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Price regulation in the context of volume decline

François Lions
Deputy Director-General
ARCEP, France

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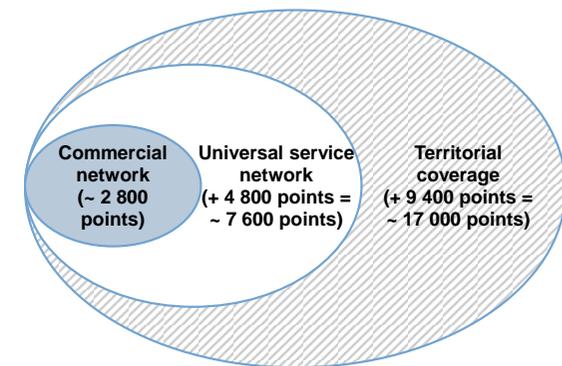
The universal service in France, the other public service obligations of La Poste and the financing of those obligations

La Poste provides the universal service in France. As such, it is under the obligation to:

- provide a mail and parcel offer, relatively broad on mail (it includes bulk mail and even a part of advertising mail) and relatively narrow on parcels (it excludes bulk parcels);
- ensure a minimum proximity of postal contact points (accessibility of US);
- collect and deliver mail 6 days a week.

Furthermore, La Poste ensures other public service obligations:

- transport and delivery of press at subsidised rates ;
- territorial coverage beyond accessibility obligation.



The financing of the obligations of La Poste:

- the universal service obligations could, in theory, be funded by a fund fed by the postal sector; in practice, in the absence of competition in the postal sector, this fund has never been activated; the cost of these obligations is financed by the Group La Poste in its whole and not solely charged to its postal activities;
- the public service obligations are in part compensated by the State in the form of subsidies or tax cuts.

In total, La Poste values the cost of all public service obligations, after taking into account State compensations at about 900 million euros in 2013 (ARCEP has never had to value the cost of the universal service obligation, which would only be done if the fund was activated).

NB: “La Banque Postale”, a subsidiary of La Poste, has also specific banking obligations; in particular it has to accept all clients.

The challenge for La Poste

La Poste Group operates, directly through the parent or through subsidiaries, in several markets for a total turnover of approximately EUR 22 billion in 2013: mail, parcels, express and banking. The universal service is provided by the parent company. It is a significant part of total mail and a small part of the total parcel activity in France.

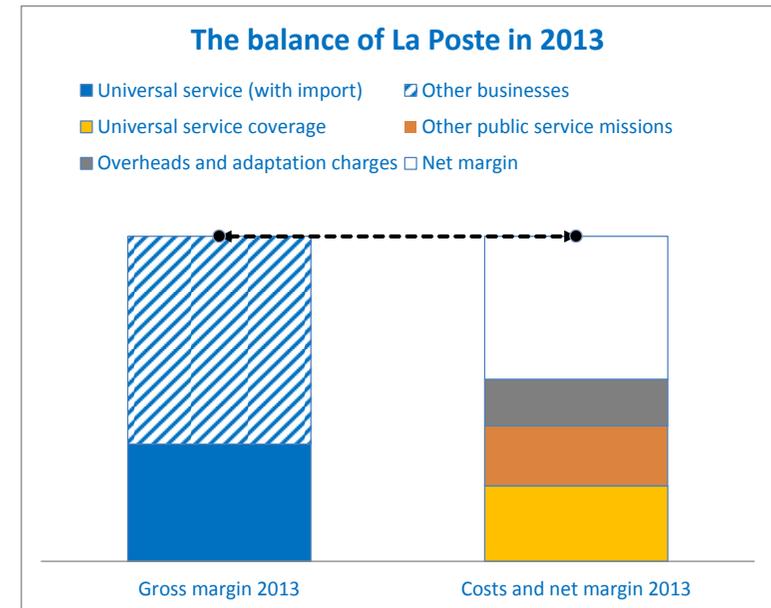
The gross margins of the various activities of La Poste (universal service, other services of mail and parcels, express, banking) all contribute to the residual costs of public service, to the overhead, to other non-attributable costs as well as to the net margin of the Group.

In 2013, the part of the universal service in the total gross margin remains significant, around 35%.

This model is threatened by the decline of postal volumes. Furthermore, the net margin at the Group level is insufficient to ensure a reasonable profitability to La Poste.

Two main issues:

- for the regulator - what is the likely magnitude of the declines in volumes and what are the capabilities of La Poste to adapt its organization to such decline without jeopardizing its universal service obligations?
- for the company, at the Group level - how the contributions of the various activities of La Poste (including universal service) can be redistributed in order to cover non-attributable costs and to contribute to the increase of the net margin?



The regulatory answer: a renewed price-cap

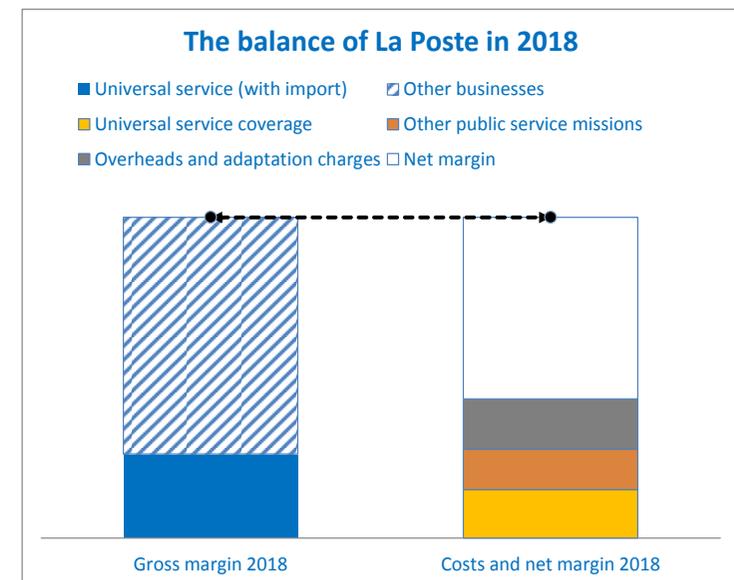
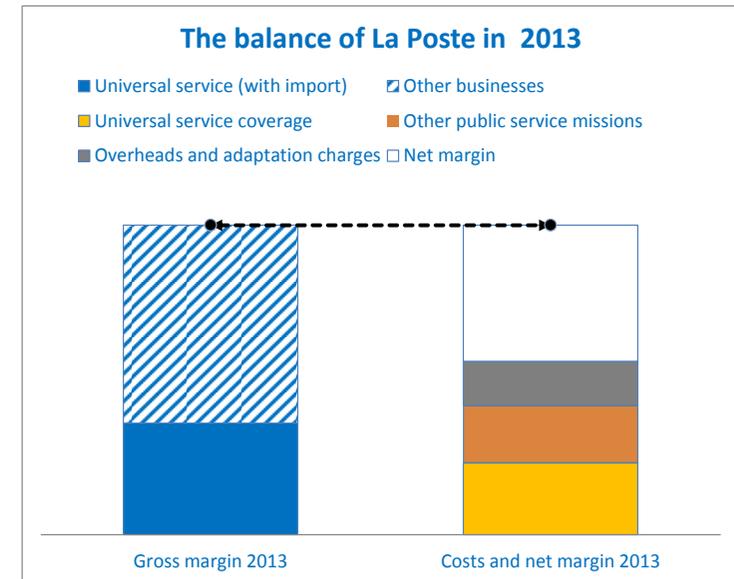
An agreement was reached under the following conditions:

- Maintaining of the net margin rate of universal service, in a context of declining volumes, both by price increases and by adaptation efforts by La Poste (adapting operating processes dimensioning to volumes, and reducing public service costs and overheads);
- Increasing of the net margin of activities other than those of universal service.

Overall, the universal service part in the Group's gross margin is expected to be reduced to about $\frac{1}{4}$ in 2018:

The main tasks conducted by ARCEP were:

- Ensuring the correct prediction of volume changes;
- Appreciating the effort sharing between the company (cost reduction) and consumers (tariffs increases);
- Assessing the impact on consumers.



The final regulatory scheme – main features

The price-cap in France covers almost all the scope of universal service. Its scope includes products having different economic characteristics:

- Single piece mail (having low price elasticity);
- Bulk mail (having higher price elasticity);
- Other services.

The scheme retained is an incentive for the company to efficiency and gives it the latitude to adjust its prices according to individual characteristics of demand.

Regarding the protection of users, ARCEP can handle it through its opinions on individual movements in tariffs, and has the ability to oppose (if the pricing principles of universal service are “clearly” not met).

In terms of method, ARCEP is seeking to maintain the margin rate (or control its evolution) on the scope of universal service. This margin rate is maintained if the price change, in real terms, compensates volume trends, once considered the adaptation of costs in real terms:

$$X = - (dp/p - i) = (1 - \alpha) dq/q$$

where α measures the elasticity of costs in real terms to volumes: $dc/c - i = \alpha dq/q$

The final regulatory scheme – ARCEP decision n° 2014-0841 of 22 July 2014

Period: 2015-2018 (4 years).

Constraint:

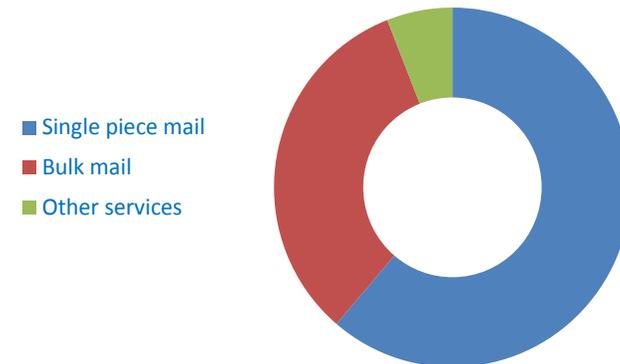
- CPI + 3.5 % per year on average;
- (inflation assumption of 1.7% per year on average, changes in volumes assumption of - 6.3% per year on average);
- adjustment clauses to adapt the regulatory scheme to changes in volumes and inflation assumptions.

Global basket corresponding to the whole scope of universal service (without import).

« Tunnel » framing the annual price-cap consumption:

2015	2016	2017	2018
50 %	70 %	90 %	100 %

Division of basket



Mid-term review at mid-2016.

[Link to ARCEP's decision n° 2014-0841 of 22 July 2014](#)

The work carried out: volumes

ARCEP conducted an econometric analysis on the evolution of postal volumes (historical series by quarters):

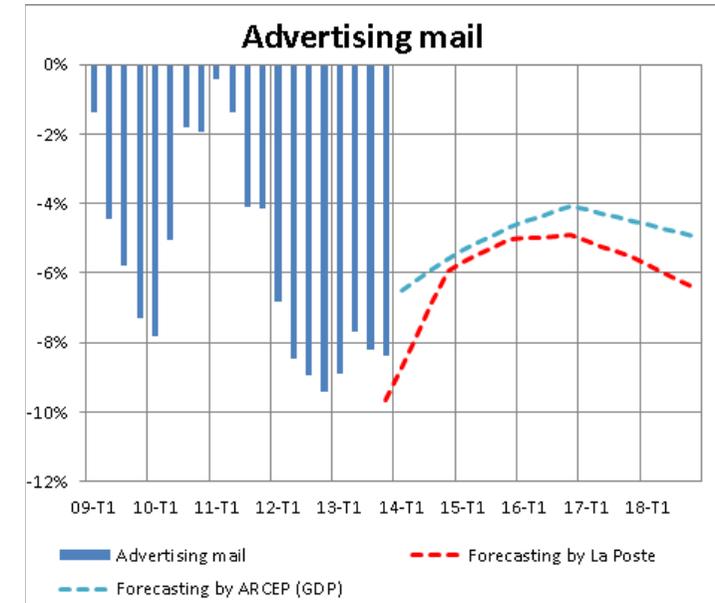
- analysing the evolution of different segments (single piece mail, bulk mail, advertising mail, etc.);
- in light of time and evolution of GDP, and neutralizing the periods of crisis.

By segment, this analysis showed a more or less good correlation between changes in volumes and:

- GDP growth;
- Time: this factor suggests a progressive disconnection between GDP growth and evolution of postal volumes.

The overall projection obtained by recomposing these analyses by segment proved consistent with the analysis conducted by La Poste. ARCEP therefore retained volumes projections realized by La Poste.

Example :



The work carried out: costs evolution and efforts sharing

1 - On the evolution of costs

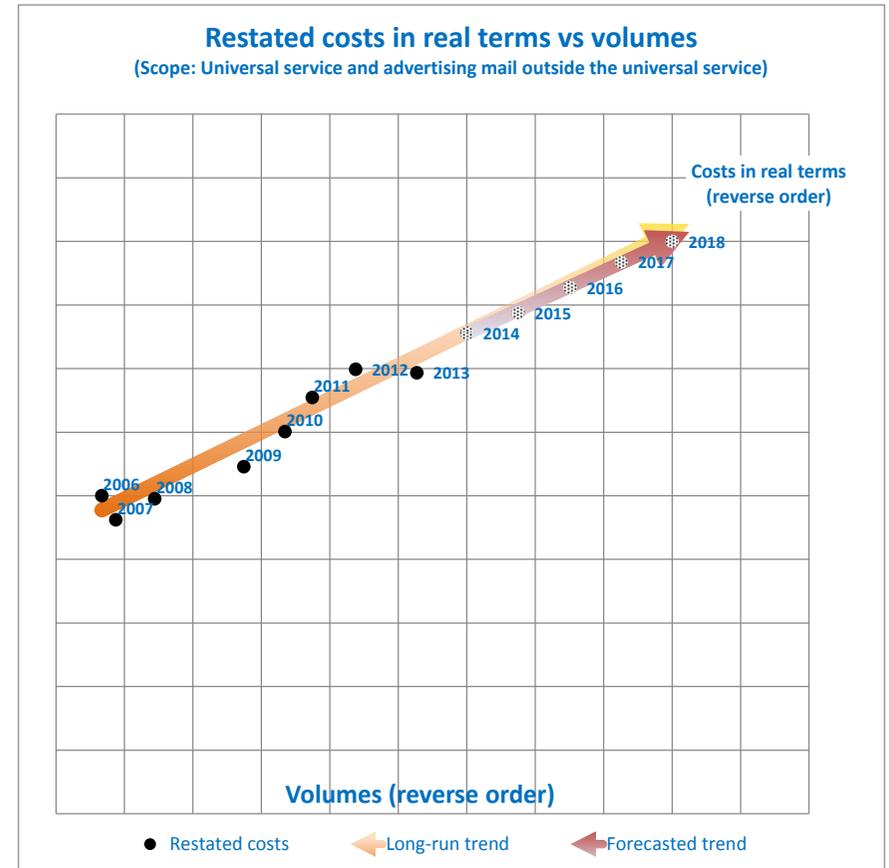
ARCEP obtained projections of changes in costs of La Poste in different areas including the one corresponding to the universal service.

These projections appeared reasonable in the light of past adaptations: the graph on the right compares costs, in real terms, restated in order to ensure comparability between years, and volumes.

The evolution projected by La Poste appeared realistic because consistent with the long historical trend. It was supported by a presentation of the concrete adaptation programs undertaken by La Poste.

2 - On the sharing of efforts between the company and consumers

The adopted regulatory scheme results in a practically stable margin rate within the scope of universal service and corresponds to a balanced sharing of efforts between the company (45%) and consumers (55%).



The work carried out: the effect on consumers

Price increases incurred by La Poste are generally distributed quite unequally between the different postal products (single piece mail, bulk mail and advertising mail): they are more unfavourable to households than to businesses.

However, households' consumption in postal services is low in absolute terms (about 4 euros per month) and it only represents a low share of their total consumption (about 0.12%). In addition, their consumption is falling.

Thus, at constant structure and traffic, tariffs implemented in 2015 by the La Poste would increase the average household bill of 11.1% compared to 2014. Nevertheless, taking into account the drop in traffic, changes in the structure of the basket and the increasing number of households, household spending in 2015 would increase by 3.8% in 2015.

These considerations have led ARCEP to consider that the significant tariff increases resulting from its new price-cap scheme weren't likely to contravene the principle of affordability for universal services.

Conclusion

ARCEP and La Poste succeeded in finding a tariff agreement for the period [2015-2018] that allows preserving the capacity of La Poste to ensure its universal service obligations, as well as its other public service missions, while ensuring an acceptable balance between the company and users.

La Poste implemented a first average price rise of 7.8 % on the 1st of January 2015.

It is now up to La Poste, as part of its strategic plan, to continue the implementation of its adaptation actions and the development of its activities.

A mid-term review is scheduled for the summer of 2016 after the first two years of implementation. On this date, the regulatory accounts for 2015 will also be available.