

Calculating the net cost of universal postal service – pragmatic approach

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The postal sector provides services of public interest. The postal services in the EU are fully liberalized with the removal of the reserved market share. Market regulation is not able to meet public needs at any time. This requires the imposing of obligation for the provisioning of the service which is a financial burden for the operator. The costs should be done with this, which imposes the obligation. This article presents methods for calculating the net cost. The main accent is put on the risks of using the method "Net avoided costs" – which was the main reason for this article. A new, pragmatic approach has been proposed by describing two postal operators. The first one is the current postal operator with obligation to provide the service. It provides service through profitable and unprofitable business centers. The second, "Pragmatic" operator includes only profitable centers of the current operator in the model is a part of it. The pragmatic operator actually avoided some of the costs compared to obliged operator, as a result of economies of scale and demand conditions. Formulas are proposed for determining the net costs incurred and practice basic conclusions about the benefits and applicability of the model.

Изчисляване на нетните разходи от предоставяне на универсалната пощенска услуга – необходимост от прагматичен метод (Здравко А. Михайлов, Валентин Т. Ценов). Пощенските съобщения осигуряват обществени услуги. Те се либерализират напълно с премахването на запазен пазарен дял. Пазарното регулиране не винаги може да отговори на обществените потребности. Това налага въвеждането на задължения за обслужване, които са финансова тежест за оператора. Покриването на разходите трябва да се осъществи с помощта на този, който налага задължението. Представени са методи за измерване на нетните разходи. Акцентирано е на рисковете от използване на метода „Нетни избегнати разходи” - основен мотив за настоящия доклад. Предложен е нов, прагматичен метод. Участват два пощенски оператора. Първият е действащия оператор със задължения. Той предоставя услугата чрез рентабилни и нерентабилни бизнес центрове. Вторият, "Прагматичен" оператор, обхваща само рентабилните центрове на действащия оператор и в модела се явява част от него. Прагматичният оператор реално избягва част от разходите, в сравнение със задължения оператор, в резултат на икономия на мащаба и условията на търсенето. Предложени са формули, основни изводи за предимства и приложимост на метода.

Ключови думи: нетни разходи, универсална пощенска услуга, задължения.

1. The need of obligation for public service

In the EU countries (Member States), there is a rapid and general liberalization of the infrastructure sectors, providing services of public interest. The market regulation of these sectors is not able to respond adequately to the public needs at any time. The market price could be very high for certain groups of users with low purchasing power or is possible not to cover the costs for providing the services. This fact requires the imposing of obligations for provisioning

of public services, which has to guarantee the right of each citizen, notwithstanding of the social status and geographical location, the access to the minimum set of services with predefined quality and at affordable price.

The guarantee of the existence of universal postal service with defined scope and parameters is related to the imposing of obligation for its provisioning. The obligation represents a financial burden for the operator. This financial burden is identified with those components and elements of the services, which the

postal operator would not offer if it were guided solely by commercial considerations. Usually, it is related to the service of population and geographic areas, which are financially unfavorable for the operator.

The postal operators has the right to claim that covering of these costs, which are related to the "burden" of the universal service should not be only their responsibility and should be done together with this authority which has imposed the obligation, i.e. the state.

Last regulatory decisions

To the above-mentioned is related also adopted on 25.01.2012 by the European Commission set of decisions on the state aid designed for postal operators with obligation to provide the universal postal service (UPS).

The decisions for the relevant postal operators are as follows [9]:

- Deutsche Post (Germany) The Commission approved a compensation of € 5.6 billion granted by Germany to Deutsche Post from 1990 to 1995 to cover the cost of the universal postal Service.

- "La Poste" (France) The Commission reaffirmed its objective of high quality public services by approving €1.9 billion aid paid by France to La Poste to finance part of the cost of the public services of delivering press items to citizens and of presence in remote areas for the period 2008-2012 ;

- "Hellenic Post" (Greece) - The Commission approved aid of €52 million granted by Greece to Hellenic Post (ELTA) to contribute to financing the modernisation of its public postal services until 2021, which will broaden the range of services offered on the whole territory of Greece, in particular in its peripheral regions.

Changes in the regulatory environment

The removal of the reserved area, which gave the possibility for compensation as well as the complete opening of the European postal market, poses a number of challenges before the operators with obligation to provide the universal postal service [1]. One of these challenges is calculation of net costs from the provisioning of the services (UPS is a package of postal services).

The measurement of the costs, related to the obligation for provisioning of the UPS is a complicated complex activity both the theoretical foundations the practical application of the existing methodologies [2]. The confirmation of this is published in the Third Postal Directive "Guidance on

calculating the net cost from the provisioning of the universal postal service" [1].

The practice shows that in the most European countries the net costs, which represent an unfair financial burden are compensated by the state budgets [4].

The changes in the regulatory environment increase the importance of the budgetary form of compensation vice the removed reserved area. This calls for development of a pragmatic method for calculation of the net costs of the obliged postal operator and for the establishment of adequate mechanisms to guarantee its financial compensation and stability.

Object, subject and purpose of the report

Object of this report are postal operators (providers) with obligation to provide the universal postal service. Subject is the net costs arising from the provisioning of the UPS. The purpose is to represent a pragmatic method for calculation of the net costs of the postal operator with obligation to provide the universal postal service.

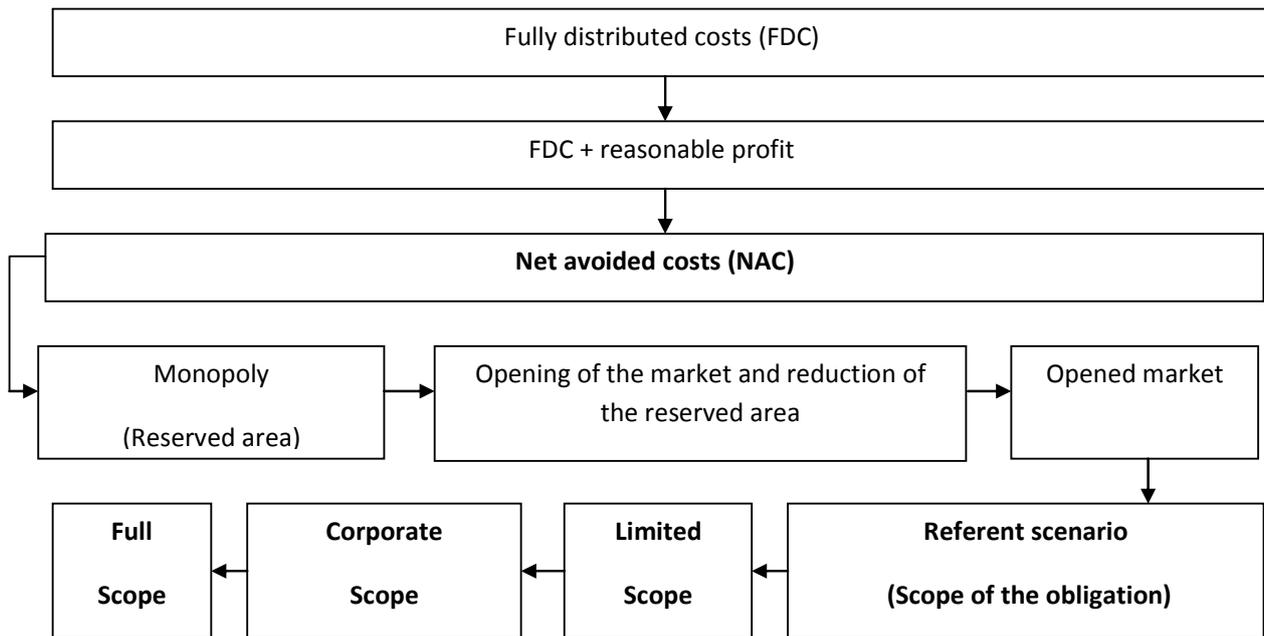
Restrictive conditions

- The accent is put on the way of calculation of lost tangible benefits without analyzing intangible and market benefits, cost efficiency and the right of reasonable profit;
- The proposed method does not deal with postal agencies as independent business center, because their revenues and costs are reported at post office level;
- The method does not take into account the impact of changes, resulting from the competitive market environment;
- The proposed method does not deal with production efficiency, which is defined in the act of entrustment;
- The method excludes the balance from international payments.

Assignments

- To define the net costs from the obligation for provisioning of the universal postal service and classification of the basic methods used for their calculation;
- To present and to analyze the basic methods;
- To justify a new pragmatic method for calculation of the net costs of the obliged postal operator.

Development of the basic methods used according to the opening of the market



Mentioned on the figure methods "limited scope" ("CA", Copenhagen Economics, 2008), "corporate scope" ("ACS", Norway Post, 2002) and full scope ("GLA", Swiss Economics, 2008) represent options of the method "Referent scenario".

2. Definition of the net costs and of the basic methods

"The net costs are the additional costs (or lost benefits) from legally imposed obligation to provide the UPS [3]". When they represent an unfair financial burden, they are subject to compensation by implementation of a certain scheme.

3. Presentation and analysis of the methods used

Fully distributed costs

The method is based on the full distribution of the actual costs [5]. However, in practice it does not calculate the additional costs arising from the obligation itself for provisioning of the package "UPS". Moreover, it does not deal at all with the net costs from the obligation if the financial result of the postal operator is positive.

Fully distributed costs plus reasonable profit

The method is based on the full distribution of the costs and average weighted price of the capital without taking into account the intangible and market benefits from the provisioning of the UPS [10].

Net avoided costs

Due to the mentioned above disadvantages of the presented two methods, the most European operators use "Net avoided costs" [4]. Under the net avoided cost methodology, the net cost necessary, or expected to be necessary, to discharge the public service obligations is calculated as the difference between the net cost for the provider of operating with the public service obligation and the net cost or profit for the same provider of operating without that obligation. [5]. Using of the method involves development of a referent scenario where the same operator operating without imposed obligations.

The implementation of this method is related to the following possible risks:

- Change of certain minimum standards to the referent scenario like:
 - Frequency of mail deliveries [8];
 - Accessibility of the access points to the services;
 - Financial affordability of the prices for users;
 - Single price for letter post items for the whole territory;
 - Non-delivery of certain free services for blind or partially sighted people, which will lead to conflicts

with recommendations of the Third postal directive [1];

- Disturbance in the balance of the interests of senders and receivers of the postal items [6];
- Choice for specific characteristics for frequency of deliveries and the part of territory and the population to be served;
 - Accepting of mail from the hypothetical operator when traffic is low = instantaneous intensity;
 - Change of points for contact with users;
 - Change of transportation scheme of access to the services market;
 - Change of standards and the quality of the service;
 - Option for many estimates and uncertainties;
 - Reliability of the results;
 - Assess the degree of acceptance;
 - Assess the degree of practical implementation;
 - Assess how the referent scenario is commercially applicable and if it leads to uncertainty for the obliged postal operator;
 - Excluding from the obligation of some components of the UPS, the costs of which would have significant influence on the final result [7];
 - Subjective determination of the scope of the obligation (postal codes, routes), which may increase the net costs [2];
 - Degree of using of different price systems for "priority" and "non-priority" letter post items;
 - Violation of collective agreements and social tension;
 - Inconsistency of time period during which the postal operator works "with obligation" and "without obligation";
 - Inconsistency of economic results from the work of obliged postal operator and the same operator "without obligation";
 - Accumulated effect from the mentioned risks and contestation of the results.

4. Reasoning for new, pragmatic method for calculation of the net costs of the obliged postal operator

Nature of the proposal

The proposed method is related to the development of other scenario, different from the referent scenario. It involves two postal operators. The first one is the current operator with obligation to provide the UPS. Under existing accounting, it provides the service through profitable and non-profitable business centers (post offices). The existence of non-profitable business centers in the obliged postal operator shows that the imposed obligations are provided under

conditions, which are not usual commercial practice and form a financial loss.

The second one is a conditional postal operator, called "Pragmatic" and comprises only profitable business centers of the obliged current postal operator and thus in the model it is a part of the obliged operator.

The second postal operator is considered as a commercial business organization, which works under usual commercial conditions as an operator "without obligations". The profitable centers works under commercial conditions, which are relevant to a big extent to an effective hypothetical operator. These are the business centers where the reported revenues from provisioning the UPS are higher than the reported costs from the provisioning of the same scope of services for a certain period of time.

The pragmatic operator actually avoids some costs, compared to the obliged operator as a result of economy of scale and demand conditions. Moreover, this operator meets the standards (elements and components) of the obligation to provide the UPS as a whole package. This removes the necessity to search services from the package, which are not offered what is supposed in the referent scenario.

Applicable formula

The net costs from the obligation for provisioning the UPS according this different scenario are calculated according to the formula:

$$HP = \left(\sum_{i=1}^n \Pi_i + \sum_{j=1}^m \Pi_j \right) - \left(\sum_{i=1}^n P_i + \sum_{j=1}^m P_j \right) - \left(\sum_{j=1}^m \Pi_j - \sum_{j=1}^m P_j \right),$$

where:

HP - net costs, total amount of the lost tangible benefits of the obliged postal operator for a certain period of time;

Π_i - operating revenue from provisioning the UPS in the non-profitable business centers;
 i - index, which is changing from 1 to n , where n is the number of non-profitable business centers;

Π_j - operating revenue from provisioning the UPS in the profitable business centers;
 j - index, which is changing from j to m , where m is the number of profitable business centers;

P_i - operating costs from provisioning the UPS in non-profitable business centers;

P_j - operating costs from provisioning the UPS in profitable business centers.

That formula can be developed as follows:

$$\begin{aligned}
 HP &= \sum_{i=1}^n \Pi_i + \sum_{j=1}^m \Pi_j - \sum_{i=1}^n P_i - \sum_{j=1}^m P_j - \\
 &\quad - \sum_{j=1}^m \Pi_j + \sum_{j=1}^m P_j, \text{ or} \\
 HP &= \sum_{i=1}^n \Pi_i - \sum_{i=1}^n P_i
 \end{aligned}$$

According to the developed formula, the net costs, which represent unfair financial burden from the imposed obligation, are the difference between the amount of the revenues and the costs from the UPS in the non-profitable business centers.

The allocation of costs

The costs from non-profitable and profitable centers are obtained from “Costs allocation system of the obliged operator by types of services” (“ABC” or other referent model).

The allocation of revenues:

- The revenues of the operation activity are obtained from the reports;
- The central revenues (excluding the revenues from the terminal dues) are allocated between business centers, according to the extent of their participation in the implementation;
- Parts of the central revenues, which cannot be allocated directly, are allocated on the basis of the reported costs.

4. European practices

The review of the international practice [4] shows that the relative share of the net costs (by the imposed obligation) to the operational costs of the postal operators by countries is from 1,5% for Great Britain to 7,8% for Switzerland.

5. Conclusion

The survey allows drawing the following main conclusions:

1. The proposed new method avoids the above mentioned risks, which is its advantage, practical relevancy and regulatory acceptability.
2. The new method uses factual and reporting data for the services, traffic, revenues and costs and thus

avoids conditionality and uncertainty of the other method based on the referent scenario.

3. Non-profitable cost centers used in the proposed method convincingly present the burden of the imposed obligations, because they work under the same price and other conditions like profitable ones. This gives grounds to assume that their non-profitability is caused mainly by the difference between urban consumer environments and raised by this difference in the demand of postal services.

4. The new method eliminates one of the major drawbacks of the methodology “Net avoided costs”, which allows different price conditions of work of actual postal operator and hypothetical postal operator.

5. The necessity of change in the volume and structure of the capital is avoided, which is unavoidable in all options of the referent scenario.

6. The proposed new method may be considered as a pragmatically oriented supplementation (addendum) of the “Guidance on calculating the net cost” of the Third postal directive.

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