenues and the compensation charge paid by the regulator)

3. Procurement of Regional Acceptance Financial Aspects: Retail Prices

2. a) Should the regulator prescribe *retail prices* on all bidders?

- Procured services must be affordable (but no more restrictive requirements)
- German postal legislation: Affordability related to the average real price level for letters on 31.12.1997

Example: Deutsche Post's price for standard letters, 20g



Maximum affordable price according to German postal legislation

- Recommendation: Regulator should not determine retail prices but prescribe maximum affordable price according to German postal legislation

3. Procurement of Regional Acceptance

Financial Aspects: Transfer Prices

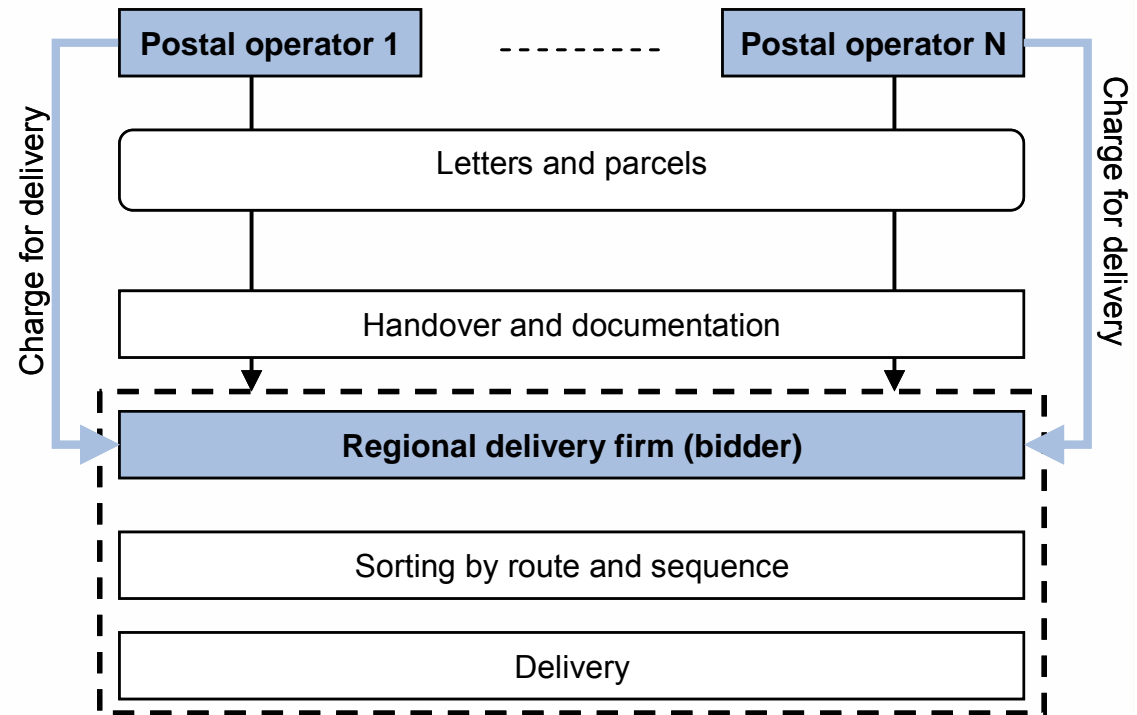
2. b) Should the regulator prescribe *transfer prices* on all bidders?

- Bidder has to pay transfer prices to his cooperation partners
- Should this price be regulated?
- ▶ No: Transfer price is limited by public retail prices of other postal operators (e.g. the incumbents)
- Fallback position: bidder can always post accepted/collected items at regular postal offices of other operators (e.g. Deutsche Post)

4. Procurement of Regional Delivery Processes and Payment Flows

Assumptions:

- Bidder has an obligation to contract with respect to all postal operators
- Bidder receives charges from postal operators for delivery



4. Procurement of Regional Delivery

Description of Subjects of Contract

1. For which service should the regulator solicit bids?

- Only service which is not provided by the market (here: delivery of letters/parcels in a specific area, e.g. a municipality)
- Functional service description; e.g.: delivery in one specific municipality, six days per week etc.

2. For which period should the regulator procure the service?

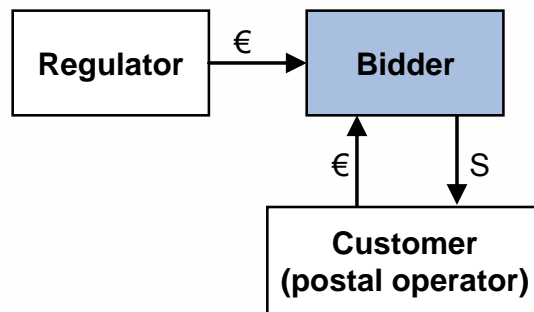
- No critical specific investments
- Short period (e.g. one year)

4. Procurement of Regional Delivery

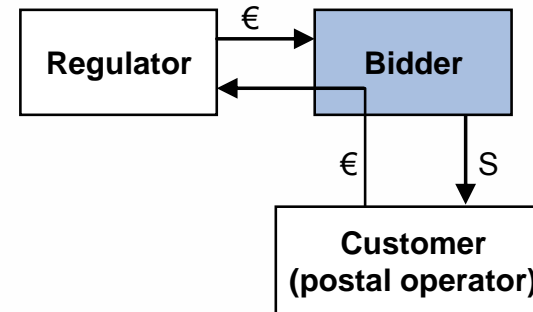
Financial Aspects: Who Keeps the Sales Revenues?

1. Should the bidder keep the sales revenues?

Option 1: Bidder keeps sales revenues (delivery charges)



Option 2: Bidder transfers sales revenues (delivery charges) to regulator



€: Payment stream
S: Service stream

- High uncertainty about volumes (dependence on DPAG)
→ High risk of revenues in case of keeping charges
 - Transaction costs (bidder – regulator) comparable lower
 - Payments are well observable (bidder receives delivery charges only from a small number of postal operators)
- ▶ Regulator should keep revenues (Option 2)

4. Procurement of Regional Delivery

Financial Aspects: Delivery Charges

2. Should the regulator prescribe *delivery charges* on all bidders?

Delivery charge: free to market

- Bidder will charge prohibitive prices
 - Additional volume increases cost, but not revenues (bidder is solely financed by compensation payment)
 - Prohibitive prices decrease volume to be delivered

Delivery charge ~ 0

- Incentive for postal operators to discontinue delivery in other regions
- Delivery will be ensured by procurement

Regulator should determine a delivery charge significantly > 0

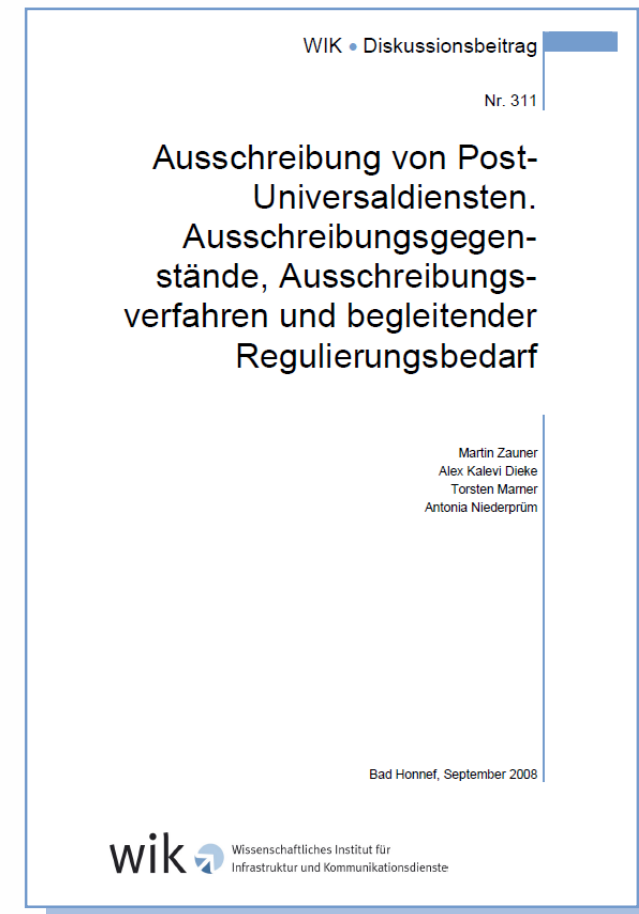
- Price should be \geq costs of other operators delivering themselves in other regions
- Simple rule: charge could be set to the **average postage** of postal operators

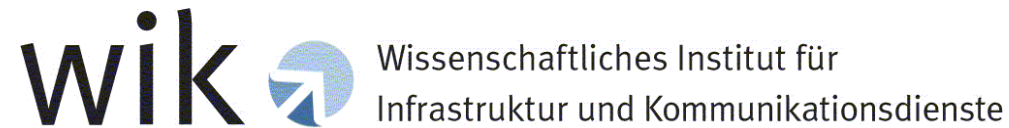
5. Conclusions

- The regulator should only procure services which are not provided by the market, e.g. for specific areas.
- Procurement of universal postal services seems manageable – procurement of universal services works in other industries – insistence on difficulties in practical implementation may be “noise”
- Open procedures should be preferred over restricted procedures (maximal competition among bidders; minimal compensation claimed by bidders).
- The regulator should use functional service descriptions rather than prescribing detailed production processes. Innovative concepts of bidders can lead to more economic solutions for providing universal service.
- Where expected revenues for bidders are highly uncertain, the bidders' risks can be reduced if they are compensated for their expected total cost (according to the bids), and the regulator receives all revenues from sales of the procured service. In this case, prices charged by the successful bidder should be determined in the call for tender.

Read More...

- This presentation contains parts of WIK Discussion Paper no. 311: “Procedures for public procurement of universal services”, September 2008
- Full version only available in German language (paper includes English summary)
- Download the discussion paper at http://wik.org/content_e/diskus/311.htm





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