Upstream Competition and Retail Price Regulation: Lessons from Downstream Access Models

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Agenda

- Introduction
- Summary of International Experience
- Role of Downstream Access

1. Introduction
Background and Objective of Presentation

- Background: Two models of competition in letters markets

Upstream competition (based on downstream access)	**End-to-end competition** (based on own delivery networks)
Examples:	Examples:
• US (53%)*	• DE (9.0%)*
• UK (47%)*	• NL (12.8%)*
• DE (~ 25%)* #	• SE (11.0%)*

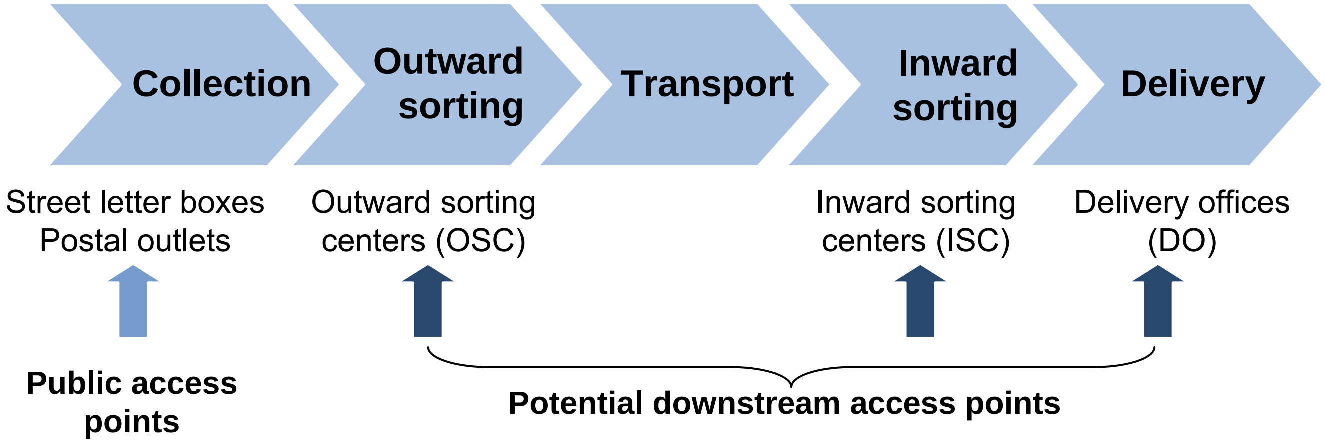
* % items via downstream access (2008)
\# estimated

* market share competitors (2008)

- Objective:
  - Analyse international experience with downstream access
  - Understand the role and effects of downstream access in liberalized markets

1. Introduction
Possible Goals of Downstream Access

- Concept:
  - Access to infrastructure facilities of the incumbent operator
  - Downstream access reasonable only at network hubs (OSC, ISC, DO):



- Possible goals:
  - Incentives to invest in infrastructure (‘ladder of investment’)
  - Development of workable competition in postal markets
  - Price savings for customers

1. Introduction
Theories That Could Justify Downstream Access

- Monopolistic bottleneck theory:
  - In most network sectors: monopolistic bottleneck identifiable (e.g. railway tracks, telecoms' last mile)
  - **Letters market**: monopolistic bottleneck not clearly identifiable
  - ► No requirement to mandate downstream access
- 3-criteria-test (applied in electronic communications)
  - Need for ex-ante regulation in a relevant market if 1) high entry barriers *and* 2) no effective competition *and* 3) competition law not sufficient
  - **Letters market**: strong need for ex-ante regulation in private consumer markets
  - ► Network access creates no benefit for private consumers; retail price regulation more suitable
- Ladder of investment:
  - In general: build-up of infrastructure networks requires high investments; downstream access helpful: capital accumulation → build-up own network successively
  - **Letters market**: no prohibitive costs to build-up own delivery networks
  - ► Ladder of investment does not apply in the postal practice

2. Summary of International Experience
USA

1. Development of downstream access:
   - History: worksharing since 1976, dropshipping since 1985
   - Reason: USPS was looking to promote volume increases and saw worksharing as a way to deaverage costs
   - Scope: sorting by route; access up to delivery office
   - Price regulation: access prices are regulated by NRA
   - Prices 2009: discounts up to 66.5%
2. Development of competition:
   - Upstream: 81% of USPS' total volume was workshared in 2008; 53% was dropshipped
   - End-to-end: Mailbox-monopoly → no competition by law
3. Role/effects of downstream access:
   - Positive effect on letter post volume (mainly between 1976 and 2000)
   - Price savings for customers
   - Advantage USPS: items via downstream access save sorting costs
   - USPS markets worksharing/dropshipping products actively

2. Summary of International Experience
Great Britain

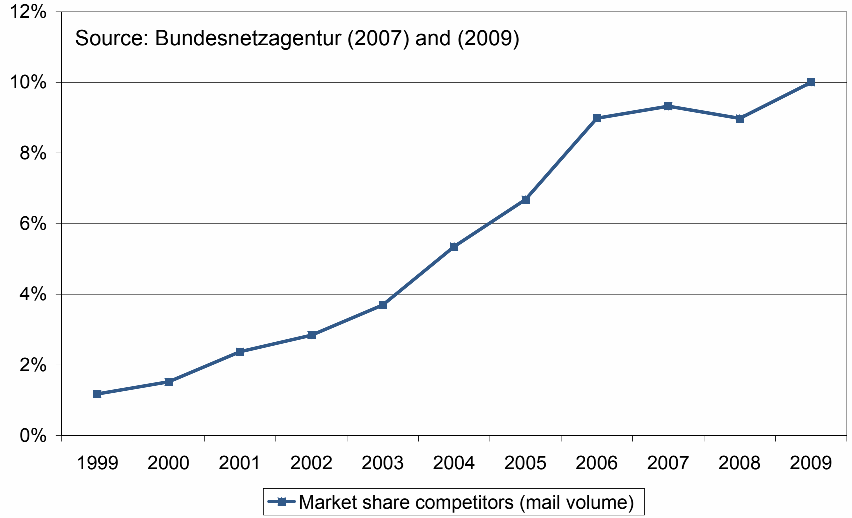
1. Development of downstream access:
   - History: Royal Mail's licence requires downstream access: first 'access agreement' with UK Mail in 2004
   - Scope: sorting by route; access up to ISC
   - Price regulation: access prices are regulated by Postcomm
   - Prices 2009: discounts up to 61%
2. Development of competition:
   - Upstream: Access volume is 47% of Royal Mail's total volume in 2008/2009. Approximately 1/3 of access volumes is from customers directly (Customer Direct Access; CDA)
   - End-to-end: delivery volume of competitors is 0.12% in 2008
3. Role/effects of downstream access:
   - Consolidators entered the market and Royal Mail offered CDA
   - Price savings for mailers
   - Negative impact on end-to-end competition;
Royal Mail kept total volume in delivery
   - Royal Mail was forced to grant downstream access.
Today, Royal Mail markets access products actively (esp. CDA)

2. Summary of International Experience
Germany (1)

1. Development of downstream access:
   - History: mandatory downstream access for customers since 1999/2000; for competitors/consolidators since 2005
   - Scope: sorting by ISC and access up to ISC
   - Price regulation: access discounts were determined by NRA in 1999/2000. In 2008, DPAG raised discounts by 5%-pts. voluntarily
   - Prices 2009: discounts up to 26%
2. Development of competition:
   - Upstream: Access volume is ~25% of DPAG’s total volume in 2008
   - About 7% is from consolidators (more than 2/3 of access volumes are from customers directly)

2. Summary of International Experience
Germany (2)

- End-to-end:



- Continuous rise of competitors' market shares (1999 to 2007)
- In 2007: Implementation minimum wage; PIN insolvency
- Market share competitors (2009): 10%
- Major competitors at present: TNT Post and regional delivery services

4. Role/effects of downstream access:
   - Limited entry of consolidators
   - Price savings for mailers
   - Increase of access volumes
   - DPAG was forced to grant downstream access; today, DPAG markets access products actively (e.g. higher discounts)
   - Consolidators are independent from delivery operators

3. Role of Downstream Access
Effects of Downstream Access

- Access creates a market for consolidators (e.g. USA, UK, DE)
- Prices decreased:
  - Indirectly for large mailers using consolidators
  - Directly for large mailers using downstream access
    - DE: more than 2/3 of the access volume is from customers directly
    - UK: about 1/3 of the access volume (ISC) is from customers directly
- Positive impact on letter post volume (e.g. USA)

3. Role of Downstream Access

Goals of Mandatory Downstream Access

Goal	Goal achieved?
Incentives to invest in infrastructure (‘ladder of investment’)	↓ No. Concept of ‘ladder of investment’ does apparently not apply in practice
Development of workable competition in postal markets	→ Partially. Markets for consolidation are only moderately developed; customers use downstream access to a large extent directly
Price savings for customers	↑ Yes. Mandatory downstream access has similar effects as retail price regulation

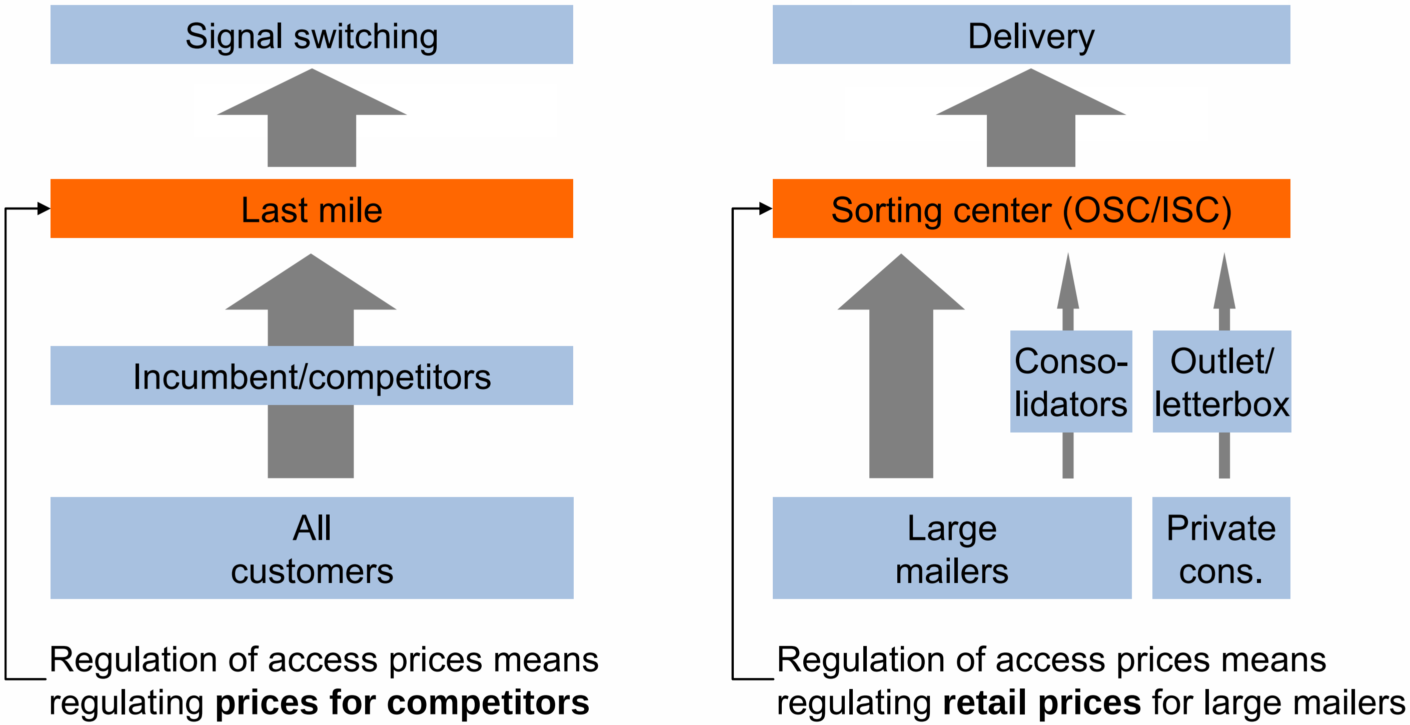
3. Role of Downstream Access
Specific Characteristics of the Letter Post Market

Other network sectors (e.g. telecommunications):

Network access can only be used by competitors

Letter post market:

Network access is used both by large mailers and consolidators



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3. Role of Downstream Access
Conclusions

- Mandatory downstream access has similar effects as retail price regulation
- In monopoly, mandatory downstream access is appropriate to replace competitive pressure
- Competition can be from entrants or by substitution. With competition, incumbents have strategic interests to offer access products:
  - DE: voluntary increase of upstream discounts after full market opening
  - UK, USA: incumbents market access products actively
- The more intense competition is, the more likely it is that the incumbent would offer access products voluntarily
- The less intense competition is, the more appropriate it is to require downstream access

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