

Chapter 5

Barriers to Entry in Post and Regulatory Responses*

Richard Moriarty and Paul Smith
Postcomm

1. INTRODUCTION

Models that have previously been proposed to explain *ex-ante* the expected pattern of new entry in liberalized postal markets have tended to focus on how new entrants can take advantage of profit opportunities created by the margin between the incumbent's geographically uniform tariff and actual cost structure (Liddiard et al 1999). Royal Mail put forward such a model when Postcomm began its consideration of how to open the UK postal market to competition. Notably, Royal Mail predicted that by 2004, it would have lost about 8% of its market share. Actual entry in the UK postal market has been very limited. As of January 2004, Postcomm estimated that new entrants had captured about 1/4 of one per cent of the regulated market, defined as items weighing less than 350g or priced at less than £1 (Postcomm 2004a). Combined, these new operators handle¹ fewer letters in one year than Royal Mail would expect to carry in one day.

This paper examines an alternative approach for understanding the likely pattern of entry in a liberalized UK postal market and the implications for regulatory policy. Rather than start from the premise of the incumbent's cost

* The views expressed in this paper are the authors and do not necessarily reflect the views of Postcomm.

¹ Some of the items handled by new entrants are 'end to end' covering all of the postal processes from collection to delivery, while other items will only be handled for part of the process, with other activities carried out by the customer, e.g. sortation, or Royal Mail (final delivery).

functions and business models, we take the perspective of a new entrant trying to build a business case for entering the market. Section 2 states how Postcomm, to date, has opened the market to competition and what has happened. Section 3 examines some key strategic considerations for potential entrants when assessing whether to invest in the UK market. Section 4 discusses how the regulatory regime can address the barriers to entry that may impede the development of effective competition. Section 5 states our conclusions.

2. MARKET OPENING IN THE UK

The EC Directive currently permits competition for mail items weighing more than 100g and/ or priced at more than three times the basic postal tariff of the incumbent. In addition, Postcomm's market opening strategy enabled operators to compete directly with Royal Mail from 1 January 2003 ("phase one") in three ways. First, operators could undertake conveyance of bulk mail, from collection through to delivery. Bulk mail is defined as mailings of more than 4000 identical format mail items from one customer (about 30% of the regulated market by revenue). Second, operators could perform upstream consolidation of mail from more than one customer for injection into Royal Mail's network for final delivery ("access"). Third, operators could apply for a license for certain 'defined activities,' such as enhanced document exchange services for closed user groups. These 'defined' activities generally involve handling mail end to end.

Postcomm's market opening strategy envisaged that from 1 April 2005 ("phase two") a further 30% of the market by revenue would be exposed to competition. At the time, Postcomm considered that this might be achieved by lowering the bulk mail volume threshold from 4000 items to around 500 items. The most significant aspect of Postcomm's market opening strategy was that from 1 April 2007 ("phase three"), the market should be fully opened to competition (the "end date"). Postcomm is currently reviewing this strategy and will announce its proposals for further market opening in autumn 2004.

So what has happened in "phase one" of Postcomm's market opening strategy? Almost 18 months on, Postcomm has granted 13 licenses to operators to compete with Royal Mail. These operators provide a range of services including document exchange for closed user groups, tracked business-to-business mail, and most recently, upstream consolidation of mail for final delivery by Royal Mail.

Although the range of entry is quite "broad," it is not "deep" in the sense of significant volumes of mail being handled by new entrants. So far, new