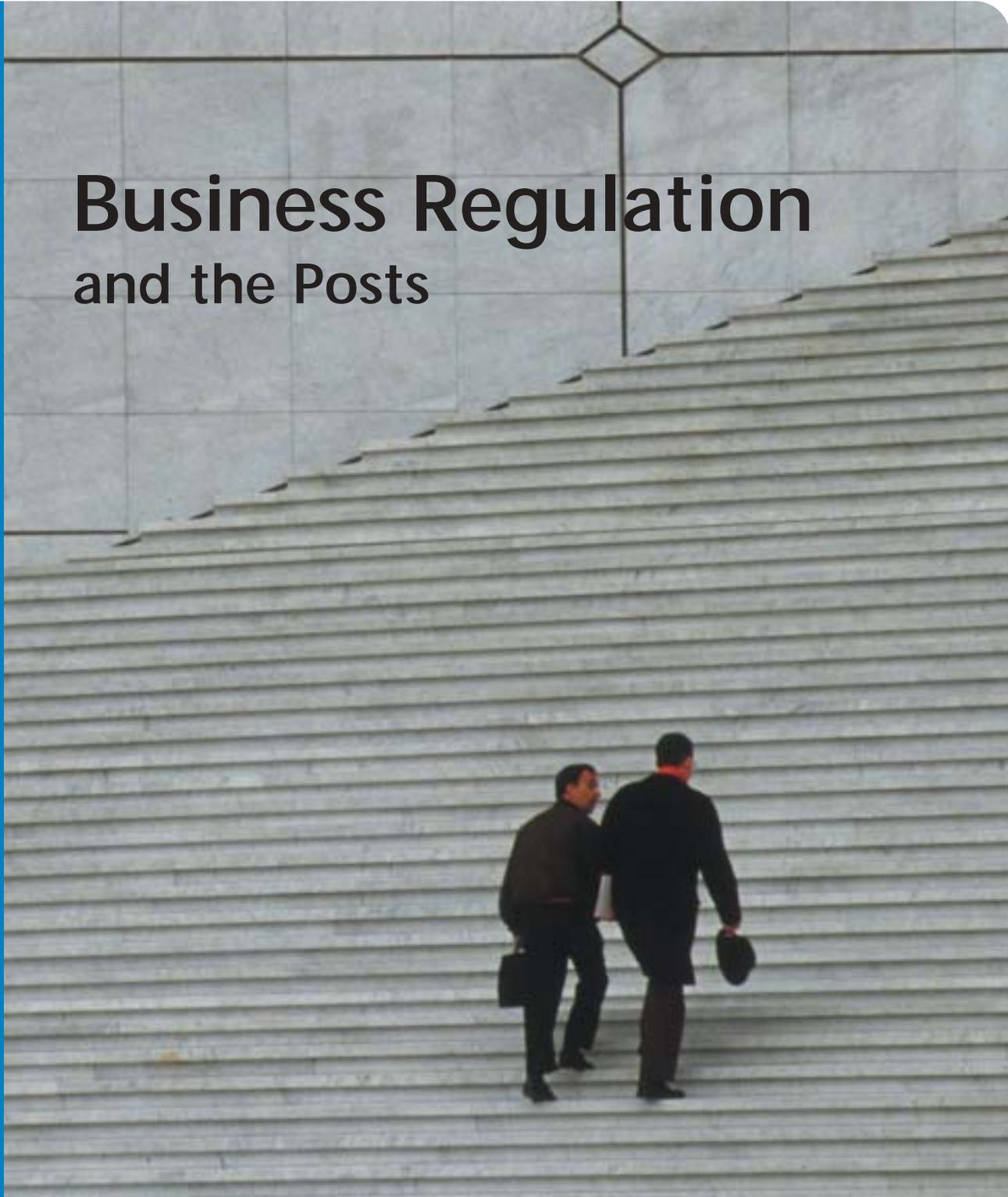


Business Regulation and the Posts



DECEMBER 2002 > SR-785 A



MOVING TOWARD
COMPETITIVE MARKETS



FUTURE OF GLOBAL MAIL PROGRAM

INSTITUTE FOR THE FUTURE

Business Regulation and the Posts:

Moving Toward
Competitive Markets

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Located in the heart of Silicon Valley, the IFTF is a not-for-profit research organization with over 30 years of experience in long-term data-based forecasting. IFTF identifies future trends and key discontinuities that will transform the marketplace. We provide key foresights and guide our members in drawing insights as input to their strategy, as well as possible action steps. Through the exploration of possible futures, we help companies, government agencies, and private foundations make better decisions in today's uncertain world.

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Introduction

We are in the midst of a profound change in how we think about regulation. This change is affecting all industries and it will have important impacts on the posts. A broad look at regulatory trends in a range of industries provides us with a perspective on the underlying changes in current thinking about regulation and how those changes will work their way into the postal market over time.

The gradual increases in levels of income, education, and access to new information and communications technologies are leading many consumers to accept more risk if clear benefits or more personal control are perceived to be the result of regulatory change. The clearest expression of this trend is the gradual growth in the reliance on market outcomes.

Recently, the lack of regulatory oversight produced problems where individuals were not in a position to counter industry power, for example when consumers (and businesses) suffered rolling blackouts in the California's newly deregulated electricity market or the higher accident rates on the British railways after privatization. But the trend of relying on markets is well in place across many industries in most countries in the North Atlantic region.

After several decades of evolution, there are four key drivers that have emerged in the most recent era of regulatory reform that will take us into the future.

- The key public definer of regulatory policy is antitrust law or competition policy.
- There is an emerging role in business regulation in the United States to use economic analysis as a basis of decisions. Modern economic theory provides the means of systematically thinking through consequences of regulation on the whole economy and on a range of consumer interests.

- The EU's drive toward a single market is changing the way businesses and consumers think about the appropriate size and scale of competition that may bring consumer benefits. EU regulators are convinced that there are clear economic and welfare benefits to being able to operate on a continent-wide base. They have set a target to make the EU the most competitive economy in the world by 2010. (Don't underestimate the ability of the EU to transform traditions—they have not only eliminated tariffs across the EU, but have set new rules for competition in areas as diverse as agriculture, financial flows, currency, privacy, and company law.)
- The courts are of key importance. This has always been true of regulatory policy in the United States—but it is increasingly so in the EU as well. The courts are now the key players in Europe calling for open market principles for competition policy.

These driving forces will influence the general tenor of regulation over the next decade, and, more important, will drive specific changes in the leading areas of regulatory change. And, they will influence the posts.

This report, *Business Regulation and the Posts: Moving Toward Competitive Markets*, takes a broad look at the regulatory landscape that the posts will be operating in over the next decade and identifies the implications for the posts. Chapter 1 identifies the principles that are the basis of current (and future) regulatory trends. In Chapters 2-5, we examine four areas that are likely to be the bellwethers of regulatory change for the posts—antitrust (competition) policy, the telecommunications industry, the media, and electricity markets. Chapter 6 discusses how current postal reform movements across the North Atlantic fit into the larger regulatory picture. And in Chapter 7, we explore what these changes mean for the posts in the coming decade.

Chapter 1

The Regulatory Context

Regulation of the postal market is driven by several key factors—the universal service obligation (that is, the need to gather and deliver letters to every household on every business day at a single low price); the reserved area (that is, the protection granted to the posts in exchange for fulfilling the universal service obligation); and, the restrictions on the flexible operations of the posts (usually based on their public role as a universal service provider). While postal organizations have a unique role in each society and regulatory issues have been built up over several centuries of experience, the current reform movement is affecting them deeply. The postal reform movement is part of a larger trend toward liberalizing markets.

We begin with a look at that wider context and how changes in other sectors are casting a new light on how regulators will treat the posts in the future. Our focus is on the regulatory areas that are the closest to the posts and share some of their characteristics—competition policy or antitrust law that defines the basis of competition for all sectors in an economy, the telecommunications industry that shares a place with the posts in the evolving communications world, the media, that, like the posts, play a huge role in delivering messages from business to consumers, and the electricity market that provides consumers with an assured and necessary daily service in their homes.

THE MOVE TOWARD LIBERALIZATION

Any broad view of regulation has to start with putting the current trend toward deregulation into context. Throughout the North Atlantic, there have been some very clear shifts in regulatory policy over the last two centuries. During the Industrial Revolution beginning in the mid-18th century, there was a trend to loosen outdated government restrictions on the operation of private business. Adam Smith, in the *Wealth of Nations* (1776), made the theoretical argument against the entrenched mercantilist world of taxes,

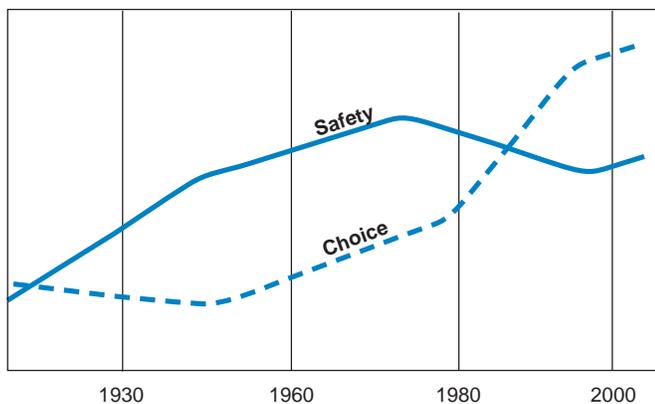
fees, and strict government controls over production. He argued that private property and open markets could provide much more dynamic growth than could an economy directed and lead by royal bureaucrats. His work influenced the first major shift toward a deregulated world. The enclosures of the 18th century, the freeing of the corn trade in England, and the radical cutting of tariffs in Germany and the United States in the 19th century were symbolic of the opening of the markets to wider trade. It was only in the late 19th century, when the emergence of large and well-organized industrial enterprises threatened the livelihood and dignity of the worker, that the modern era of regulation with worker protections, social security systems, and antitrust legislation began (see Figure 1–1).

The need to provide protection for the consumer (and regulation of the overall society) grew during the period of economic misery of the Great Depression and the two World Wars. This period led to the rapid growth of direct government involvement in the economy in Europe and strong antitrust activities in the United States. On both sides of the Atlantic,

businesses in key areas like finance, health, electricity, telecommunications, and transportation were strictly regulated.

There was another sea change in regulatory policy during the 1970s and 1980s. Thirty years of peace and increasing prosperity produced a growing middle class that wanted access to a range of choices that new technologies were making available, even if it meant getting less protection. The result was a dramatic shift in regulatory policy toward a reliance on open markets, a greater acceptance of risk on behalf of the consumer in exchange for wider choices, and more innovation from business. These notions were embodied in a movement toward deregulation in both North America and Northern Europe. In the United States, several industries, such as the airlines and trucking, were deregulated early on. Others have since followed, including telecommunications and electricity markets in several states. And in Europe, the national governments have sold off and privatized many of their holdings in railroads, telecom, electricity, finance, and even some of the posts.

Figure 1–1
Key Shifts in Regulation



Source: Institute for the Future

Several forces have been pushing movement toward deregulation over the last two decades, and they will continue to drive changes over the next decade.

KEY DRIVERS OF REGULATORY CHANGE

Regulation is very specific within a country. It reflects the particular social and political pressures reacting against a body of law and customary judicial and regulatory interpretation of the society. However, all of these forces permeate borders and today, more than ever, in a global economy with the free flow of ideas and concepts, shared regulatory thinking is a part of that global world. Here we attempt to put an international perspective on the key drivers of regulatory change.

New Consumers

There are important demographic changes that are transforming regulation. Just as urbanization and industrialization around the turn of the 20th century provided the impetus for a burst of regulatory reforms around consumer protection, the rise of the sophisticated new consumer at the end of the 20th century was the basis for another transformation of business regulation—one that provides for increasing choice and technological experimentation.

The characteristics of new consumers are clear: they are better educated, live in households with higher incomes, work in white collar, information-based jobs, and have access to the new digital forms of information. As income, education, and information-intensive job experience go up, consumers tend to behave very differently in terms of how they gather and process information: they tend to use more channels and sources for information, they receive and process more information, they rely more on information in making decisions, and they prefer interactive information sources.

These sophisticated consumers are also more interested in controlling and influencing the world around them. This has already had a huge impact on regulation—reinforcing the emphasis on information as a key component of effective consumer choice, providing a greater diversity of inputs on the development and implementation of regulations, and a rethinking of the impact of technology diffusion on consumer options.

The Future

The number of these new consumers is growing rapidly. Demographic analysis shows that the share of the adult population with at least two of these key characteristics—some college education, living in households with over \$50,000 in annual income, or with a white collar-information intensive work experience—is growing at 4% each year. This group makes up nearly 50% of the U.S. population and about 40% of the population of Northern Europe and will continue to increase through 2010.

Changing Nature of Risk

New consumers have also redefined risk tolerance. Sophisticated consumers with access to more information are more amenable to the trade-off between choice and risk. They support free trade when it provides consumer benefits such as more goods or lower prices; they support deregulation when it means more airlines competing and offering lower prices or new drugs coming to market quicker.

One clear example of the acceptance of greater risk is the composition of financial holdings in Europe and the United States. One of the most significant outcomes of privatization in Europe was the dramatic increase in shareholding in the ex-state enterprises by households. And in the United States, households are now much more willing to hold their assets in riskier investments—equities rather

than more stable deposits and bonds—than they were just a decade ago. They are also much more willing to accept responsibility for their investments than they used to be.

Whereas, only 20% of household financial assets were held in equities in 1990, the share increased to 40% by 2002. And of private pension plans, approximately 56% of the total was in defined-contribution plans with the responsible management in the hands of the individual. It is also important to note that the share held in equities did not drop during the sharp fall in the stock market during 2001-2002, though share prices fell quite dramatically.

The Future

The stock boom in the share markets drew many householders into the market over the course of the 1990s, and there was a lot of frustration when the share values fell sharply. But to date, despite the fact that many consumers are now a bit shy of investing in the market, there has not been a rush back to reliance on cash, bonds, Social Security, or defined-benefit retirement plans. The growth in consumer acceptance of risk will continue as more consumers gain higher levels of income, education, and experience in working with information technologies. This trend will increase the share of consumers that are interested in increasing their range of choice and options, even if it comes with a slight increase in risk, and this attitude will have a profound impact on regulatory actions.

Technologies That Blur Boundaries

Scientific advances and new technologies have always had a role in driving new regulations. But today, we are witnessing the beginnings of several technological revolutions—genomics and nanotechnology to name just a couple—that are likely to blur traditionally defined regulatory boundaries over the next decade. For example, the genomics revolution will, in part,

transform the boundary between the world of medicine, dietary supplements, and food. Specifically, nutrigenomics—the science of looking for the interactions of proteins and gene expression at the molecular level and their relationships to nutrition and health—will generate new products that cross and blur the boundaries between traditional foods, dietary supplements, and drugs, and in turn create new challenges for regulators in defining product categories and applying appropriate standards to them for approval.

The Future

Over the next ten years, new technologies are likely to flow at a faster rate than regulators can create and apply new rules. Regulators will face serious challenges in regulating the fruits of scientific advances, first in creating and revising definitions for product or service categories, and second in deciding how to regulate new, desirable, and potentially risky products and services. There is the potential for some regulatory agencies, to become overwhelmed by new technologies without adequate staffing—both in terms of numbers and expertise. Consumers that are willing to take more risks, especially with products that might improve their health, like food, drugs, and medical devices, will put increased pressure on regulatory agencies to access new technologies quickly.

Redefined Markets

Traditionally, the most important characteristics used by antitrust regulators were size of market and market share. But the boundaries of markets are shifting—current trends have made it difficult to define the boundaries of a market because the basic notion of a market is changing. Over the past 20 years we have seen the following market-boundary blurring trends come to the fore.

- The reduction of tariff and non-tariff barriers among major trading countries, which has made it cheaper, quicker, and easier to move goods across borders and make market boundaries international in scope.
- Falling transport costs, which make products produced far away competitive in local markets.
- The growth of multinational firms that link geographically dispersed markets within the boundaries of a single firm.
- The rapid growth of e-commerce, which allows individuals and firms to shop and make purchases for a wide range of goods, almost free of geographical boundaries.
- Technology has created more areas where substitution across products is viable for consumers—airlines for trucks for the transport of small goods; cellular phone service for wireline phone service; satellite TV for cable and local broadcast TV; and videos for theatrical movies.
- The retail revolution has created many new access points for consumers and others to purchase products—malls, strip malls, supermarkets, convenience stores, discount stores, warehouse stores, catalogs, and online stores. The retail revolution means that there are stores and sites available for consumers 24 hours a day, 7 days a week. Over the last two decades the amount of commercial space per capita in shopping centers alone increased by 15% between 1990 and 2000.

Because of all these dramatic changes in the characteristics of local markets, economists and legal experts have moved away from pre-defined notions of “acceptable” market share and have gradually incorporated new measures of consumer value—choice, efficiency, innova-

tion, and price—in competitiveness calculations. Overall, the new, more complex system brings benefits to many consumers. Some contemporary commentators articulate this idea very clearly: regulations are not meant to protect existing industries but to benefit consumers through enhanced competition.

The Future

Over the next decade, the simple act of defining a market and who is an effective competitor for a consumer’s attention will become even more complicated and will pose challenges for regulators. As we move farther down the road toward a global economy with technologies that speed the flow of information and the movement of goods, defining the boundaries of potential markets and market share will continually get harder. With local producers in any market in North America or Europe now competing with Chinese and Brazilian manufacturers it is hard enough to define a geographic market. But with the Internet now competing with phone services, free local newspapers competing with national magazines, targeted radio shows competing with TV news, and food products competing with pharmaceutical products, it is, and will continue to be, extremely hard for regulators to define the boundaries of a competitive product market.

The Burdens of Business Failure

We are in the midst of a very slow recovery from a recession and a sharp decline in the stock markets. The recession was generated by a steep drop in business investment that had been focused on the dot-com, software, and telecom sectors—all of which went through a period of rapid expansion in capacity that the markets were ultimately not ready for. And in 2001 and 2002, a seemingly unending stream of revelations about abuse and misuse of cor-

porate power and knowledge compounded the general lack of confidence in business.

While consumer confidence in business leaders rose during the share market boom, it fell back again with the burst of the new economy bubble and revelations of abuse (see Figure 1–2).

The Future

The boom of the late 1990s built up confidence in the leaders of the business community and drew investment funds from individuals in record amounts. In turn, the bust, along with the attendant corporate scandals, will lead to growing skepticism about business in the years to come and more support for regulations that limit the discretionary authority of corporate leaders.

Personal Security and Privacy

Concerns over threats to privacy increased in the 1980s and 1990s as new technologies enabled the collection, manipulation, and dissemination of vast amounts of personal information. The trend is most clearly expressed in

the United States. In 1978, only 64% of the population expressed concern about threats to their personal privacy. Concern steadily increased to its peak in 1996, during the early days of the Internet, at nearly 90%. Today, the share of those concerned has dropped slightly but remains at more than 80%.

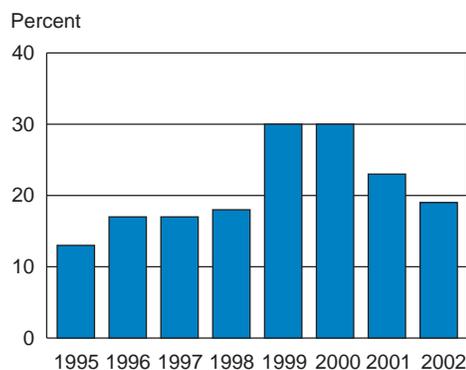
The terrorist attacks of September 2001, further incidents involving anthrax and bombings, and the continuing tensions in the Middle East have added to the underlying concern about people’s personal safety. In the wake of September 11, new laws in the United States that increased law enforcement powers of surveillance and wire-tapping were quickly approved. In the weeks after the terrorist attacks, public approval for a national ID card soared to 70% according to a Harris Interactive survey. Security seemed to have taken precedence over privacy.

However, this was not the end of the battle between privacy and security. In fact, this battle has been underway for a very long time, and will not end soon. For example, just six months after the terrorist attacks, public support for national ID cards had dwindled to 26% according to a Gartner survey and in the summer of 2002 federal lawmakers consciously slowed the pace of security-minded proposals. The issue of the war against terrorism and what it means for domestic and international security, differing treatment for immigrants, tracking of funds transfers, and monitoring of communications and Internet activities has become a significant political element in the United States, as well as in France, the Netherlands, and Germany.

The Future

The conflict between keeping the populace secure and respecting deeply held rights to privacy is not going away. There are strong trends—concern over security, the benefits

Figure 1–2
Confidence in U.S. Business Leaders Way Down
(Percent of adults with a great deal of confidence in Wall Street leaders)



Source: Harris Interactive

that companies get from having such information available, and the benefits that better-educated consumers are discovering in the discreet use of their personal information—that are acting to keep even some of the most private information available for public use. But there are also privacy concerns that are very important for individuals and for the functioning of an open society. In fact, over the next ten years, the tension between privacy and security will increasingly be a part of many legal and regulatory debates.

Elections

Regulatory change reflects politics. There is no question that we are in a period where political forces across the North Atlantic are evenly divided between parties and political perspectives. In the United States, the 2000 and 2002 elections were the most closely contested since the middle of the 19th century. And even with the Republican gains in the 2002 election, their advantage remains slim. In addition, elections in Germany and the Netherlands reflect the same close division. In the United Kingdom and France, one party is in control, but there are sharp divisions over regulatory policy within and between the parties. In the end, even these sharp divisions do not portend any major shift away from the search for the cautious extension of market and competitive forces in the regulatory world.

The Future

The decidedly even political split will make it difficult for any ideological camp to press for a major shift in regulation away from the current consensus of experimenting with modest increases in competitive forces. And we are not likely to see dramatic electoral shifts that would push us off this course for at least the next five years.

LOOKING FOR LESSONS FROM INDUSTRY EXPERIENCE

Virtually every industry is undergoing regulatory ferment and change. There has been a general trend over the last two decades of governments across the North Atlantic to rely more on markets to bring efficiencies and consumer benefits—the role of government regulators has shifted from being a substitute for markets when markets fail, to one of fostering appropriate market functioning.

This trend toward market-based regulation is in operation for a range of business sectors. Several of these sectors are particularly relevant to a discussion of where postal regulation is going. We have selected four—antitrust, telecommunications, the media, and electricity markets. These four are important because they set the ground rules for market competition and deal with the critical issues that postal regulation must address as well—universal service, access to new providers, and how members of the communications industry are regulated. We use three criteria for our selection: these are bell-wether industries that set the pace for regulation; trends in these areas tend to be transmitted quickly to international markets; and regulations are closely connected to key postal issues.

Chapter 2

Lessons from Antitrust and Competition Policy

Antitrust, or competition policy, is the broadest of regulatory activities because it defines the nature of a competitive market. Most importantly, it defines the rules of competition that will govern the mail-delivery market, the media market, and the overall communications market in the coming decade. In the long run, antitrust policies will define the competitive position of the posts.

THE UNITED STATES

From the late 1930s through the 1970s, antitrust enforcement in the United States was strictly bound by the rule that no market should have a player with enough power to set prices or stifle competition. Rulings on mergers or expansions were driven by a clear concept of acceptable market share, with any player holding a dominant share blocked from merging or acquiring an even larger share.

But in the 1960s, a new burst of theoretical economic thought by market-oriented University of Chicago economists—led by Milton Friedman, Frank Easterbrook, and Richard Posner—attacked the notion that a single and simple measure of market share should be the basis for antitrust policy. They looked at the evolution of markets and saw that a number of factors other than company size or market share were influencing the degree of competition—a richer and broader economy that fostered business diversity, more effective international competition, new technologies which both broadened market knowledge and permitted the freer entry of new competitors, and deregulation which allowed competition in markets where it had previously been restricted by law.

The Chicago economists said that antitrust enforcement, by relying on the single standard of market share, failed to define the operation of markets accurately, ignored productivity gains, and stopped transactions without proof of competitive harm. They found many examples of firms that through mergers were able to achieve efficiencies that low-

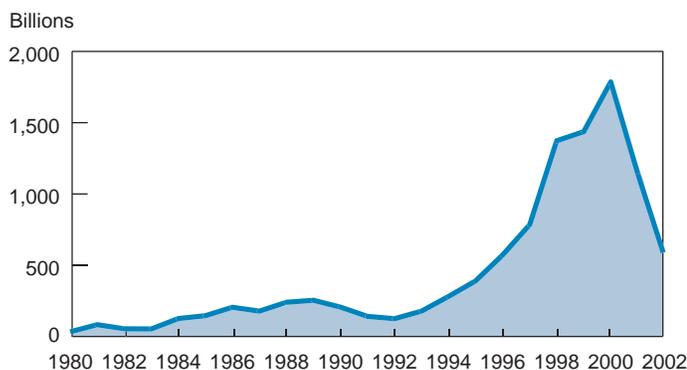
ered costs, develop innovative products, or bring products or services to areas that didn't have them. They also identified many cases where these sorts of benefits would have been realized if proposed mergers had not been rejected. They emphasized that all of these things can be beneficial to both the companies involved and to consumers. Their new thinking helped shift the focus of regulatory bodies and the courts to the complex issue of figuring out the peculiarities of competition in each market and the virtues of efficiency that could come with size and that could benefit the consumer.

The movement for reform resulted in a more permissive climate for mergers (first recognized in the General Dynamics decision in 1974) and some key cases in the late 1970s ruled that an understanding of competitive issues were important considerations in mergers (*Continental v Sylvania*, 1977). The movement came to a head with the election of Ronald Reagan as president. He appointed William Baxter as Assistant Attorney General in charge of the Antitrust Office. Under Baxter, the basic guidelines for antitrust enforcement and mergers were rewritten.

The new Baxter rules moved enforcement guidelines away from restrictions on market size toward a more flexible set of rules that measured the competitive nature of the market, the value and benefits of efficiency that can be passed on to consumers, and the ways that companies could show that value to enforcement officials. Both the Department of Justice and the Federal Trade Commission (FTC) accepted the new rules. And while subsequently modified during the Bush I, Clinton, and Bush II administrations, they remain the basic rules of antitrust today, and current rules remain much more open to mergers and acquisitions that can deliver benefits to consumers. The result has been a record number of business mergers since the Baxter rules were adopted in 1982 (see Figure 2–1).

Still, market dominance remains an important consideration, and the notion of acceptable size and scale still exists. Indeed, over the last few years there have been agreed upon divestitures of portions of firms' holdings before mergers with other large companies (e.g., in the mergers involving Exxon and

Figure 2–1
Mergers Soar After Baxter Rules
(Value of mergers in billions of dollars)



Source: Institute for the Future; *Mergers and Acquisitions*.

Mobil, BP and Amoco, Time Warner and Turner, and WorldCom and MCI).

Antitrust policy has been applied in a different way to the high tech sector. Young, fast-growing technology industries that depend upon assembly of parts or rapidly changing communications technologies need standards that facilitate transactions with suppliers and customers. In many supply chain industries this has led to the emergence of dominant standards, and often, dominant players. The most important antitrust cases over the last 50 years were probably been those brought against high-tech firms that were standard setters in their respective industry—IBM (in the 1950s), AT&T (in the 1970s and early 1980s), and those against Intel and Microsoft (in the late 1990s and early 2000s). In the recent Microsoft and Intel cases, settlement negotiations led to resolution of the issues and modest behavior changes without breakup or serious market repercussions.

CANADA

Canadian regulators in general, have been more open to mergers in the last decade as the North American Free Trade Area raised the sights of Canadian firms to play on a larger playing field. However, they remain cautious when acting on industries that consumers rely on for important matters, like banking. For example, while U.S. banks were going through a national consolidation in the mid-1990s, creating national banks in the United States for the first time, regulators did not see a parallel need in Canada. There were already five national banks in Canada and when the four largest were involved in a double merger (Toronto-Dominion with CIBC and Royal Bank of Canada with Bank of Montreal), the government turned the mergers down. While the ability to grow to compete in the U.S. market was an important consideration, the gov-

ernment considered such dominance in the Canadian market simply unacceptable.

EUROPE

The European Union (EU) is using competition policy as one of the key elements in building a common market. The goal is to have all antitrust policy coordinated through the competition minister in Brussels with a single standard for all mergers within the community. But it has been a long struggle to build such a policy on the basis of a diverse set of European experiences. The Commission has been hesitant to forbid mergers though it has been somewhat more active in recent years—but not without controversy.

In the summer of 2002, the EU's second highest court—the Court of First Instance—for the first time overruled the Commission's blocking of a merger between Airtours and First Choice. This merger would have left 79% of the U.K. air tour travel market accounted for by only three tour companies. But the Court ruled that the Commission had acted without gathering the most basic evidence about consumer benefits (on such issues as prices and choice) to justify its decision. The court asked the Commission to lay down clear rules for defining “collective dominance” and to explain how the issues affect consumers—notions much closer to recent American standards.

The Airtours decision was followed by two other rulings that overturned the Commission's rulings on the same grounds (Schneider-Legrand and Tetra Laval Sidel). But courts are retrospective in the EU system (that is, they can only rule after the fact) and the Commission remains rule setter, investigator, prosecutor, jury, and judge. Of 2,000 merger cases reviewed since 1990, only 18 have been rejected and of those only nine appealed. But there now have been three major rejections and

there is real movement to bring reform to the system. Plans are in the works to allow for greater interaction between the Competition Commission and companies before rulings are made, and to set up a separate court to quickly respond to antitrust rulings by the Commission.

Aside from the issue of approving mergers, there are a number of other issues that define the rules of competition among European companies. The EU Commission and key states still disagree over some basic assumptions about treating companies. There are three issues of great concern for European companies when making a decision on merger activity.

- *Domestic protection.* Many EU states provide for special ownership rules for what they consider key industries. German law, for example, provides for “golden shares” that give selected minority shareholders (in many cases the national or state government) veto power over mergers and other key corporate decisions affecting location and employment. This protects firms like Volkswagen from foreign takeovers. Spanish and Italian laws prevent foreign power companies from buying stakes in domestic power companies. Germany has been working aggressively to stop the Competition Commission from eliminating such provisions.
- *Ailing industries.* Concern over the viability of important employers or key investments often lead to special treatment. Germany and France, for example, have been at odds with the EU over protection of ailing industries. Recently Germany has provided support and traded its support for other issues to convince France Telecom to support the failing MobilCom; it has also recently tried to rescue a big regional engineering firm, Babcock Borsig, from failure.

- *International mergers coordination.* The EU competition authority has been at odds with the United States over important international merger activity. The European Commission blocked last year’s merger between two U.S. firms—GE and Honeywell. And it continues to look at the impact of Microsoft’s activities in Europe despite the settlement of the case in the United States. Going forward, the EU and the United States have agreed on having parallel and simultaneous review procedures.

THE LESSONS

Antitrust law has moved from reliance on information alone in the late 19th century and strict market rules in effect for much of 20th century, to a wide interpretation of how consumers can benefit in the last 20 years. Clearly, antitrust enforcement has retained some teeth in opposing market domination, but it has accepted a wider concept of risk that consumer benefits can flow from larger enterprises.

The United States is leading the way toward redefining antitrust or merger rules in light of a growing body of economic evidence that consumers can benefit from large firms that can provide scale, purchasing power, access to investment, and innovative technologies. The Europeans are slowly moving in the same direction, but the opposing interests between the EU and national governments will remain strong on several issues around competition. For example, EU has a goal of building a single market in which companies can compete effectively across borders. But national governments are concerned with employment and growth opportunities within national borders as well as domestic social policies that are at odds with EU policies. Thus, there is a richer set of issues in the interplay between national and EU interests in European competition policy.

For the posts, though, antitrust and competition policy is the framework that, in the long run, will determine the rules for effective competition in the communications and media markets and ultimately in the mail and delivery markets. Look for increasing debate around the issue of consumer benefits. The consumer benefit from increasing the competitiveness of markets is one of the reasons behind a rethinking of rules for media ownership in the United States and experimentation with effective competition in the mail delivery markets in Sweden and the United Kingdom.

Chapter 3

Lessons from the Telecommunications Industry

Telecommunications, by providing an alternative means of communicating directly with virtually every household, has been the longest-term competitor of the posts. Telecommunications regulation has had to deal with some of the same critical issues that postal regulation does—universal service, competition in a network industry, and access to the network for alternate providers. Recent changes in telecommunications are important for the post to take notice of.

THE UNITED STATES

AT&T, the dominant (and heavily regulated) provider of telephone services in the United States, was broken up in 1982 under the settlement conditions of an antitrust suit. The breakup was driven by the emergence of new competitors in the long-distance market. But the breakup did not solve the issue of a lack of competition in the local markets since the seven newly independent regional operating companies (the “local” or “regional” Bells) continued to be the single purveyor of wireline connections to homes and businesses inside their new territories. It took the explosive use of new technologies in the 1990s—wireless, Internet access, and voice access through cable connections—to present individuals and businesses with a wide variety of local options.

The rise of wireless and cable alternatives produced the Telecommunications Act of 1996, and took telecom deregulation activity away from the courts and individual states and made it a national policy. The goal of the act was to increase competition without permanently harming the traditional telecom companies who were responsible for providing local services. Ultimately, this leaves regulators with a dual and largely conflicting role—they must promote competition while also protecting the revenue flows of regional operating companies who are responsible for maintaining

the infrastructure investment necessary for effective operation of the local loop.

Current regulatory debate includes three big issues.

- *Saving the wireless players.* The wireless sector of the telecommunications market has been growing rapidly, currently accounting for about a quarter of telecom revenues. But the wireless players were hit hard by the collapse of the investment boom in the late 1990s. Part of their rapid growth came from the opening of vast new bandwidth spectrums that the government controlled and auctioned off to wireless companies in the mid- and late-1990s. As some of those wireless firms have gone bankrupt and others have been unable to raise funds to use their allotted spectrum, the government and the courts have been adjudicating the responsibilities of the bidders and what happens to the spectrums in the case of default. The Federal Communications Commission (FCC) has tried to ease the snarl by clarifying responsibilities of parties and returning some of the funds debt ridden companies paid for spectrums they now cannot use.
- *Providing access to the network.* The 1996 Telecommunications Act made it easier for alternate carriers to enter the local market. The rise of new players in the Bells' local market has been notable. Regulators continue to be protective of the Bells so that they will continue to invest in infrastructure and new equipment. At the same time, regulators are slowly encouraging the local Bells to open their local networks to alternative providers by controlling access prices. But, the new competitors are dependent upon the regional Bells to maintain the local loop. This situation is a major roadblock to true competition and makes the

new players dependent upon a government-controlled access price.

- *Promoting broadband competition.* The proliferation of enhanced copper-wire connections and the laying of thousands of miles of fiber-optic cables dropped the marginal cost of bandwidth dramatically. But so far, cable-based services have had the regulatory edge over phone-based services, since they can draw on the capital base coming from selling entertainment content and they have not had the recent expense of the huge increase in laying fiber optic lines. In addition, their broadband services are not delivered via the telephone network. So while new broadband players have to fight to gain access to regulated local phone networks in order to offer DSL service, cable companies can use their existing networks.

In making its regulatory decisions, the FCC is striking a balance between promoting competition, creating an attractive investment opportunity, ensuring the broadest possible access to consumers, and keeping rates as low as possible. However, recent court rulings have further muddied the water.

The Supreme Court ruled that the Bells must open their networks to competitors. Simultaneously, the District of Columbia Court of Appeals ruled that current regulations that guarantee access to new entrants are not neutral and, in the end, lessen the incentive for existing local service providers to make further investments in infrastructure and ultimately reduce consumer benefit. The switch to Republican control of Congress will probably provide more incentives for the regional Bells to expand broadband service and less pressure for them to provide access to new players for at least the next couple of years.

The balanced and moderate steps of regulators have not made the telecom players very happy. The regulations have produced controlled increases in competition within markets but done so without driving companies people depend upon out of the market. But, especially in the local phone market, the competitors remain dependent upon the local infrastructure controlled by the regional Bells and haven't taken significant chunks of market share. Still, with technologies changing relatively quickly, consumers are finding options for services (see Table 3-1).

CANADA

Like the United States and the countries of the EU, Canada has been going through a process of opening its telecom market up to competition. As elsewhere, the pressure of rapidly increasing wireless use has been a key technology push for change. In 2000, 19% of all traffic went through wireless devices.

While long-distance competition was authorized in 1987, it was the 1993 Telecommunications Act that outlined the general thrust of deregulation across all service areas. By 1997, the local-services market was open to competition. Competitive forces have worked well in the business markets, but less so in the final mile of wired connections. By 2000, alternate players carried 49% of busi-

ness long-distance traffic and 50% of international calls. In contrast, new players accounted for only 4% of total fixed wireline service.

Canadian regulators are very concerned with the provision of reasonable access to a widely dispersed population. The cost of basic service for low-income households—provided by the incumbent regional networks—is paid for out of funds collected that are based on the total revenues generated by all telecom operators. Thus all market competitors share the cost of the universal service obligation (USO), depending upon their relative success in the market.

Another issue in the deregulation debate in Canada is the cost of access for the non-incumbents. In 2002, the regulatory body in Canada—the Canadian Radio-television and Telecommunications Commission (CRTC)—ruled that the current local provider had to drop its access rate by 15%-20% (against a request by the new players for a drop of 70%). While offering some help for new players, it still means hefty protection for the revenue flows of incumbents for the next four years. On another front, there is an ongoing parliamentary review that would increase the current marketshare limit (20%) for Canadian telecom and media companies in order to provide more effective competition in the market.

*Table 3-1
Market Penetration Rates of New Players
(Percent of marketshare held by new players in each market)*

	1982	1992	1996	2001
Long distance market	2	38	52	59
Wireless providers in total market	—	5	12	25
Local phone market	—	—	1	10

Source: Federal Communications Commission, *Trends in the Telephone Service*.

EUROPE

Before the 1980s, all European telecoms were state-owned monopolies, in many cases housed in the same departments as postal services. As government agencies, they were subject to multiple government goals—supporting the national communications infrastructure, providing affordable access for all, and helping to meet national economic goals like adequate investment and employment levels. Profits from long distance (especially business long-distance) services subsidized not only residential service, but also provided funding that the government could use to achieve other goals.

Britain, which was an aggressive proponent of deregulation under the Thatcher government in the early 1980s, led the way in telecom deregulation. British Telecom (BT) was set up as an independent telecommunications company in 1981—separating telecom and postal services. The British Telecommunications Act of 1984 privatized BT and, for the first time, established a semi-independent regulator, the Office of Telecommunications (OfTel). By the mid-1990s, the national telecommunications markets on the continent also began to open—the Swedish market was opened in the early 1990s, the German and Dutch markets were opened soon thereafter. And, wireless service penetration of the market grew rapidly through the 1990s in all European markets.

But the main thrust of reform emerged at the European level. During the late 1980s, the European Union initiated a major move to create a single European market. One element of the plan was to create a single EU telecom market. The EU started a general debate about telecom deregulation with a Green Paper in 1987. In 1993 a goal was set for a fully liberalized EU market by 1998.

The 1998 Directive stated that the goal of telecom reform was to generate consumer benefits through an increasingly competitive market. While the provision of wider choice and availability of new technologies were clear goals, the EU was also intent on making telecom services available to everyone—emphasizing the USO. To provide for a competitive market, the EU opened the satellite services sector to competition, lifted restrictions on cable operators providing telecommunications services, required transparent interconnection options for the wireline local loop, and opened a wide range of public frequencies for wireless operations. At the same time the EU required affordable universal service, which meant that simple fixed public switched telephony lines capable of voice, fax, and low-bandwidth connections be available to everyone at an affordable price.

As in the United States, the incumbent players were slow to open up the local loop to alternative providers. There were continuing issues with cross-subsidized pricing, heavy social service requirements that went beyond the provisions of minimum services, and special pricing discounts for access to the local loop for favored players or subsidiaries. In virtually all EU countries, the old national phone company continued to provide more than 90% of all wireline local phone traffic, and more than 60% of the rapidly growing wireless traffic. During 2002, the EU took legal actions against the dominant state-owned telecom providers in Germany, France, and the Netherlands for blocking access for alternative phone companies to the local loop.

An interesting case is the proposed merger of the Swedish national carrier—Telia (70% state owned)—and the Finnish national company—Sonera (53% state owned). This is the first cross-border merger of two national tele-

com companies. The two governments are likely to play as big of a role as the companies do in whether or not the merger happens. For example, the more Telia pays out in cash, the more likely that the Swedish government would have to provide the funds, and therefore own a majority of the combined company. There are also major cultural and dominance issues that are political in nature that will be played out in this first major merger among the old national carriers.

THE LESSONS

Telecommunications regulation must deal with many of the same issues as postal regulation and there are important lessons to be learned from the telecom experience.

- *New entrants.* Regulatory reform in the telecom market is based upon the notion that increased competition will bring more choice and new products to consumers. But, regulators must move slowly and carefully because they have to make sure that reforms do not discourage incumbent players from making regular investments in spending large sums for maintenance and repair, as well as in continuous innovation and the introduction of new services.
- *Universal service.* Social policies in virtually all countries demand that everyone has access to the telecommunications network. This means that regulatory reforms special attention must be sensitive to the costs involved in providing service to hard-to-reach consumers. While the cost of providing universal service can be significant, ranging from 1%–8% of revenue in large countries, there is a marketing benefit attached to being the universal service provider.
- *New technology.* The telecom sector is markedly different from the posts in the way that new technologies have brought change to the market. Fiber-optic cable, wireless communications, cable connections, satellites, and the Internet have each offered services that compete with basic wireline service. Similar technological pressures for rapid adaptation have yet to appear for the posts.
- *Pricing.* The buildup of telecom capacity and the tremendous cost-savings inherent in some of the new technologies have created a market subject to rapidly declining prices. In a market of cheaper services, it is easy for consumers to see clear benefits in change. But, unfortunately for the posts, it may not be so easy for consumers to see benefits in postal reform where innovation typically more comes slowly and service costs (postage) increase regularly (as postal costs, especially for salaries, increase).

Chapter 4

Lessons from the Media Industry

Another area that competes for a part of the communications market with the mail is the media. The media industry is defined as the channel of mass communication that broadcasts or publishes for a wide audience and generates at least a portion of its income from advertising. The media includes network and cable TV, radio, newspapers and magazines, and selected Internet sites. As a major channel for delivering business messages to consumers, the media industry provides an alternate to the mail. Governments have seldom seen the media as a universal service provider with everyone having a “right” to access. But, the goal of both public and private media organizations has always been to make the larger media channel as accessible as possible. And they have been very successful—TV and radio ownership in the home is higher than that for the telephone. Regulation of the media is relevant to the posts because it defines the rules of the game for many of the posts key competitors.

THE UNITED STATES

People’s access to media channels and other communications media has grown dramatically over the course of the last century. The penetration rates for radio, television, cable, and Internet access have increased dramatically, with some reaching extremely high penetration rates (see Figure 4–1 on page 22). However, as a communications channel, nothing tops the universal service for mail. Over the last few years, technology has brought significant changes to the competitive world of the media. Total spending on advertising in all of the major media industries has increased over the last decade, in large part because of the new outlets available. In addition, the number of selections in each one of the individual channels has increased, as well. And as the number of options in each of these channels of information has increased, the audience

share for any single program or channel in any media outlet has decreased.

Over the last decade, the shift in antitrust policy toward a greater tolerance for larger company size has led to substantial consolidation in the media industry. The growth in the number of media conglomerates like News Corp, Disney, Vivendi, Bertelsmann, and AOL Time Warner is indicative of an attempt to access capital to increase reach and to improve content and to build synergies among media groups—combining in varying amounts television broadcasting, cable, satellite broadcasts, movies, content production, online portals, magazines, and books.

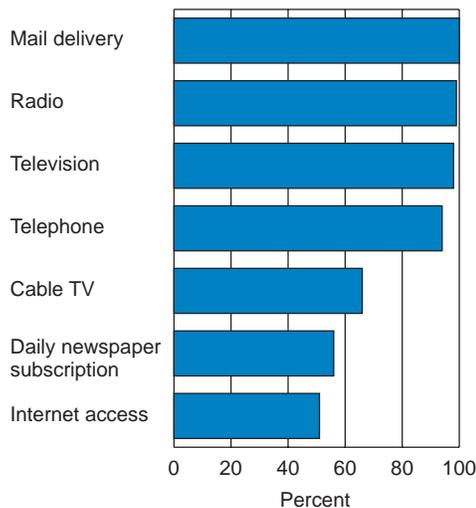
The regulatory issues in the United States are centered on the ownership and control of media outlets. Traditional regulations were focused on having a diversity of viewpoints expressed in each channel and across channels. This meant that the FCC capped the amount of control that one company could exert in a sin-

gle media market and limited cross-ownership of media channels, such as radio and TV stations or radio stations and newspapers in a local market. The FCC also used antitrust laws to block mergers that gave too much control to one company in a media sector—the most recent being the proposed acquisition of Hughes’ DirecTV by EchoStar, which would have brought together the two largest players in satellite TV. The FCC is counting on competition in the satellite market to provide price pressure for the cable TV market and didn’t want to see that option diminished.

But several basic trends have helped to undermine these rules: the gradual rethinking of antitrust policy to look for more consumer choice, increased access to a variety of new options driven by technology, and the rapid expansion of alternate media (cable systems with a large selection of channels; satellite access to an even broader selection of channels; the Internet as an alternate forum for news and entertainment; and the proliferation of magazines and community newspapers). In fact, there has been explosive growth in the number of media outlets (i.e., the number of separate radio, television, cable, Web sites, magazine titles, and newspapers). A recent study by the FCC looked at the growth of broadcast media channels in a selection of communities of all sizes. The number has been growing by about 3% per year (see Figure 4–2).

The increasing number of outlets and the increasing cost of providing and distributing content have produced pressure for consolidation. Advertising dollars are moving rapidly toward the big national media players in the United States, as businesses selling branded products and services are trying to reach the largest possible audience. To do this, they are funneling their money through large advertising firms that can have a national impact.

Figure 4–1
Communication Media Penetration Rates
(Percent of households with ... in 2000-01)



Source: Institute for the Future; U.S. Statistical Abstract.

Over the last few years, huge media players such as AOL Time Warner, Viacom, USA Networks, and the News Corp have emerged. These companies are all looking for cross-media synergies and access to large advertising accounts. The Tribune Company, for example, has announced a core strategy of owning newspapers, TV stations, and Web sites in the three largest markets in the United States—New York, Los Angeles, and Chicago.

But, under current rules, a single company cannot own a TV station and a newspaper in the same market. There are other restrictive rules such that a single broadcaster's stations cannot reach more than 35% of U.S. viewers; a cable company cannot own more than 30% of the national market; and the number of TV stations a single company can own is limited. However, a recent series of rulings by the District of Columbia Court of Appeals struck down the limits on cable and ordered the FCC to re-examine the television station ownership cap for individual markets. Studies of media markets have demonstrated that consolidation does not necessarily lead to fewer choices. In

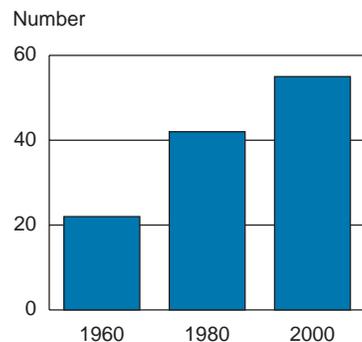
fact, as the media industry has become more concentrated, media companies have been able to deliver a greater diversity of channels and content to consumers. This is because larger companies have more available capital to produce and distribute content. In response to the court, the FCC has announced that it will review all the ownership rules.

CANADA

Canada is facing many of the same forces of competition that other countries are. But it also has some unique issues associated with Canada being located next to the huge U.S. media market. Cable, satellite, and Internet options are broadening the base of Canadian programming, while the capital costs of production and distribution are driving consolidation among media firms.

But the key element of Canadian regulation is the need to keep options open for Canadian artists and producers. Such mandates are at the core of the Broadcasting Act of 1987 and reiterated in a 1999 update. CRTC's goals are to ensure that quality Canadian programs are available on the media at times when most Canadians are watching or listening. Under these goals, underrepresented Canadian programming is given a priority programming label in the renewal of all broadcast licenses. Large stations are required to devote 8 prime-time hours per week to such programs, extra premium time is spread out for special options, and specific amounts of additional spending are set aside to produce such programming. Indeed, TV broadcasters spent about \$1.5 billion Canadian dollars on Canadian content in 2000. There is also government support for special channels (e.g., ethnic, French language, Canadian, and local community interests). Finally, the CRTC imposes limits on consumer costs for cable.

Figure 4-2
Media Outlets Growing Consistently
(Average number of media outlets for 10 selected markets)



Source: Federal Communications Commission, Media Bureau Staff, *A Comparison of Media Outlets*, 2002.

Canadian media companies have requested more flexibility in consolidation in order to provide the necessary capital for wider choice. There has been some movement in consolidation already in the radio market that has led to a growth in use of the FM spectrum.

THE LESSONS

The regulation of media is important for the posts. Media and mail are the two biggest channels for business advertising. How the media is treated will have a direct impact on the competition for advertising spending. In the United States, legislators, regulators, and the courts are adapting their views of the dangers of concentrated ownership in the media.

They are being more flexible in their approaches and are rethinking the size and scale of media players and the kinds of rules that provide the best options for consumers. Both Canadian and U.S. regulators are gathering data on media availability in specific markets, the range of content offered, the consumer trade-offs, substitutability among media markets, and the relative concentration of ownership. Answers to major market surveys will help drive future regulatory goals and decisions. In addition, the Canadians have developed a model for assuring that current market participants fund social goals (Canadian content) in an effective manner.

Chapter 5

Lessons from Electricity Markets

Like other key sectors with intensive government involvement across the countries of the North Atlantic, the electricity market is in the process of deregulation. The general goal of energy deregulation is to use competition to build efficiencies into the system. There seems to be an emerging consensus that deregulation can do just that when implemented carefully.

The retail electricity market is highly susceptible to monopoly delivery of the product to the final user so that alternate wires or pipes aren't built for each user. But the bundling of all electricity or gas services—from generation to distribution and retail delivery—in a single company restricts competitive forces. One of the goals of deregulation has been to “unbundle” energy generation, transport, distribution, and sales. Liberalization still leaves a few key regulatory issues including access rules to final-mile connections, pricing clarity for users of the final mile connections, and price controls on delivery costs.

The electricity market is particularly interesting for the posts because it involves an essential service to all residences and places of business; places top priority on the security of delivery; has a need for regulated access; and has a functional split between generation, transport, and final delivery that parallels postal activities (collection, sorting, transport, and delivery).

THE UNITED STATES

Electricity generation and distribution were separated and deregulated in the early 1990s in many states. The goal of deregulation was to move away from tightly controlled natural monopolies or markets with very strong network effects to a more competitive environment where new players would add new ideas, products, and services all along the supply chain. One difficulty with deregulation in the United States is that the overall market is regulated at two distinct levels. While the federal regulator—the Federal

Energy Regulatory Commission (FERC)—regulates the wholesale power market, retail power markets are regulated by the states.

The goal of deregulation is to build flexibility into the system by increasing competition among a greater number of players. The states that are pushing for deregulation are unbundling generation, distribution, and supply. And FERC is encouraging this move to a broader market by creating effective regional grids that make the shifting of power across state lines easier.

But the deregulated markets at the state level have run into problems. The failed deregulation program in California that led to rolling blackouts through the state in 2000-2001 and the misuse of market freedom by the giant energy trading company Enron and others has raised public sensitivity to the dangers inherent in deregulation.

California made the mistake of fixing retail prices but leaving wholesale prices to an open market; the system worked while wholesale prices remained steady, but did not survive the upturn in wholesale prices. The situation resulted in the major energy distributors in the state being forced to continue to deliver expensive electricity at a loss and they eventually faced bankruptcy. The state finally stepped in and purchased its own long-term future contracts, committing to purchases of some \$40 billion at well above market prices. Subsequently, the California market was re-regulated and lawsuits were filed against a number of energy traders who were involved in market manipulation.

FERC at the national level is still working toward an open market for electricity on the wholesale level and selected retail sectors with competitive markets and free entry for those who want to purchase or sell. It thinks the key to success is to build regional transmission organizations that would move electricity to

where it is needed through market forces. FERC is ready to remain as a presence in the market to assure good market information, provide adequate infrastructure, and enforce market rules.

The electricity market has a few features that have constrained deregulation—it has fewer technology options than the telecom market and the alternatives that do exist are capital intensive; it must place much greater reliance on long-term supply systems built on very expensive infrastructure; and the system has an extremely low tolerance for service shortages. Since electricity is a necessity in modern economies, supply breakdowns have had dire consequences. The rolling blackouts in the winter and spring of 2001 in California led to a quick political response. And the subsequent and shocking revelations about out of state energy trading companies gaming and manipulating the market has slowed, but not stopped, the movement to bring some form of competition to parts of the electricity market.

CANADA

Canada is following the trend in the United States to deregulate its energy markets, but more slowly in the hopes of avoiding some of the disruptions that occurred in the United States. The Electricity Act of 1998 set the conditions for opening the electricity market in Canada. It established an independent market operator that would operate the wholesale market, maintain the grid, and set the rules and procedures of the marketplace. There is also an energy board that has the responsibility to approve rates and to license participants.

While the market is unbundling, the role of the regulators in terms of licensing, price setting, operation of the grid, and setting market rules assures a firm public hand over the market. It protects the market from disruptions but also lessens the range of effective competition

in the markets that could ultimately make a difference in competitive efficiencies or investments in innovative services and technologies.

Still, when the Ontario government opened the power market in the summer of 2002, there was a surge in electricity prices. Lack of investment in the post-Enron climate meant fewer new plants were coming online and there was little private interest in buying shares in the big energy producers. The result was a rapid rise in local wholesale prices. By the end of the year, the government re-entered the market to freeze retail rates and voted to provide a small rebate to households and small businesses. As in California, retail electricity markets have proven to be a sensitive political issue.

EUROPE

As in other areas, the Europeans have multiple goals in energy deregulation—they want to build a single competitive market that transcends national boundaries; they want to reduce the government's direct role in running energy businesses; and they want to bring competitive forces into the marketplace. The EU is moving ahead cautiously in the energy market, but continues to make progress. In the late 1990s, the European Commission set a goal of having 30% of the energy market open for competition (essentially that part used by large industrial users). In the spring of 2002, the Commission set a target of liberalizing 60% of the EU gas and power market by 2004 (which would include all business users).

France has been one of the more interesting cases in the recent deregulation debate. The French market is dominated by two key national players—Electricité de France (EDF) and Gaz de France (GdF). They are the former government monopoly players in the electricity and gas markets, respectively. EDF, in fact, is one of the largest energy companies in the world.

While lagging behind liberalization in most EU countries, the French energy market is slowly adapting to meet the EC regulations. Though slow to open, market response has been significant. EDF and GdF have recently opened only 30% of their respective markets to competition—their largest customers are free to solicit bids from other suppliers. Among these large users, about 20% have moved to alternate suppliers and competition has had an impact by lowering the prices charged to other users.

As domestic markets came under competition, EDF has sought to replace lost revenues at home by moving abroad, spending €15 billion on foreign purchases in the last four years. Its goal is to receive half of its revenue from foreign sources—up from about a fifth in 1999. But competing in foreign markets means that EDF has to place a much heavier emphasis on commercial operations and become less of a French national enterprise.

Privatization has been an important goal as well—it raises money for the state directly and it provides access to private capital markets and funds that can be used for expansion and the purchase of new technologies. Both EDF and GdF will be privatized in next two years, though the French government will retain a majority of the available shares.

One of the major issues for EDF is its role as a key national firm that has a social role in France. With 160,000 employees, EDF supports a large unionized workforce represented by the Confederation Generale de Travailleurs (CGT), a political powerful force. EDF supports a large worker fund out of its annual profits and carries huge pension liabilities. (Current pension liabilities alone amount to more than €40 billion on EDF's books). Such social and labor traditions make working for EDF an extremely attractive proposition, but

will also make it difficult to compete as a private firm on international markets. Pension issues can be thorny and difficult to resolve. The attempt by the French government to deal with pension issues when the state railways were privatized was one of the key reasons behind the series of strikes in 1995 that brought down the right wing government.

In the United Kingdom where privatization of state-owned companies and liberalization of the markets has been in place for almost a decade, there has been a series of ownership turnovers with U.S., French, and German firms first entering and then leaving the market. The attraction of foreign investment has created some excess capacity and the recent failure of British Energy reflects the dangers of making investments in an energy market with too much capacity.

In general, though, the opening of the energy markets created a tremendous move toward consolidation throughout Europe with the larger firms trying to get large enough to compete outside their national markets and to build diverse companies with generation and retail assets combined.

EDF and two German energy companies—RWE and Eon—are emerging as the premier international players. EDF, for example, has \$40 billion in annual revenues from operations in 20 countries and has major stakes in power companies in the United Kingdom, Italy, Spain, Germany, Sweden, Austria, Argentina, and Brazil. With such big players in the field, some worry that a few players with enormous assets and reach will dominate the newly liberalized market.

One of the issues with national diversification is lop-sided deregulation; a key example of this has been the ability of EDF to move into markets through Europe while it has yet to face effective competition at home. France has recognized this issue and has agreed to

accept liberalized domestic markets with foreign participation by 2004.

The EU has tried to set the ground rules for competition across markets but has had trouble getting national governments to agree because of the key roles that the national energy companies play at home.

The EC has also had trouble imposing a required independent regulator on each of the national markets. Germany preferred to keep its complex systems of rates and access rules that are built on complex local government and industry arrangements as they are today. Other countries accuse Germany of using this complex system to shield domestic companies from foreign competition. Without clear rules for access to the market and transparent pricing, competitors cannot promise to reach households with guaranteed prices that are competitive. In this case German resistance to the establishment of a single regulatory body for all competitors is slowing the progress of reform.

THE LESSONS

The lessons for the posts in the energy deregulation experience are important. Deregulation as a means of bringing competition and efficiency into energy markets is a strong driving force across the countries of the North Atlantic. All governments are moving in that direction in fits and starts but remain sensitive to the cost of upsetting former national monopolies and disrupting important social and political power networks. Reform does however offer attractive advantages to the former monopoly players. They will have opportunities for large scale growth and that they will have incentives for investment and improved access to capital.

But there are clear dangers in energy deregulation. While electricity deregulation continues to make substantial progress with a lot of

support, the public is sensitive to the possibility of energy shortages. The key lesson is to carefully plan when the public wants, needs, and counts on the assured supply of a given good (in this case energy) and have the market mechanisms and incentives in place to fulfill those objectives. Politicians are sensitive to public fears. They are also sensitive to the political importance of national firms that play a key role in the daily lives of citizens, such as EDF, but this has not stopped the progress of liberalization among the states in the United States or in the national markets of the EU.

The structure of the electricity market has many similarities to the posts but some critical differences as well. It is subject to low probability-high impact events like energy shortages. Revenues are oriented toward the generation side (70% in generation, 20% in transmission and delivery, and 10% in retail), in contrast to the posts where a much larger share of revenues is in the delivery end of the chain. But energy companies are facing the need to adapt their traditional behavior patterns that are based on being a key player in a national business culture to those that make sense in an international business that responds to market competition and shareholder values. A tall order, indeed, for these organizations. The posts are likely to face a similar challenge when fully liberalized.

Chapter 6

Lessons from Postal Reform

The deregulation movement in countries across the North Atlantic has had a tremendous impact on the posts. The variety of experiences within the postal world has been striking, however, and it is important to understand the wide range of experiences. The reforms have been pushed on two levels: those driven by the actions of the European Union as part of its goal to build a single market for Europe; and those coming from national governments operating within the general context of reform.

THE EUROPEAN UNION

Postal reform in the EU has taken place in the context of the general trend toward liberalization and privatization and in the context of the larger EU goals of allowing companies to participate in the wider economies of scale that come from a continent-wide market, encouraging market forces, and building large-scale and flexible institutions to help harmonize economic life across borders.

Large companies are the biggest mail customers. As these large companies increasingly operate across borders to develop and distribute products and services, their communications needs are broadening. With more messages being created in digital formats, they can be distributed through decentralized printing technologies close to the intended recipient, for example. This gives companies more options in terms of where mail will be produced and how it will be transported and distributed. One of the goals of the EU reforms is to open Europe to continent-wide thinking by companies that want to provide services across traditional borders. In looking at the success of the post in the United States—in providing continent-wide services that encourage more intense flows of letters and messages—reform of the posts is seen as an important part of the general deregulation trend.

While individual countries like Sweden took the early initiative in postal reforms in the late 1980s, the European

Union took action to assure that the posts were included in the general liberalization movement. In response to the growing pressures to move to a single market, the EU circulated a Green Paper (discussion document) to its members in 1992, proposing postal market reform. This led to the approval of a Directive on Postal Services (1997) that was the opening round of a series of steps to liberalize and harmonize postal services across all members of the community.

The Postal Directive contained two key clauses. It defined a minimum universal service obligation for all posts—a service of a specified quality to all points in the country at an affordable price. It also permitted a reserved area that would be granted to those who provided universal service “to the extent necessary to maintain that service.” But the reserved area is bounded and will shrink over time. The reserved area was set at letters under 350g in 1997; and it will fall to less than 100g in 2003, and 50g in 2006.

Every country must develop national standards for the USO and the gradual shrinking of the reserved area that, at a minimum, reaches the goals set by the EU. The EU has promised to look at the impact of the gradual liberalization on the health of the posts and their ability to fulfill the USO at the end of the program in 2007. One of the implied goals of the EU reforms is to make the posts commercially profitable operators that can compete with the private sector. This means that the thrust of the EU reforms is to narrow the reserved areas, to increase the amount of competition that the national posts face, and to allow the posts more freedom of operation in related activities that might support their organizations.

THE LIBERALIZING POSTS

Posts in all developed countries around the world are experiencing significant changes in how they are regulated. A few countries, such as New Zealand and Sweden, have opened their markets completely. Right behind them are several countries in the EU—most notably Germany, the Netherlands, and the United Kingdom. All have plans in place to go beyond the minimum requirements for EU member states (see Table 6–1).

Table 6–1 captures the opening of the market for competition. But it also reflects the trade-offs between two critical variables that define the traditional world of the posts—the reserved area and increased flexibility for postal operations. These two variables are rich in implications.

- *Reserved area.* The national posts have been given an area of operation—usually addressed lettermail delivered to households—over which they have exclusive rights. This reserved area gives them protected earnings that allow them to fulfill the USO. At issue in liberalization is the trade-off between a reduction in the size of the reserved area against the costs to fulfill the USO.
- *Flexible operations.* The other major issue in liberalizing the posts is their freedom to act as a business with a prime focus on efficient and profitable operations. At issue is the ability of the posts to buy and sell other companies, to form joint ventures, and to participate in affiliated businesses versus their ability to cross subsidize these activities with revenues generated in reserved areas of operation.

The legislative and regulatory authorities in each country have dealt with these two key issues in different ways. It is informative to

track the varied responses of some national authorities as they have dealt with these two issues over the last few years.

New Zealand

New Zealand has seen the most radical liberalization of a national post. The goal of liberalization was to promote the benefits of competition for its customers. The reforms encourage competition while maintaining traditional high standards of universal service.

- *Reserved area.* New Zealand Post (NZP) was made a state-owned enterprise in 1987, with all shares currently owned by the government. After a series of reforms, the 1998 Postal Services Act abolished the postal monopoly, moving to a simple letter of agreement with NZP to achieve certain delivery and service goals. The postal mar-

ket has no reserved area; any qualified business can deliver letters within New Zealand and any postal operator is free to set its own prices. The NZP must offer access to its system to competitors at the same price that it charges its large business customers.

- *Flexible operations.* NZP can acquire other companies (with government approval) and enter into joint ventures. It can borrow from private markets and is subject to taxation. NZP has succeeded in the new environment. It has focused on increasing efficiencies of delivery and has capitalized on its broad customer reach across the entire market to keep itself attractive to its business customers. Because of its obvious efficiencies in delivering letters across a diverse island country with a limited total market, NZP has been able to keep rates

Table 6–1
Increasingly Open Postal Markets
(Current and future portion of mail market that is open for competition)

	2002	2003	2006	2007
New Zealand	Completely open			
Sweden	Completely open			
Netherlands	> 100g open Direct-mail sector			
Germany	> 200g open Direct-mail sector > 50g open	Completely open		
United Kingdom		Mailing lots > 4,000 items open		Completely open
European Union	> 350g open	> 100g open	> 50g open	Review impacts

Source: Various national posts

very low (lettermail is priced at less than half the cost of a letter in the United States, for example). As a part of its letter of agreement, NZP agreed to hold increases in the prices of a basic letter to the consumer price index minus 1% and will continue to do that through 2005. Despite the increased competition, NZP has been able to hold onto the vast majority of the mail market.

Sweden

- *Reserved area.* The USO in the Swedish Postal Services Act includes uniform nationwide rates for single-piece mail at reasonable prices on all business days. The license for Sweden Post includes the USO, and so far no other licensee is required to provide it. There is no reserved area and no mailbox monopoly. Well-funded competitors like City Mail, which is owned by Norway Post, have operated in Sweden for almost a decade and have carved out some of the direct mail delivery market, but Sweden Post continues to deliver 94% of the country's mail.
- *Flexible operations.* Sweden approved the end of the mail monopoly in 1993. Sweden Post became a limited liability company with shares owned by the government. It receives no government subsidies but can borrow from private markets and acquire firms, invest in joint ventures, and form subsidiaries. The government regulator—the National Posts and Telecom Agency—licenses firms to provide limited mail services. It has granted about 50 licenses, though only one other firm, City Mail, is a major player. City Mail covers about 40% of all Swedish households with deliveries several times a week. It accounts for about 4% of the total Swedish mail market with

concentrations of activity in Stockholm and Gotenberg. In the face of competition and liberalization, Sweden Post has focused more clearly on being the leading messaging and logistics player in Sweden. It no longer provides payment and banking services and it will gradually move all of its postal offices into stores and retail outlets.

The Netherlands

- *Reserved area.* The Netherlands is a small, highly urbanized country. Thus, speedy delivery to every household at a reasonable price is relatively easy. Universal service is required of the Dutch post, TNT Post Group (TPG), and obligates it to provide universal service for all postal items deposited in mailboxes intended for the public. But bulk mail is a competitive market outside of the obligatory area and TPG must provide access to its delivery services to competitors.
- *Flexible operations.* TPG is a private company in which the government owns only 35%—though the government has retained golden share majority voting rights over key transactions. TPG can pursue an aggressive commercial strategy, raising funds privately, and is free to acquire other companies and form joint ventures. Price increases in the overall mix of services are set and can rise only with the general index of wages in the private sector. But charges for individual sectors can be adjusted within the overall cap. TPG has used profits from a healthy postal market to help fund a flourishing international logistics and express delivery business. The mail business, which accounts for 34% of revenues, provided 68% of recent profits.

Germany

- *Reserved area.* Germany has already moved to open more of its domestic mail market than the EU targets demand. Approximately 20% of total mail volume is open to competition, mainly in the area of larger-sized direct mail pieces. The government has set a target of 2007 for complete liberalization. Within this gradually opening market, German law still provides for the provision of basic postal services at affordable prices. It includes a set prices that are adjusted for inflation. At the same time, the regulators have issued a number of licenses to others for operation in special service areas, such as delivering magazines and bills, though competition in the core of letters and direct mail is limited so far.
- *Flexible operations.* In Germany, Deutsche Post (DP) was re-organized as a corporation under private law in 1995, and in 2000, 31% of the shares in the post were sold to the public, bringing in about €6 billion. DP has the ability to act like a private corporation in terms of procurement, mergers and acquisitions, and raising private capital. In fact, it issued private market bonds to raise €1 billion in 2002. Since 1997, DP has used its access to the capital markets (and its postal profits) to conduct an aggressive acquisition campaign that has made it a major player in European-wide logistics, parcel, and express mail delivery, in postal banking, and in international mail. DP still does not have to pay taxes in the reserved area, and its pricing changes are subject to review with the regulator. The postal operations that account for only about 34% of total DP revenue still account for 75% of total profits. DP is testing the limits of its newfound flexibility. In the

summer of 2002, for example, DP was penalized by the EU Competition Commission for using postal profits to subsidize its business parcel service, funding which was ruled an illegal subsidy from its reserved area. But while that may have been a bit of set back, its flexibility allowed its two subsidiaries—DHL and Danzas—to show dramatic upturns in air-freight movements during the recent dock-worker strike on the west coast of the United States.

Consignia (Royal Mail)

- *Reserved area.* The USO in the United Kingdom requires delivery to every address each working day at affordable prices. One of the goals of the regulator, Postcomm, though, is to foster competition. There is no reserved area for Consignia (soon to be renamed Royal Mail), although to date, Postcomm has been very cautious in granting licenses to competitors—limiting them to certain types of communications in restricted markets and limiting their volume to well under 1% of total mail volume. Its formal goal is to open the market for full competition by 2006.
- *Flexible operations.* Consignia became a government owned postal company organized under company law in 2000. It pays taxes and has been given limited freedom to spend a portion of its surplus on acquisitions and to enter some markets through joint ventures. At the same time, Postcomm has granted about ten licenses for other delivery agents to experiment with very limited operations. (The text box, “The Potential New Delivery Players,” gives an idea of the extent and scope of the new licensees in the United Kingdom.)

Despite Liberalization, National Posts Still Dominate

There is ferment among posts in the developed countries. The single-market initiative of the EU in the late 1980s provided a general context for liberalization, which has deeply affected the posts. Major European posts have been granted a substantial amount of flexibility in their operations—in the ability to act like a private company in raising funds, acquiring and forming joint ventures in new areas, and operating in related businesses. Most posts do still carry substantial requirements for a universal service obligation. And a few have some vestiges of competition in local mail markets. But as yet, the competitive threat is small and some of their activities in related areas—like logistics, express mail, financial services, and Internet services—are substantial. After almost a decade of liberalization, the national posts retain control of the vast majority of the letter market (see Table 6–2).

But while the national posts are certainly holding their own in lettermail, there have been increasing inroads in the unaddressed mail sector across the EU—today, most of the national posts deliver well under 50% of unaddressed mail.

*Table 6–2
Postal Operators Still Dominate Their
Reformed Domestic Markets
(Percent share of domestic letter market)*

TPG (Netherlands)	100 *
Consignia	99
Deutsche Post	98
New Zealand Post	98
Sweden Post	94

* Letter mail less than 100g in weight.

Source: Postcomm

OTHER POSTS IN A LIBERALIZING WORLD

Some posts are slowly moving toward reform and keenly watching the liberalized posts, but are not yet willing to experiment with their valuable business and social asset.

France

La Poste in France is moving along the path toward liberalization in line with the EU rules. It remains a government agency with strong national public policy goals—a strong USO, a reserved area in line with the EU guidelines, and important social and labor responsibilities. However, La Poste has been given some freedom to operate in other areas and is currently very active in financial services (utilizing its postal service centers as agencies), in providing a range of electronic services, and in European logistics operations.

United States

The postal markets in North America have been much slower to change. For example, the last major change in U.S. postal regulations came with the 1970 Postal Reform Act, well before the push for liberalization. The regulatory issue in the United States is clouded by the strong performance of United States Postal Service (USPS) over time—it has been able to tie together a huge continent with a widely dispersed population through an extremely efficient delivery system with timely delivery and relatively low cost. On a per capita basis the USPS delivers about twice as much mail as the other posts in developed countries. There are few potential competitors in letter delivery, but rivals in areas like express delivery, logistics, and electronic services are quick to protest or raise court actions if they feel that USPS is using funds from its reserved areas to expand into areas that are open to commercial competition.

THE POTENTIAL NEW DELIVERY PLAYERS

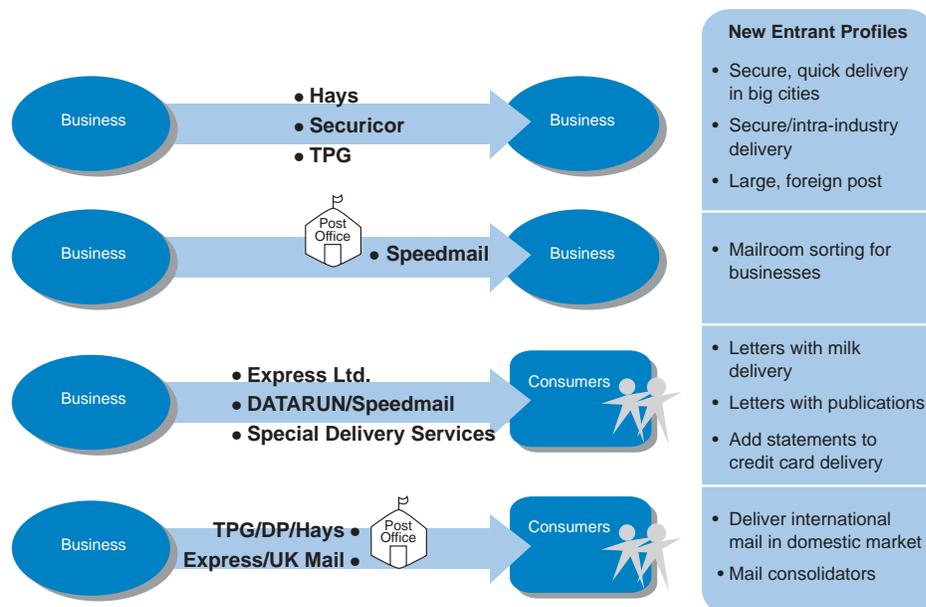
Expanding information technology infrastructures, closer interactions along the supply chain, and more flexible logistics have created new possibilities for delivery of paper-based messages. One way of defining the competitive space for the posts is to look at the kinds of players that might emerge in a fully competitive market. A good starting point is the EU. The longer-term goal of the EU is to bring competition to the mailing industry, with an open market for all mail over 50g by 2006. This is a major change but it still leaves the vast majority of letters and simple direct-mail pieces within the reserved area of the national posts.

Some countries in the EU are moving faster than others. An interesting case is the United Kingdom. The U.K. postal regulator, Postcomm, is trying to foster effective competitors for Consignia. It wants to create the conditions that would foster viable companies in the market that can push Consignia to

better performance by the time the U.K. market opens for full competition in 2006.

Postcomm has begun to issue licenses for companies to provide limited postal services within the reserved area. Though licensees to date are limited in what they can do, it is interesting to look at how these new players have carved out segments of the market that they think they can operate in profitably. To date, each of the licenses grants rights to operate in a limited market segment, covers a limited period (one year), and restricts the total market size of the new entrant to well under 1% of total Consignia volume. But even such limited licenses do offer a rich set of opportunities for the new carriers to explore a market segment in one or several metropolitan areas. Figure 6-1 shows the purposes of the licenses and how the new player fits into the larger postal picture.

Figure 6-1
The World of Competitors for Postal Mail Delivery in the United Kingdom



Source: Institute for the Future

To build and protect such a vast and successful system, USPS retains an extremely wide-ranging reserved area—it has a monopoly on letters delivered to the mailbox, meaning there is no real competition for delivery of mail to households. For this reason, USPS is limited in its ability to compete in other areas and thus the flexibility that most other posts have to build competitive businesses in logistics, courier services, finance and banking, or Internet services is strictly limited.

USPS also needs to maintain personal letter delivery in an economy that is finding increasing efficiency in technology. It is also expected to be a model employer with excellent pension and health benefits for a relatively low-skilled labor force. USPS also has to deal with a huge burden of pension and health care liabilities to retirees that date back to the 1970 act. The act allowed postal employees to stay inside the government pension and health systems, which results in high current expenditures as pensions and health premiums rise over time. To pay for its accumulated pension and health liabilities, USPS operates on a pay as you go model and thus it has taken on a huge future liability that could total up to \$100 billion.

There is little support for reform in the United States. There was a proposal in Congress that was debated and talked about for eight years—the McHugh Bill—that would have provided an increase in pricing flexibility for USPS, but it was never able to generate enough votes to get out of the Postal Affairs Committee.

Canada

Canada moved early to make Canada Post an independent crown agency with profit and loss responsibility. However, as a provider of universal service across a sparsely settled continental country, it retains a strong reserved area

and has been constrained from operating in fields too far removed from its core businesses.

LESSONS FOR THE POSTS

Our review of recent activities inside and outside the posts provides three clear and important lessons: posts can operate effectively in other handling and information-intensive businesses; lettermail markets are extremely difficult for other organizations to compete in; and governments continue to recognize the importance of universal service.

Our review also points to the fact that there are a variety of players in the delivery business who could emerge as effective competitors to the posts. Not surprisingly, the best funded and most aggressive of the potential competitors are other national posts. For example, TPG and Deutsche Post are getting licenses to compete in the United Kingdom in sectors of the business-to-business market and possibly in the business-to-consumer market as well. In addition to the posts, there are a variety of other players from local express companies, to milk delivery companies, and magazines distributors that are using their licenses to build local delivery routes.

It is in this context that we look at how the movements toward liberalization that are so strong in other areas of economic enterprise are likely to work themselves out in the postal world.

Chapter 7

The Future of Postal Regulation

The forces for postal reform are growing. While the postal world is one of the areas in which deregulation and liberalization have come late, their effects are now being felt in the affluent countries around the world. While still heavily influenced by national concerns and cultural traditions, we will see some changes in postal regulation over the coming decade. Those posts that don't adapt to their new regulatory environments, or are restrained from adapting, will find themselves increasingly isolated from the dramatic and important changes in the wider world of communications in which they operate.

LESSONS FROM THE WIDER WORLD OF REFORM

In Chapters 2–6 we explored regulatory changes in several industries that share some characteristics with posts and ongoing postal reform efforts in several countries. These basic trends in the regulatory arena will, in the long run, be important determinants of how governments and societies will think about the posts. By looking at the broader picture of deregulation, we can identify the key lessons for posts as they go forward into an increasingly liberalized world.

The posts deliver paper-based messages. But their world is just one part of a wider world of communications and message delivery that takes place through broadcast, cable, print, online, wired, and wireless technologies. This wider world is experiencing major technological changes and rapid growth. In addition, the regulatory environment in these other areas of the communications world is changing rapidly, and these changes are part of larger regulatory trends, such as the deregulation movement that has been underway for the last couple of decades. Some of these basic trends, like the changes in the rules of competition are extremely relevant to the posts. And, there are some other enterprise areas—like the electricity and telephone markets—that bear striking resemblances to the postal

world in terms of being networked industries with strong universal service obligations that are experiencing deregulation of their markets and facing competitive challenges from new players for the first time.

If we place all of these regulatory trends in a matrix along with the two issues of key

interest to the posts—the reserved area (and its relationship to the universal service obligation) and the opportunities for flexible operations—we can see how postal regulation compares and contrasts to what is going on elsewhere (see Table 7–1). While the posts are unique, they are definitely a part of the overall

Table 7–1
Posts Can Learn Lessons from Other Industries

	Reserved Area	Opportunities for Greater Flexibility	Unique Qualities of the Posts
Antitrust	<ul style="list-style-type: none"> All markets competitive—but size and scale can be beneficial to consumer. Tech standards are important for some industries. 	<ul style="list-style-type: none"> Greater focus on effective competition and options to add technology and services. 	<ul style="list-style-type: none"> Labor-intensive daily delivery not susceptible to innovative technological competition. Dense delivery areas are needed to cross-subsidize rural and remote areas.
Telecom	<ul style="list-style-type: none"> Local network provides a key service. Cash flow and capital are critical for a healthy provider. 	<ul style="list-style-type: none"> New technologies foster change. Falling prices promote consumer adoption. 	<ul style="list-style-type: none"> Integrated service from pick-up to delivery makes it difficult to calculate a fair access price.
Electricity Market	<ul style="list-style-type: none"> Huge “sunken costs” need to be recovered. Security of power supply is essential. 	<ul style="list-style-type: none"> Create competitive conditions in wholesale market. 	<ul style="list-style-type: none"> Huge network of physical and labor infrastructure makes comprehensive entry into retail market extremely difficult for new players.
Media	<ul style="list-style-type: none"> Assumption that diverse ownership leads to diverse opinions. 	<ul style="list-style-type: none"> Technology is opening many alternative channels and wider content choices. 	<ul style="list-style-type: none"> Public has a keen interest in low-cost paper-based delivery of information.
The Posts	<ul style="list-style-type: none"> Universal service is a deeply embedded notion. Reserved area cross-subsidizes other services and provides a valuable asset. 	<ul style="list-style-type: none"> Diverse channels provide options for communications. 	<ul style="list-style-type: none"> Cross-industry-lessons identify options for rethinking postal regulation.

Source: Institute for the Future

shift toward regulations based on the goals of increased efficiencies and integrating new technologies and other changes through a greater reliance on market forces.

While the differences between the posts and the other industries are important, there is also an important message that emerges from the matrix—the push to open up networked markets and accept competition and flexible operation is a strong underlying trend. And, legislators, regulators, judges, and consumers and industries that are customers of regulated industries are interested in the benefits that may flow from reform and increased competition and in building options for further improvements.

DRIVERS FOR POSTAL REFORM

There are five major forces that will drive postal reforms over the next decade. Each of the five will exert influence, but none will dominate and result in a single outcome for all posts.

Consumer Demands for More Choices

Consumers are strong advocates of choice and have had their voices heard in many areas, pushing regulators to open markets that were long closed—pharmaceutical products, food and nutritional supplements, financial services, telecommunications, cable, and transportation—and then responding to the new opportunities that resulted.

Consumers will not have a direct impact on posts because they are not the primary customers for postal services and are likely to continue to receive high quality services under the reserved system. But their demands for more choice will have an impact on communications from businesses—the primary postal customers. Businesses are likely to demand greater flexibility in postal services in light of their changing communications needs.

Technology Advances

New technologies have had two dramatic effects on liberalizing regulations. They have increased the number of channels that are available for businesses to communicate with consumers—digital cable and satellite TV offer dozens of extra channels and new printing technologies make producing smaller-sized newspapers and magazines feasible, for example. New technologies have also led to sharp declines in the cost of telecommunications services and media alternatives. Together, these trends have made the fruits of deregulation—primarily lower costs and increased choice—easier for consumers to see.

New technologies are not driving such rapid changes in postal markets, but they will bring important changes over the coming decade. Digital formats will allow for electronic substitution in payments and billing flows, as well as for account statements and transaction confirmations. Database technologies will improve the quality and relevance of mailing lists and allow direct mailers to send better directed and more timely mailings. In addition, new printing technologies will make smaller batches printed closer to the consumer feasible.

All of these allow businesses and consumers to vary the pacing and control over messaging and facilitate the emergence of new and significant players along the messaging chain. These new players and their customers will have an interest in more flexible postal services that can meet their needs for more timely and targeted deliverables.

Emerging New Players

Europe will become a center for new types of postal activities in the next few years. As European posts become more business-like in their activities and more of them take on the attributes of private companies, they will begin to compete with other posts. As the

reserved areas shrink, large, aggressive posts like Deutsche Post and TPG will look for opportunities to make profits in other countries. First they will look for international business customers and they will combine their communications activities with their mastery of logistics and distribution to provide a range of services to global firms.

In addition there will be others (for example, local firms that deliver packages or specialize in delivering new credit cards) what will find that they can make a profit from activities in previously reserved areas. These new players will form a growing group that will be in favor of faster or more extensive opening of reserved areas, and they will use the general rubric of open competition to push for change.

Trend Toward Open Markets

Popular confidence in market mechanisms is slowly increasing. But there are still large numbers of people who are skeptical of what an open market will do for them. And feeding this skepticism is a number of cases where market opening has failed (for example, electricity deregulation in California and Ontario, commuter rail line deregulation in the United Kingdom, and a lack of financial controls in the rapid telecom expansion).

But, on the whole, a substantial block of sophisticated consumers has experienced and enjoyed the benefits flowing from the gradual opening of markets. The list of such benefits is long—a wider range of investment opportunities; a pocketful of payment choices; faster approval times for an increasing number of pharmaceutical products; a wider choice of broadcast, cable, and satellite TV channels; cheaper air fares and more frequent flights to where most people travel; and new goods on the shelves of their favorite stores sooner and cheaper than in the past. Over time, more consumers have shifted their thinking from “I

need the government to protect me” to “if properly overseen, the market can do things for me (such as, offer me more options, bring me new technologies and choices, and guarantee efficiency) that no government or regulatory body can.”

Antitrust Policy and the Courts

Processes are becoming important as well. As regulatory law continues to adapt, it will be speeded up by two key engines of change—competition or antitrust law and the courts. We described the importance of antitrust trends on the general regulatory landscape in Chapter 2. In addition to antitrust laws, the courts in the United States have long provided a perspective on competition independent of regulatory bodies. And increasingly we are seeing the European courts take on an active role in interpreting and criticizing regulatory activity. The result of such activity is twofold: companies can seek advantageous changes by challenging regulatory decisions or by challenging decisions that have not yet been made.

All of these factors are building momentum for further changes that will affect the posts as well as other previously protected industries. There are a number of factors that so far have protected the posts from the full onslaught of liberalization—the strength of postal unions, the fact that consumers are a step removed from the impact of postal regulation and are not yet clamoring for change, the number of other industries that are still protected from competition, and the view that posts are on the periphery of some of the big forces for change. Despite these current factors, the posts are not immune. Over the next decade they will suffer the slings and arrows that will be coming from new technologies, demanding consumers, new players, and a host of other factors (see Figure 7–1).

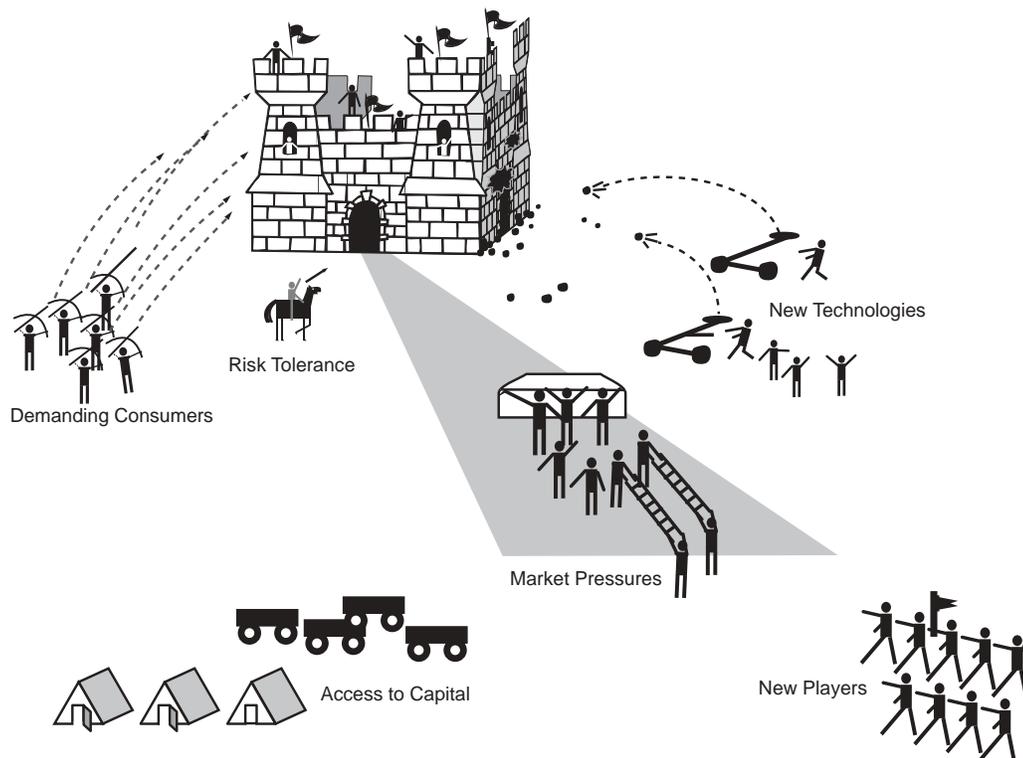
A SPECTRUM OF REFORM AMONG THE POSTS

The postal reforms that have gone the furthest come from two distant geographic areas. The first set is in two countries that have small populations and are relatively isolated—New Zealand and, to a lesser extent, Australia. The second set includes countries within the EU where the push to create a single, open continent-wide market has resulted in a number of countries—Sweden, the Netherlands,

Germany, and the United Kingdom—beginning to build postal models that can survive in a liberalized world.

These models actually span a spectrum of current and planned responses—from the Swedish model which welcomes outsiders in its open and competitive domestic market, to the German model which has used revenues from the reserved area to build a well-balanced logistics and delivery player that can be

Figure 7-1
Defending the Ramparts



Source: Institute for the Future

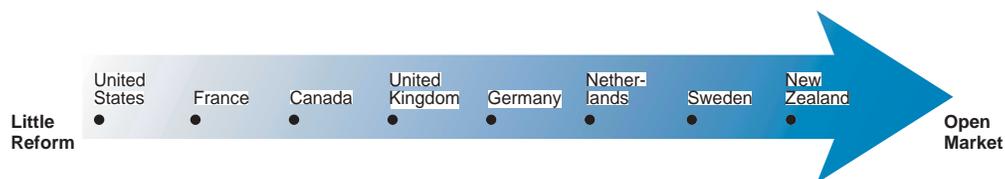
competitive across a range of activities in wider international markets and beyond (see Figure 7–2).

THE POSTS IN 2012—TWO SCENARIOS

Despite its delayed arrival, regulatory change is coming for the posts, with Europe leading the way for North Atlantic countries. Like most basic reforms and most postal matters, it will take time to work its way through the system. But the ability of the EU to bring change to member states is too strong to ignore the likely long-term impacts it will bring to the

posts. The EU has consistently surprised its critics, and has moved successfully from a simple customs union, to tackle complicated areas like agriculture, financial flows, currency, common budget and tax policies, and commercial law to form the basis for a single market that encompasses an economy larger than the United States. It is now nearing the tenth year of its “single market” implementation program and 98% of the relevant EU laws are now approved in member states. Going forward, the EU has said it wants to be the world’s most competitive economy by 2010.

Figure 7–2
The Current Spectrum of Liberalized Posts



- **United States:** USPS is an independent government agency with budget responsibility. The letter market remains closed to competition and USPS has little flexibility in operations.
- **France:** modest reform in 1990 gave La Poste more autonomy in its operations but kept strong social and public policy goals in terms of employment, regional planning, and low cost service and government control over operations.
- **Canada:** an early reform made Canada Post a commercial crown company, giving it commercial goals as well as social responsibility, but with limited flexibility and freedom to act.
- **United Kingdom:** only about 5% of the market is open, but the regulator is giving a range of alternate players a chance to establish themselves in different market niches.
- **Germany:** about 20% of the market is open to competition, but the high profits from mail services and ready access to capital markets are supporting Deutsche Post to cover the market well and to fund rapid growth in related activities (e.g., finance, logistics, international mailing services).
- **Netherlands:** more than half of the market is open for competition, but this small compact, urban country gives advantage to the company that can operate throughout the country efficiently.
- **Sweden:** completely open market with no reserved area with competition from at least one sizeable and well-funded player.
- **New Zealand:** completely open market with no reserved area, but small, isolated, diverse market favors a single efficient player.

Source: Various national posts

While the mechanisms for change are sometimes painstakingly slow, its record of transformative changes over the long term is extremely impressive.

Postal reform is a part of the larger European movement toward a single competitive market. There are unique features to the postal world, and at the end of the next decade, there will not be a single outcome for all the European posts; rather there will be variations within the cultural and political context of each country. But across the nations of the EU and North America, widely accepted rules of the game will change.

Assumptions for 2012

Before presenting our two scenarios for the posts in 2012, we need to describe the four key assumptions that are behind the postal regulatory regime of 2012.

- *Mail remains a key communications device.* Paper-based communications sent at the discretion of the sender remain a welcome route for important business messages to existing and potential customers and an unobtrusive way for recipients to receive and sort messages.
- *Certain roles for the mail are declining, but slowly.* Financial transactions will continue to decline over the decade, but the decline will be slower than anticipated as both businesses and consumers welcome a range of payments and confirmation options in managing their household finances.
- *New roles for mail emerge.* There will be a major revival of single or small group correspondence as better identification of interests and new printing technologies allow for decentralized and immediate preparation of timely and targeted mail.

- *Four key parties will drive change.* Postal reform will be pushed by four parties that have a vested interest in how the posts operate: 1) businesses that want to become new communications players by using new digital technologies that will allow them to offer products and services that are similar to postal products and services, 2) business that want to communicate with consumers more effectively, 3) consumers that want the mail stream to adapt to their needs, and 4) some national posts and other delivery companies that are capable of operating across borders or in wider arenas.

**SCENARIO ONE:
THE NEW EUROPEAN POST**

It's 2012 and the EU has been successful in its bid to liberalize all of the national posts in member states using a legal framework for a single competitive business market. The New European Post (NEP) is a transformed national post and is typical of many posts in Europe—not at the cutting edge like a few, and not lagging behind by meeting the minimum EU standards like some of the others. These days, there are three basic rules for posts across the EU: the posts are treated as independent enterprises that have responsibility for their own accounts and are driven by commercial as well as social goals; the reserved area, where it still exists, is much smaller and the required activities within it are clearly articulated; and there are clear rules about how others in the downstream delivery system can work within the postal market. It is not surprising that under these new regulatory notions that the traditional posts have continued to do well. Their strength (versus the upstarts that joined the market in the last several years) is their efficient and widespread delivery capability for communications that need to reach the national market or segments of the larger market.

Within these general regulatory rules, NEP has built a strategy for success that is based on three principles: developing strong customer loyalty through ever-closer ties to consumers; rewarding postal employees and managers for experimentation and innovation; and linking the traditional mail-delivery service with new value-added services.

NEP, in particular, is promoting its unique ability to deliver to every address on a daily basis. This has proven to be a powerful tool and has made NEP the preferred carrier for any national direct-mail campaign and for the increasingly sophisticated segmentation policies of businesses that demand quick and tailored responses to groups of consumers that are geographically dispersed. In addition to such traditional services, NEP is finding increasing success by taking advantage of changes in the regulatory landscape in four key areas.

- Competition in the area of basic letter delivery (the reserved area was completely eliminated by NEP's regulator a few years ago) has given NEP a standard to measure overall productivity and has given its management a mandate for more flexible utilization of resources.
- NEP is using its hard-fought independence to gain access to capital markets. It has used the funds raised in the private capital markets for new delivery-support equipment and technologies that allow it to increase its productivity in moving, sorting, and delivery and has allowed NEP to generate discretionary funds that support a range of value-added services.
- NEP is also benefiting from the transformed regulatory environment by experimenting within the letter market. Now that the regulator does not set prices for services, NEP has the flexibility to negotiate special rates with key customers and is working on alternative delivery options, such as local printing on demand, personal delivery for secure communications, and evening and special package-delivery services.
- With plenty of available capital and fewer restrictions on what it can and cannot do, NEP is free to move into new value-added services. It is engaged in a variety of innovative activities—offering mail preparation and mailroom functions for large companies, running variable data decentralized printing operations to facilitate timely and targeted communications to consumers, working in the area of commercial design and content management, cross-channel coordination; and even helping some firms with their communications strategies.

**SCENARIO TWO:
THE NEW NORTH AMERICAN POST**

Across the Atlantic, the North American posts have largely been isolated from the changes that have been taking place in Europe. In 2012, there are two continuing differences between the NEP and the New North American Post (NNAP)—NNAP had been operating efficiently in the context of a continent-wide market for decades and therefore didn't have to build a logistics infrastructure as the EU did, nor did it have to coordinate with a number of independent national posts (and new players) for local delivery of common materials as NEP had to do.

It is interesting to note, however, that in the world of telecommunications while the Europeans were thinking of ways of creating competition among their national operating systems, the United States was in the process of creating regional Bell operating systems that would develop more effective competitive models from local bases. In such a continent-wide market, it was thought that there was the possibility that local or regional players could provide a competitive alternative to the posts for locally-based campaigns. In practice, the outcome was not to follow the Baby Bell model of breaking up the delivery system into regional players, but to follow the emerging electricity model where competition is encouraged in the generation and distribution of power. Increasing freedom was given to the NNAP to buy, partner, and venture with a variety of systems and logistic players to build a flexible and responsive infrastructure that can move large volumes of mail and packages across distances. In essence, the core attribute of the NNAP is delivery.

The focus on delivery as the core of NNAP allows it the required flexibility to compete more effectively in a rapidly changing communications environment. For example, NNAP is developing a flexible business model that could fully integrate it into the rough and tumble communications industry. This innovative idea came in the wake of the legislature's decision that if NNAP had the

option of competing in the wider world of communications it would help NNAP solve its longer-term budget dilemmas of providing decent salaries as well as health insurance and pension benefits that were the standard for the market.

Several key legislative reforms came near the turn of the decade. NNAP is now being explicitly treated as a commercial organization, has gained access to private financing options, is able to offer value-added services in and around delivery, has gained control of some businesses outside its traditional mail delivery, and has more flexibility in dealing with its labor unions.

Of critical importance is the ability of NNAP to work with players on building permission-based mailing lists and coordinating them with a full range of cross channel options. This involves active ventures (joint R&D and process planning) with direct mailers, software designers, advertising and communications agencies, and bankcard companies. At the turn of the decade, these new ventures were primarily in experimentation and beta test modes, but everyone was surprised at how quickly they moved into the marketplace. These types of activities have provided a boost to a budget that was under pressure.

But while all of these reforms have been good for it, NNAP has found that there is some increasing competition in its previously reserved area (which was a part of the legislative cost of being allowed to operate more freely in value-added areas). These challenges on the delivery side (primarily allowing select firms to compete in narrowly-defined delivery markets) are creating some uncertainties in a few large urban markets. But, they have also lead to some changes in processes at the local level, which have raised productivity rates substantially and allowed rates in some of those areas to fall. Given a bit of time, the officers of NNAP are confident that they can find success in the new regulatory regime.

IMPLICATIONS FOR THE POSTS

There are five important lessons that flow from our look at regulatory change.

- *Change is coming.* The bias of regulation in the postal world is toward a very gradual opening of the market. But the posts' biggest customers—businesses—are finding that the postal system needs to change in order for them to more effectively reach their target audiences. In addition, new players are finding opportunities in doing some of the things that the posts are doing now in new and different ways. If the posts are resistant to change, they will find that such resistance leads to a continuing digital challenge in key markets, the loss of momentum in value-added areas to other players more willing to change, a gradual decline in consumer loyalty to the mail, and litigation from disgruntled businesses and consumers that feel that the posts no longer deserve protection in a changing world. The best bet for posts is to work with regulators to define the needed reforms that, in the end, give them a fair chance to compete in the new world.
- *Change will be varied.* Not all posts will look alike in 2012. Despite the fact that the EU drive for a single, unified market is the most important regulatory force at play for most of the established posts, national regulators across Europe will still have a significant voice in what happens to their domestic postal markets and players. But, while cultural, social, and national interests will give each country its own flavor of postal regulation, because of the overarching EU rules, the differences among the postal markets are likely to get smaller over the coming decade. In addition, inside and outside the EU, the growing importance of global business enterprises, the new opportunities presented by the range of new communications options, and the more active interest of new sophisticated consumers in finding relevant information will be three strong underlying forces for change. So, although some key postal markets are temporarily isolated from direct competition, examples of the benefits to businesses and consumers from reform in Europe—successful new players, efficient new markets, and litigation across boundaries—will eventually help to bring change even to them.
- *Options are important.* The world of communications that the posts operate in is changing rapidly. Postal regulations and the reserved areas protect the posts to some degree from those changes. But, as time goes by, the ability to participate in those changes will be far more important to the posts than the value of the protection they get. In fact, the value of being the single point of national delivery is likely to rise in relative importance as size and scale become more important to branded product and retail firms. In the end, because the core competency of the posts is national delivery, they will find it relatively easy to accept gradual changes in the protections of the reserved area. The posts will value operational flexibility more as time goes on and will be willing to trade off some of their reserved areas for it.
- *Keep your eye on the new players.* New and sometimes surprising players will be emerging in the physical message delivery arena—newspaper and magazine delivery services, milk and food deliverers, and secure credit card deliverers. These players will be smaller, more flexible, and will concentrate their efforts on a single market, especially where there is the opportunity for providing value-added services. But

these players are important early indicators of new market opportunities and point to areas with the potential for rapid growth. Just as the large traditional retailers learned a lot from small specialty stores and from the growth of e-commerce, so the posts can learn from the experimentation of the small players who add specialized services to mail delivery.

- *Keep your eye on your strengths.* The successful posts will recognize and build on their core strengths—being the most important deliverer of highly-valued paper-based messages to modern sophisticated consumers; the vital role posts play as the universal service provider; the huge advantage in owning the final mile; and the tremendous advantage in controlling the largest personal-services organization in an era when personal services are disproportionately growing in importance.