QUT BlueShift Business Case Competition

Business Case: Australia Post

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Contents

Overview

As Australia Post CEO Ahmed Fahour took in the sweeping vista of the Brisbane River and Botanical Gardens, he reflected on what had been a challenging few months. The beginning of March had seen an important step towards change, with the Federal Cabinet approving a proposal from Communications Minister Malcolm Turnbull, which would see a two-tiered pricing system for letter delivery.

In late 2014, Mr Fahour announced the results for 2013-14. Australia Post had recorded a $116.2 million profit after tax – not a bad result in its own right, but it was down by more than a third (34.2%) from 2012-13. The operating loss from the traditional mail services business had widened by 15.2% to $328.4 million, wiping out most of the $337.5 million profit made from the parcel services business. It was clear that the mail services business would continue to lose money and within a year or two cause the entire business to be a loss-making entity. As part of the key background to the reform proposal, Minister Turnbull had noted that without reform, Australia Post will lose $1.1 billion to 2017-18 and $6.6 billion over the next decade. A report commissioned by the government prepared by Boston Consulting Group predicted the letters business of Australia Post would lose up to $12 billion over the next decade.

The dividend paid to the sole shareholder, the Australian Federal Government, was down by 59.1% to $78.8 million, and soon Mr Fahour knew that there would be no dividend at all. And Minister Turnbull was clear - taxpayers should not be called on to subsidise Australia Post's losses, particularly given that 95 per cent of all mail is sent by business and government.

On the upside, Australia Post had been keeping Australians connected for more than 200 years, and was one of the most respected brands nationally.

Digital disruption and the decline of traditional mail

The Australia Post business had been disrupted significantly by the broad-based shift to digital channels. Australians' increasing use of the internet and mobile devices to communicate, access services, shop and pay impacted all of Australia Post's key businesses, but in different ways.

Letters Business

The letters business was the worst affected. With the advent of the internet and mobile communication had come initial trends towards email and text messages that had taken significant volume out of the business. Then, the movement of payments to electronic bills and direct debits and more recently the explosion of online communication through social media had further eroded the share of letters as a medium for communication.

Mail volume growth had tracked in line with GDP growth for decades up to the year 2000. Then it began to gradually decline for about eight years until 2008 and since then demand has fallen dramatically. The rate of decline had accelerated from 2-3 per cent at first to more than 6 per cent in 2013-14, and is forecast to fall away even more dramatically in the coming years. The result was that in 2013-14 there were 1.2 billion or 25% fewer letters delivered than at the mail peak in 2008. On a per capita basis the result was even worse, given that population growth had tracked at 1.5-2 per cent over the same period.

The entities posting mail was also a strong indication of further decline. Only 2.2% of mail volumes were Consumer-to-Consumer. The remaining 97.8% was made of Business-to-Business communications (46.3%), Business-to-Consumer (38.2%), and Government and Government Service Providers (13.3%). The Australian Federal and State Governments have adopted 'Cloud First' policies, promoting communication and storage of data electronically, and more specifically, online. Meanwhile, business continued to increase its adoption of online communication and applications. As a result, a structural decline in demand for physical letter delivery appeared to be a certainty.

However, Australia Post was limited in its ability to respond to these changes. As a regulated monopoly, it has a number of obligations it has to satisfy by law (i.e. the Australian Postal Corporation Act 1989). As a result, Australia Post has little control over its profitability – its costs in mail sorting and delivery are effectively fixed by these community service obligations (CSOs) as outlined in Table 1. For example it is currently obligated to deliver 5-days-a-week to 98 per cent of addresses and within stipulated timeframes. With population growth, the delivery network is expanding by 150,000 new points each year, meaning that a dwindling volume of letters is being delivered to an ever-expanding network.

CSO performance standards	Target	Actual 2013–14
Retail outlets		
Total	4,000	4,417
Rural and remote areas	2,500	2,560
Street posting boxes	10,000	15,805
On-time delivery (domestic letters)	94.0%	94.5%
Addresses receiving deliveries:		
Five days a week	98.0%	98.8%
At least twice a week	99.7%	99.9%

Table 1

This is being amplified by Australia's relatively unique population density. The majority of the population lives in a handful of coastal urban centres, while the regional population is dispersed over a significant area. This results in a need to maintain a regional network without sufficient population demand to run these services at a profit. Ultimately, resolving the competing priorities of balanced budgets and maintaining compliance with CSOs is proving unsustainable under the current business model. This is a key strategic challenge for Australia Post going forward.

Retail Business

The Retail business, consisting of 4,417 retail outlets across Australia, has also felt the brunt of the digital shift in the community. Two of the key drivers of retail outlet foot traffic, personal mail volumes and bill payment, have been adversely impacted as both communication and customer payment systems increasingly move online. These are the two main factors contributing to post office customer visits being down 24 per cent in the past six years.

The business recorded a $175.6 million profit at EBIT level in 2013-14, broadly in line with the previous year. This was impacted by declining customer visits to post office outlets (down 9.7 million or 5 per cent), which resulted in lower merchandise sales and payment revenue. Growth in the financial, commercial and trusted services portfolio was not enough to offset the revenue implications of declining customer visits. Conversely, post offices in regional areas, provide a critical array of retail and business services that is vital to the community.

Although the performance of the retail business has held up relatively well in the face of a challenging environment, the decline in foot traffic is predicted to continue and is likely to have a more pronounced impact in years to come.

Parcels Business

The Parcels business is the sole unit which has benefitted from digital disruption. This unit consists of the Australia Post parcel service as well as subsidiary, the recently acquired StarTrack, which over the past 12 months has been integrated to create a logistics provider that services both business and consumer markets. Rapid growth in e-commerce and online shopping have significantly boosted parcel delivery volumes over the last decade, and Australia Post has been the partner of choice for most of these B2C e-commerce deliveries. Domestic parcel volumes have increased by 39 per cent over the last four years, with 70 per cent of total parcel volumes currently generated by an online transaction.

This has led to an operating EBIT result of over $337.5 million in 2013-14, up 20.8 per cent from 2012-13 and nearly double the $170 million result of 2009-10. This is the fourth consecutive year of profit growth in Australia Post's parcels business – and it was achieved despite a slowdown in ecommerce activity and intensifying competition across the parcels market.

This business has been a focus of significant investment for Australia Post in recent years, and in 2013-14 a substantial portion of the total of $523.1 million of investment was directed towards to the Parcel business. This included heavy investment in expanding parcel facilities with the ultimate goal of doubling processing capacity. In addition, the parcel business has been expanding its service offering by investing in parcel locker services across the country as well as providing parcel delivery on Saturdays, which is due to commence in late 2014.

Parcels should continue to be a strong growth area for Australia Post moving forward, although an increasingly competitive market is likely to put pressure on both margin and market share. Australia Post has performed well against its traditional competitors, such as DHL, UPS, FedEx and TNT Express. However, disruption through innovative technology and business models could change this over the long term. Seemingly outlandish technologies such as drones are already being tested in pilot programs by Amazon, Google, and DHL. Therefore, traditional competitors and significant new entrants to the sector may prove to be formidable and erode the healthy market share Australia Post currently enjoys.

The politics of privatisation

Australia has a turbulent political history when it comes to government owned corporations. With rising government debt and politically dominant beliefs that private enterprise is more efficient, governments from the left and right have released policies of 'asset sales' and 'privatisation' at various points in the past decade. This has included icons such as Telstra (Australia's predominant government telecommunications provider) and Qantas (Australia's national airline) undergoing a gradual release of ownership into private hands. These programs have not always been received well by the Australian public, often due to concerns of offshoring jobs, diminished quality of service delivery to regional areas, and even a perceived reduction in national sovereignty due to excessive foreign ownership. This has been a divisive and ultimately decisive issue in several elections, which is why politicians approach the topic with exceeding caution. The current Federal Government has briefly floated the idea of privatising Australia Post. However, it soon withdrew this idea when there was an unfavourable reaction in the press and public opinion. The Opposition came out against the proposal so bipartisan support is unlikely in the foreseeable future. Selling off parts of the business, such as the profitable parcels arm may be tempting to maintain profitability in the short term. However, this may be short-sighted in the face of the likely losses that will grow from the letter business in the coming years. Similarly, it is unlikely that private enterprise would wish to inherit the distressed letter arm of the business, and the rigid CSOs that accompany it. As such it is not immediately clear whether privatisation can form part of the solution to Australia Post's significant challenges. Nonetheless, consideration of privatisation, or conversely acquisition of other firms to extend Australia Post's capabilities (e.g. StarTrack) shouldn't be ruled out.

Moving forward

The age of digital communication and commerce had brought with it numerous challenges for Australia Post, many of which it continues to adapt to. The partnership between Australia Post and China UnionPay International, the world's largest card organisation, announced in mid-2014 would now be impacted by the recently signed China Australia Free Trade Agreement. And in late 2014, Australia Post launched ShopMate, a parcel forwarding service for Australian shoppers buying products from online sites that only ship to the United States. The MyPost digital mailbox had also been introduced as a personal online tool to manage mail and bills, but to date, uptake had been below forecasts.

Ahmed Fahour knew the rest of 2015 was an important time of challenge and change. But at the same time, the business could not ignore its first priority, which by legislation it had to commit to – "serving all Australians wherever they reside". Community service was not just an obligation, but the very reason for the existence of Australia Post. The business needed to respond to the many changes in its environment without losing sight of its primary purpose.

Mr Fahour and his team had spent many hours, weeks and months analysing data and information about Australia Post, but he wanted fresh perspectives and new ideas. That was why he approached your consulting team. He read over the brief for your team to prepare your report.

Brief for consulting firms

Scope

Your consulting team must present a report which includes:

1. Cover page (one A4 page)
2. Table of Contents (one A4 page)
3. Executive Summary (one A4 page)
4. Understanding of the business and industry (maximum two A4 pages)
    - Clear and complete analysis using relevant financial and business analysis tools and frameworks
5. Recognition and understanding of the business issues (one A4 page)
    - Summary of the current position and key issues challenging Australia Post
6. Innovative business solutions (maximum three A4 pages)
    - Present and describe **three** innovative business ideas for Australia Post
        - The ideas should clearly:
            - Address a key weakness or threat for Australia Post; and/or
            - Capitalise on a key strength or opportunity for Australia Post; and
            - Be justified and supported through research to show they are realistic for Australia Post to adopt
        - The ideas can be a new product or service for Australia Post, or can present ways to better market or implement an existing product or service, or could be suggested changes to business policy or practice.
    - Recommend **one** of the business ideas that Australia Post should prioritise and implement.
        - The recommendation should include a budget for key expenditure, timeline for implementation, and clearly highlight positive impacts for the Australia Post business
7. Overview of your consulting team, including team name and profile of each team member (one A4 page)
8. List of references and sources (no page limit)

Research starters

The overview and briefing are the starting points for the task. The following reports are also provided:

- Australia Post Annual Report
- IBISWorld reports on postal services in Australia
- Boston Consulting Group report

Your team is expected to undertake other research to develop your report.

Appendices

Appendix A – Australia Post Annual Report 2014

Published and authored by Australia Post. | 4 September, 2014.

The report can be accessed at http://auspost.com.au/about-us/publications.html

Appendix B – More mail-outs: Federal election drives revenue growth over current year

Published by IBISWorld. Authored by Caroline Finch. | March 2014.

IBISWorld

WHERE KNOWLEDGE IS POWER

More mail-outs: Federal election drives revenue growth over current year

IBISWorld Industry Report I5101

Postal Services in Australia

March 2014 Caroline Finch

www.ibisworld.com.au | (03) 9655 3881 | info@ibisworld.com

This document has been provided digitally for your convenience. The public can access IBISWorld Industry Reports and other business databases in the libraries on QUT campuses.

Appendix C – IBISWorld Industry Risk Rating Report: Postal Services in Australia

Published and authored by IBISWorld. | September 2014.

IBISWorld

WHERE KNOWLEDGE IS POWER

IBISWorld Industry Risk Rating Report

Postal Services in Australia

September 2014

This document has been provided digitally for your convenience. The public can access IBISWorld Industry Reports and other business databases in the libraries on QUT campuses.

Appendix D – Australian and International Postal Services Overview Background Report

Published and authored by Boston Consulting Group. | June 2014.

Australian and International Postal Services Overview

Background Report

June 2014

THE BOSTON CONSULTING GROUP

The report can be accessed at
http://www.communications.gov.au/__data/assets/pdf_file/0020/235550/BCG_Postal_Services_Background_Report.pdf