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Possible End Games in the European Postal Market: Qui Bone?

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1. Introduction

The aim of the liberalization of the European postal markets, as laid down in the *European Postal Directive 2002,* is to achieve more competition in its postal markets. A competitive market will result in lower costs of resources used to deliver services, lower market prices, higher quality of services and thus an increase in overall value created. At first sight, the incorporation of state postal services, then the privatization of those corporations, and next the partial liberalizaiton of postal markets, did have a tremendous beneficial effect on costs, quality of service, and the development of postal service firms like Deutsche Post in Germany and TPG Post in the Netherlands. This liberalization is aimed at introducing competition in local markets. New entrants in local markets may be new firms starting from scratch, e.g. Sandd in the Netherlands, or they may be a subsidiary of a postal firm having its home market in another country, e.g. TPGPost in the UK. This phenomenon of incumbents taking footholds in each other markets, adds a new dimension in the market dynamics of the European postal markets. These footholds are to be interpreted as a change from the competition *in* national postal markets to a competition *for* the European market. This change from competition in markets to competition for markets may have different effects for large and for small countries: the first having a natural advantage over the latter. Add to this that postal services, as part of the wider business of logistic services, by its very nature have **L**-curve relations between average costs and volume, as a result of which large companies have an advantage over smaller companies. The **L**-curve relations suggest that in the end the result of the liberalization of the European postal markets is not that the market structure will develop into a state of pure competition, that is, a large number of players, but that most likely the outcome will be that a few players dominate this market. The unfolding of this scenario is supported by the phenomenon of asymmetric liberalization, as this presently is the case in Europe. Even more, the process of liberalization of postal markets has entered a new phase in its development, in which some players to compete for the European postal market deliberately use asymmetric liberalization. To present our argument we summarize in section 2 the main argument for liberalization and explain why the benefits of liberalization are not naturally distributed equally across countries and companies of different sizes. Section 3 briefly describes the current state of the postal liberalization process, showing the asymmetry between the member states. Section 4 explains the changing nature of the business of postal services and the strategies the key market players are pursuing. Section 5 introduces the concept of strategic supremacy, which we will subsequently use in section 6 to analyze the present situation in four major postal markets. In section 7 we describe the new phase of development in European postal markets, suggesting that asymmetric liberalizations deliberately is used in strategies to compete for markets. In section 8 we formulate several conclusions on the basis of the analysis presented.

2. The true nature of free trade and liberalization[1]

The policy of privatization (this is, transferring ownership of state run postal services to private ownership, be it closely held or in public corporations) and liberalization (that is lifting regulatory restrictions and monopolies in postal services) is pursued to increase the general welfare in a country: lower consumer prices, higher economic growth, minimizing externalities with respect to the environment, etc. The results of the liberalization of markets in the western world after the Second World War by and large have proven the neo-classical economic theory to be true (Turner, 2001; Yergin & Stanislaw, 1998). Liberalization of markets may however also lead to counter-intuitive results: increasing prices and lower quality of services (as in the case of the liberalization of the Dutch taxi-market and for the case of the Californian electricity market (Stiglitz, 2003)). In the case of the European postal markets it is assumed that the liberalization and integration of its markets will contribute to the growth of the European economy and thus its welfare. The Dutch Planning Agency estimates that achieving the single European market will increase the gross national income with 6.5% (Mooij & Tang, 2003:30). Traditional economic theory assumes that benefits of economic integration, through liberalization of trade, will equally benefit all economies involved.

[1] The title of this section is inspired by (Kay, 2003)

This neo-classical theory comprises a number of assumptions on liberalization, which do not hold up for the liberalization of the European postal market. Traditional economic theory on free trade and integration of markets assumes that the process of liberalization in the individual markets is *symmetric and synchronous* and that *neither differences in scale nor the nature of technology* affects the distribution of the benefits of this liberalization and integration. Further, it is assumed that all economies involved have sufficient comparable advantages available to share equitable in the created additional welfare. The underlying assumption is that resources are not mobile, that is they cannot be removed from a country or specific region. This is true for land as a production factor, but land is of decreasing importance as a production factor. So it is for minerals and infrastructures like distribution of electricity and water. The assumption of non-mobility of production resources does not hold for capital, including physical capital nor knowledge. Some services may be immobile in geographic terms, e.g. the delivery of a letter at a specific address, but other services, e.g. call center and other back office activities are mobile, as is demonstrated in the case of off shore call centers.
As a result value chains can be redefined in mobile and immobile components, allowing firms more choice to optimize, across borders, their manufacturing and delivery processes. The mobility of production resources has two effects with respect to economic integration and free trade:

I. The combination of mobile production factors with free trade enables firms with a large domestic market to concentrate mobile production and back office activities in a single place, thus optimizing economies of scale. As a result these firms can serve small adjacent markets with limited additional investments and costs. The small country may enjoy lower prices, but it will suffer loss of jobs, these especially being the knowledge intensive jobs, thus suffering welfare effects;

II. Large companies with large home markets have an additional advantage, as their mobile production factors, such as capital, knowledge and infrastructure-type production capacity, enjoy increasing returns. While non-mobile production factors, such as land, small-scale production and non-knowledge intensive services are subject to the law of diminishing returns. The danger becomes apparent that the attractive compensation for capital, knowledge and large-scale infrastructure-type production shifts to large countries, while the profits on non-mobile production factors flow towards these large countries through corporate holding relationships.[2]

[2] "The new trade theory incorporates sectors producing under increasing returns to scale in general- equilibrium models, and has shown that trade liberalization may lead IRS industries (industries that operate under increasing returns to scale) to flee countries with small home markets (Kind, 2002). Illustrative to the argument is the

According to the Stolper-Samuelson theorem, in the case of significant economies of scale, countries with abundant resources will benefit most of economic integration (Grieco & Ikenberry, 2003:47-49). In the case of increasing return industries, the largest, most powerful economies are the ones to gain the most with free trade and economic integration. The competitive advantage of countries or regions relates to the ability of locations (regions, countries, or sub regions) to offer the immobile assets necessary for the mobile assets of domestic and foreign firms to be used more efficiently – both to add value to those assets and to create (through innovation or tapping into indigenous capabilities) new assets (Dunning & Wymbs, 2001).
With the postal services business being scale intensive, partly subject to modularization and the European liberalization process being asymmetrical the question should be raised whether the current liberalization process in the postal markets will lead to an equitable distribution of welfare benefits between the six large countries and nineteen small countries. In section three we will briefly address the current (asymmetrical) status of the liberalization process, while in section four we will point out the relevance of economies of scale in postal operations and the potential for modularization and sharing of back-office functions within multi-business-multi-market firms.

3. The asymmetric liberalization in European postal markets

The formal state of liberalization in Europe can be split between a group of pro-liberalization northern-European countries (United Kingdom, Germany, Sweden, Denmark, Finland and the Netherlands) and a group of southern member states (of which Belgium, France and Austria are the main exponents) where the national postal markets are still hardly or not accessible for third parties **(Bot, 2003)**. Even in countries where the EU postal directive is implemented correctly, practical entry barriers of a technical or economical nature remain. Differences in the degree of liberalization between postal markets result in asymmetrical competitive situations between European market players. Companies operating from a protected market have an advantage vis-à-vis firms operating from more liberalized markets, as the firm from the protected market can access the more liberalized markets, and thus attack de player in the liberalized home market, while the other way around is frustrated.

The resistance to further liberalization of the European postal markets is stronger than expected. A majority of the European Union governments re-

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statement made by the CEO of KPN, Ad Scheepbouwer, that KPN (Dutch Telecommunications Company) contemplates on redirecting its investments to foreign countries, Het Financieel Dagblad, 11-08-2003 fuses further liberalization. This resistance appears to be prompted by their fear for a further increase in unemployment in the current economic climate, but this may also be a cover for serving the interests of their national postal companies ambitions for the European market.

4. The nature of the business of postal services

To understand the dynamics of the European postal market and the structures that may develop at industry level, it is necessary to understand the context of the postal services. The nature of the business of postal services can be described with respect to (a) its market(s) and (b) its operational processes and (c) whether it being a stand-alone business or being part of a multi-business firm. Table 2 provides an overview of the activities of the four main European market players, Deutsche Post, La Poste, Royal Mail and TPG. This overview demonstrates that the portfolio of these players is no longer confined to postal services.

		TPG		Deutsche Post World Net		Royal Mail Group		Group La Poste	
Activity		**Revenues in EUR x M**	**% of total revenues***	**Revenues in EUR x M**	**% of total revenues***	**Revenues in EUR x M**	**% of total revenues***	**Revenues in EUR x M**	**% of total revenues***
Mail	Reserved	*1,159[1]*	*10%*	*7,900[2]*	*20%*	*6,850[3]*	*54%*	*6,586[4]*	*38%*
	Open	*2,846*	*24%*	*5,005*	*13%*	*3,030*	*32%*	*3,667*	*21%*
	Total	4,005[5]	34%	**12,905[6]**	**32.8%**	**11,123**	**86%**	**10,253**	**59%**
Express[7]		**4,398**	**37%**	11,250	28.6%	1,687	13%	3,074	18%
Logistics		3,389	29%	9,152	23.3%	53	<1%	n/a	n/a
Financial Services		n/a	n/a	8,872	22.6%	n/a	n/a	4,005	23%
Total revenues		11,782		39,255[8]		12,940		17,332	

Table 1: Overview of total business portfolio's of main European postal players[3]

[3] Sources: Annual Reports 2002, TPG, DPWN, Royal Mail & La Poste. Notes: *) Due to differences in rounding up/down and inter-company revenues, the percentage of total revenues does not always add up to 100. 1) TPG Post Postal concession report 2002. 2) RegTP, Marktbeobachtungsdaten Postmarkt, Auszug aus dem Jahresbericht 2002 der Reg TP. 3) Royal Mail, Regulatory Financial Statements 2003. 4) Contrat de Performances et de Convergences entre La Poste et l'État 2003-2007. 5) Mail revenues include parcels for TPG Post. 6)

Mail is both part of the communications market and the logistics market. To its users mail is part of their total communication mix and budget. However, from a process perspective, the postal service most logically is to be defined as part of the market of logistic services. In the execution of postal services synergies can be realized by sharing certain (parts of) activities with other activities of the value chains of e.g. express, parcels and logistics. In addition to operating synergies, financial synergies may exist (internal financing) with unrelated activities, e.g. in the case of Deutsche Post with its financial services. Figure 1 provides an overview of such possible synergies.

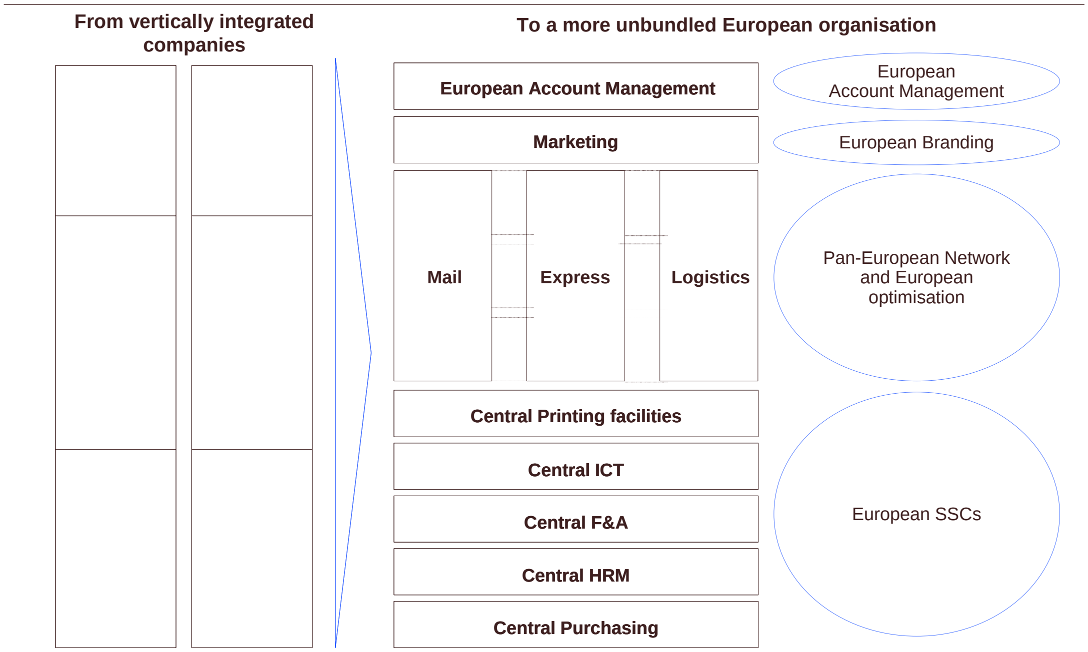


Figure 1: Potential synergy areas on a European scale

A process of unbundling of traditional vertically and functionally integrated value chains is progressing in today's economy (Evans & Wurster, 2000). The reason for this being that distinct parts of the value chain have different profitability levels as a result of differences in economies of scale and scope. Deutsche Post World Net is an example of a large, multi-product-multi-

Including revenues of Global Mail, which Deutsche Post records under Express. 7) Including parcel revenues for DPWN, Royal Mail and La Poste. 8) Total revenues of DPWN are € 42,179 million – € 2,924 million for other revenues / consolidation.

market corporation that is building its own group-wide infrastructures, to exploit economies of scale and scope and to exploit its accumulated knowledge under its STAR program[4]. These company-owned group-wide infrastructures are often called Shared Service Centers and can be used in back-, mid- and front-office processes to support market-oriented business units to enter new markets faster and cheaper than was previously possible[5]. Initially it was believed that synergies between mail, express and logistics were limited[6], now the assumption is justified that by implementing Shared Service Centers a great deal more synergies can be realized systematically (Strikwerda, 2003). To this has to be added that the value chain of postal delivery by technology and contracting can be perfectly unbundled in separate activities, each to be performed by separate, specialized firms coordinated thgrough the market (see Strikwerda in Kok *et al.*). The consequences hereof are that (a) the dynamics in the competition in postal services no longer should be considered only through the lens of vertical integration, but should be considered as well through the lens of horizontal competing; (b) as this unbundling corresponds with that in other logistic services, exploiting synergies along functional specialized axis is possible; (c) competition in postal services will be from outside the traditional business borders of postal services. Especially in this process of unbundling players will try to compete through cost effective infrastructures. Given the cost-dynamics of these synergetic infrastructure activities, companies will pursue infrastructures on a pan-European or even global scale. The business units (being the commercial or market oriented activities) within such a group have a rather diverse optimal volume, varying from very small (Local postal delivery) to pan-European (European account management, logistics). The implication of the existence of large international groups, consisting of both Shared Service Centers and market oriented business units with strongly divergent optimal scales, is that these international players can serve local and national markets at lower costs, than their national or local counterparts. The former chasm between *local responsiveness* versus *global economies* is becoming smaller and is actually reversed to a logical and necessary combination, with the help of modern technology.

With physical mail volumes declining as a result of substitution by e-mail and other Internet message services, several former postal operators are expanding their portfolio of activities into other areas in order to pursue a sustainable corporate strategy. As table 2 shows, most players have expanded into the related parcels, express and logistics markets, while some players

[4] Annual Report Deutsche Post World Net, 2002:12-17

[5] From the perspective of an investor, respectively of the group holding, these business units have lower *entry* and *exit* costs

[6] Statement made by the European Commission in Case No. IV/M.1168 DHL/Deutsche Post, cited in (RBB, 2003)

are also (still) active in the market for financial services. With most companies being active in both protected and free markets, this raises the question how asymmetric liberalization may relate to or interfere with the expansion strategy of national postal service providers. As the de facto mail activities are not organized in single business firms and because synergies are to be exploited between postal services and other activities, the future competitive configuration of the European postal market cannot be analyzed at the level of the mail business. This argument is supported by the fact that it is not attractive to reinvest the free cash flows generated by the declining mail business, into the existing mail activities (apart from investments needed to increase efficiency and to broaden its geographical operations). It could be argued that the resulting cash flow should be handed over to the open capital market, which it will then reinvest in new opportunities. However, modern enterprises promise their stakeholders sustainability in order to maximize stakeholder value themselves, including shareholder value, and therefore opt to reinvest the free cash flow through their internal capital market into new opportunities.

5. The Concept of Strategic Supremacy

Which theoretical concepts are available to analyze, describe and predict a possible outcome in terms of market structure, number of players etc. for the European postal market? The traditional field of strategic management is restricted to the conduct-level of the SCP-paradigm, whilst the field of industrial organization is limited to pricing behavior. What needs to be acknowledged is that firms not only compete for customers or for market share, but also display conduct to push competitors from a market, pursue containment strategies, etc. (D'Aveni, 1994). In a way firms pursue power strategies in and for markets comparable with geo-political players in international relations (D'Aveni, 2001). In this paper we will use D'Aveni's concept of strategic supremacy to analyze and describe what will likely happen in the European postal market. D'Aveni's concept of strategic supremacy consists of three elements: the concept of spheres of interests, the concept of competitive pressure and the concept of competitive configuration.

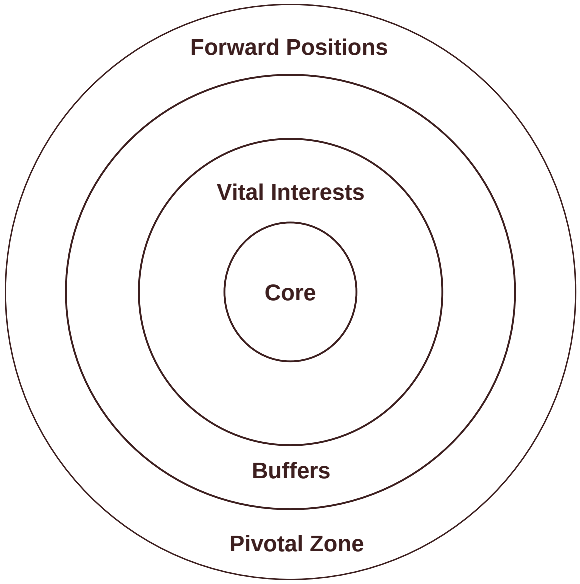


Figure 2. D'Aveni's sphere of interests (D'Aveni, 2001:29-31).

D'Aveni, see figure 2, describes the activities of a firm in terms of core activities (those products, markets with respectively in which the firm generates its major cash flow, now and in the future), in vital interests (this sphere consists of products, brands, distribution etc. that contribute to the profitability of the core activities, through for example complementarity and its ability for attracting customers, although in themselves less profitable then the core activities), buffer activities (this consists of products or other activities that hinder competitors to attack core activities or vital interests), pivotal zone (products that reflect the future products and markets of the firm) and forward positions (products, positions in geo-market to attack specific competitors). This portfolio of activities, which D'Aveni defines as a sphere of interests, serves to optimize the company's power base as prerequisite to sustainable revenues and profit. Firms may use this labeling of their activities and especially that of their competitors to analyze the way they compete. By taking footholds in each others markets, firms may signal their intentions and learn about response capacity of their competitors. In the next section we will use the concept of the sphere of interest to analyze the competition in the European postal markets.

The second element in the concept of strategic supremacy is *competitive pressure*. D'Aveni (2001:295) defines this operationally as:

$$M_{ba} = \sum_{i=1}^{n}\left[\left(\frac{S_{ai}}{S_a}\right)\times\left(\frac{S_{bi}}{S_i}\right)\right] \quad (1)$$

In which:

M_{ba} = the magnitude of the pressure felt by the focal firm (*a*) from its overlaps with competitor (*b*);

S_{ai} = Euro (or unit) sales of focal firm (*a*) in the geo-product market *i*;

S_a = total euro (or unit) sales of focal firm (*a*) in all its geo-product markets;

S_{bi} = Euro (or unit) sales of competitor (*b*) in geo-product market *i*;

S_i = total dollar (or unit) sales of all competitors and the focal firm in geo-product market *i*;

i = a geo-product market among the *n* geo-product markets served by both focal firm (*a*) and competitor (*b*)

The first term in the equation, (S_{ai}/S_a), is a measure of the importance of the geo-product market *i* to the focal firm (*a*). The practical meaning of competitive pressure is whether one or more competitors of the focal firm have the ability to choke the (free) cash flow, which focal firm (*a*) enjoys from its activities in geo-product market *i*. This choking of the cash flow may be through price competition (above the line, below the line), forcing the focal firm to spend more on marketing, merchandising, product differentiation, etc. Reducing the cash flow of the focal firm (*a*), especially if the cash flow generated in market *i* is the main source of cash flow, may restrict the focal firm (*a*) in its resources and ability to expand to new markets, future sources of income and profit, or disable the focal firm to make investments in new products or technology. In the formula the sales volume of the focal firm is taken as proxy for the (free) cash flow, as many corporations do not publish the specific sources of their free cash flow explicitly. In other cases this source may be known to competitors, e.g. in the case of home markets, through disclosure or through business intelligence, and competitors may choose to, and often do, attack the focal firm in that geo-product market from which the focal firm generates most of its free cash flow. In the case of state monopolies, as for some parts of the postal market, competitors cannot attack the cash flow from those protected market segments for legal reasons. In the case of a monopoly no competitor exists and hence term (S_{bi}/S_i) is zero and thus M_{ba} is zero. In the case the focal firm has only one geo-product market: (S_{ai}/S_a) = 1. D'Aveni's formula then suggests that in this case the focal firm is more vulnerable for competition. The total competitive pressure M_a on a focal firm (*a*) with *m* ($m \ll \infty$) competitors S_j and active in a total of *n* markets labeled *i* is:

$$M_a = \sum_{j=1}^{m} \left(\sum_{i=1}^{n} \left[\left(\frac{S_{ai}}{S_a} \right) \times \left(\frac{S_{ji}}{S_i} \right) \right] \right) \quad (2)$$

In which S_{ji} is the Euro (or unit) sales of competitor (j) in geo-product market i.
In case of a single business firm the total competitive pressure is

$$M_a = \sum_{j=1}^{m} \left(\frac{S_{ji}}{S_i} \right) = 1 - \left(\frac{S_{ai}}{S_i} \right) \quad (3)$$

That is, the total competitive pressure on focal firm (a) is 1 minus its own market share.[7] In case of the focal firm (a) being a monopolist, the competitive pressure on (a) is zero. In case of infinite competitors (and focal firm (a)'s market share being very small) the total competitive pressure is 1, in this case of a pure market, assuming no friction etc., the marginal costs will equal marginal revenue and the profit will be zero (in this case however, the concept of strategic supremacy does not apply). In case that the focus firm has one competitor who is a near monopolist (as in some postal markets), and the focus firm is a single business firm with postal services only, the competitive pressure is equal to the market share of the incumbent player, e.g. 0.95 in case the incumbent player has a market share of 95%. In the following section we will apply D'Aveni's formula to the situation of some of the major European postal markets.
What is the importance of differences in the order of magnitude between companies market share within the same market, as is the case between the European postal markets where market shares differ in the order of magnitude of a factor ≈10, with the incumbent player holding a dominant market share ~ 95% in its home market? A numerical example illustrates.

	Europe	USA	AP	Total
Firm A	240	25	35	300
Firm B	64	210	6	280
Firm C	16	15	109	140
Total	320	250	150	720

Table 2. Numerical example to calculate competitive pressure between companies in geo-markets of comparable sizes. Table 3 shows revenues for Firms A, B, C in the indicated markets.

[7] D'Aveni (2001:296) suggests that the pressure measures (M_{ba}) should be scaled such that their sum across all of a given focal firm's competitors will be equal to one. From the analysis given it follows that this scaling is not necessary and wrongly denies the role of the market share of the focal firm.

In the example of table 2 the competitive pressure of firm A on B is 0.25, and the pressure of B on A is 0.23, computed by applying formula (1). Suppose the USA market is much larger and the market shares of A and B in the USA are ~1%, the numerical example is given in table 3.

	Europe	USA	AP	Total
Firm A	240	25	35	300
Firm B	64	2100	6	2170
Firm C	16	15	109	140
Total	320	2140	150	2610

Table 3. Numerical example to calculate competitive pressure between companies in geo-markets of strongly differing sizes. Table 3 shows revenues for Firms A, B, C in the indicated markets.

In the example of table 3 the competitive pressure of A on B is 0.03 and the pressure of B on A is 0.25, computed by applying formula (1). More in general, it can be argued that incumbents with large home markets naturally exert a higher competitive pressure on incumbents with smaller home markets.

The third element in D'Aveni's concept of strategic supremacy is the concept of competitive configuration. This concept describes what may happen in a market with multiple players that exert different competitive pressure on each other, be it in core markets or through pivotal and or forward positions. In general competitive configurations in mature markets, with entry barriers and transparency with respect to pricing and other competitive behavior, will tend to move to a balance of powers between a few players, in order to avoid destructive competition and protect profitability.

The current European postal market consists of six large countries and nineteen small(er) countries. It is doubtful if the corresponding situation of six large postal service providers and nineteen small postal service providers will automatically result in a stable competitive configuration, particularly in view of the fact that postal services in several cases is part of a larger (European) portfolio of activities. The question remains which stable competitive configuration may result from the liberalization process and along which paths the migration will move. This question will be dealt with in the next section.

6. The competitive configuration in some European postal markets

Our analysis takes TPG as the focal postal firm, and our analysis is concentrated on the four largest postal markets Germany, France, United Kingdom and the Netherlands, in part due to restrictions in time and budget and as this paper originates from a study performed for TPG Post on the question what the possible effects are of asymmetric liberalization of the European postal market on the Netherlands. The major players and their respective positions in these four markets are depicted in table 4.

Mail Market Share	Germany	France	UK	Netherlands
Deutsche Post	97%	-	License granted	2,5%
La Poste	0,5%	99%	-	0,1%
Royal Mail	-	0,2%	96%	1%
TPG	1%	0,1%	1%	95%
Total approximate market value	€ 10 b	€ 10 b	€ 9.5 b	€ 4 b

Table 4. Market shares of European postal firms in each others mail markets[8]

Table 4 shows that the incumbent firms are still the dominant players in their home market and table 2 shows that Mail for most players is their core in terms of the sphere of interest. Using the spheres of interest, table 4 suggests the pattern of footholds amongst the four players, as shown in figure 3.

[8] NNI analysis on the basis of the Annual Reports (2002) of the four companies and reports from the respective National Regulatory Agencies

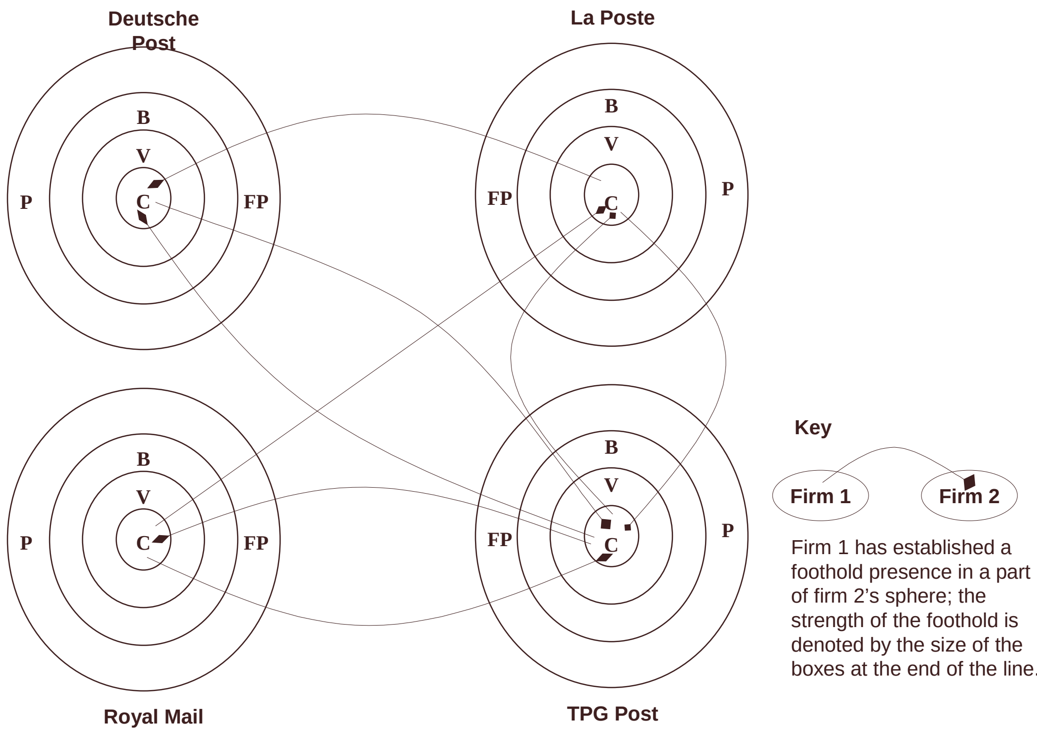


Figure 3. The pattern of footholds in four postal markets in Europe

The pattern of footholds throws some light on a possible pattern of competitive configuration, e.g. that La Poste endures the least competition and TPG the most, but two elements need to be added to this analysis. The first is that significant differences exist in sizes of firms with respect to their postal services, as depicted in figure 4.

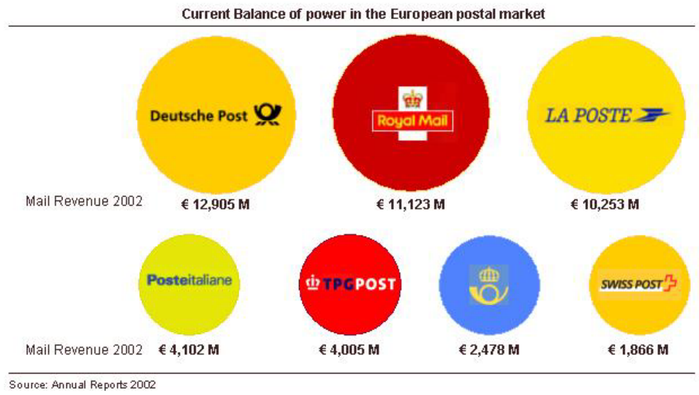


Figure 4. Overview of mail-turnover for the largest European players

However, total competitive pressure is to be taken across all activities of these firms, e.g. including their express, logistics and financial services. Taken these into account, the power relations are suggested as in figure 5.

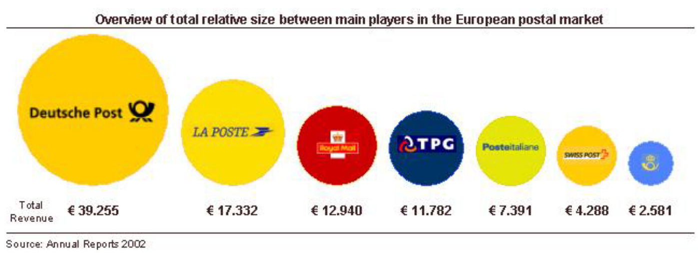


Figure 5. The total turnover of the players in the postal market

The second thing to be taken into account is that differences between the four countries exist with respect to liberalization. The Dutch market currently being ahead in liberalization, the UK market being opened up to a large extent in 2003 with full liberalization expected in 2007, the German market still relatively protected as a result of a complex license system and the French market in practice still being closed. The effect of this asymmetric liberalization is that the players from the more protected markets can access the more open markets of its competitors, draining its cash flows, while the opposite is not possible for the players from the more liberalized markets. Add to this that La Poste and Deutsche Post both have an additional protected source of cash flow in terms of their financial services activities (vital interest), leaving competitors only with the opportunity to attack the companies buffers in Express and Logistics. Taking this into account the pattern of footholds in figure 3 needs to be redrawn as in figure 6.

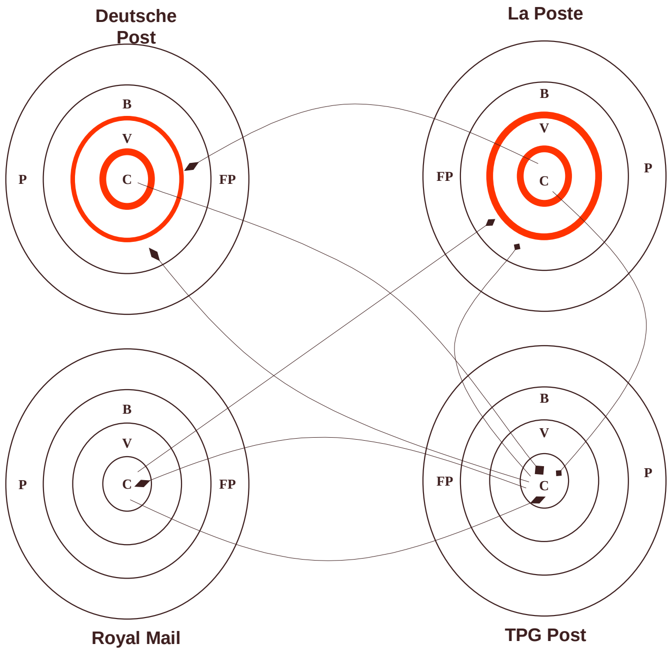
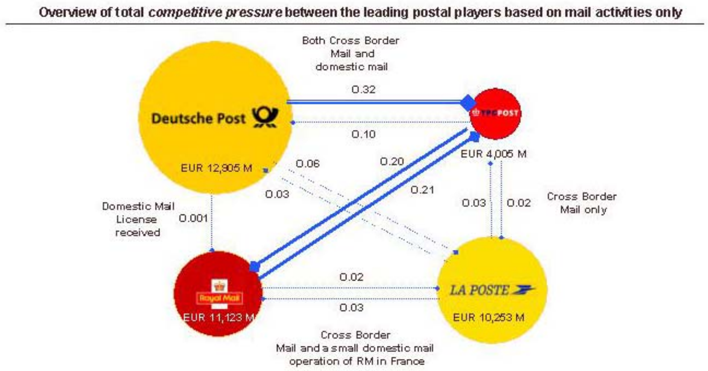


Figure 6. Deutsche Post and La Poste are able to attack Royal Mail and TPG from protected, walled sources of cash flow

In the case of the US United Parcel Service (UPS) versus Deutsche Post, UPS charged Deutsche Post to use its profit (cash flow) generated in its monopoly activities in letters to subsidize its price competition on parcel express services in an attempt to push UPS from the market. The European Commission sentenced Deutsch Post with a fine of 24 million euro. In July 1999 the European Commission has started an inquiry whether Deutsche Post amongst others, uses its cash flow from protected core and vital interest activities to compete with other players in the postal and logistic markets (Miert, 2004). Also in the case of the Belgian Post the European Commission has ruled that it used cash flow from its protected core activities to compete with other players in either their core or forward positions. More in general we see that in the fight *for* the future European postal, express and logistics market, players use asymmetric liberalization to develop and play out a competitive game that can adequately be described by D'Aveni's concept of sphere of interests. The fact of asymmetric liberalization therefore results in asymmetric competition and asymmetric competitive pressure.

Calculating the competitive pressure for the four main European postal companies on the basis of their mail revenues in each other's markets provides the following result (see figure 7).



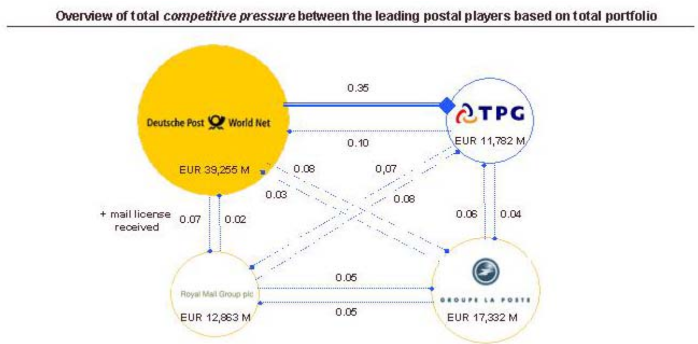
Symbols				
Pressure measures	0.01 - 0.10	0.11 - 0.29	0.30 - 0.40	≥ 0.40
Explanation	Toehold (Marginal Overlap)	Solid Foothold	Strong Foothold	Substantial Overlap (Clear Invasion)

Source: D'Aveni, 2001 and NNI Analysis

Figure 7. Competitive pressure calculated for four players postal activities[9]

As was to be expected, on the basis of the size of its home market and its total portfolio, Deutsche Post exerts a significantly higher competitive pressure on TPG Post than vice versa. When, as in the case of TPG, that market generates a relatively high proportion of the total free cash flow of a company, the vulnerability of that firm for new entrants increases proportionally. In the case of TPG the mail activities make up 34,0 % of TPG's total revenues, but 66,7 % of its operational profit.
When taking all activities of the four players into account, an even more dramatic picture emerges with respect to the balance of powers, or lack thereof.

[9] Source: calculations made by NNI, revenues based on the Annual Reports 2002 of the four companies, total market value figures for the respective markets are based on the reports of the respective National Regulatory Associations (OPTA, PostComm, RegTP and the performance-based contract between La Poste and the French Government). The calculated *competitive pressures* in this figure suggest a certain accuracy, which does not correspond to the accuracy of the sources used. Given the conceptual nature of this report, we forgo a formal error analysis. It is sufficient to note that between the highest calculated competitive pressure and the lowest competitive pressure there is a difference of a factor 10. As the competitive pressure analysis is used for strategic decisions, and not for say the determination of prices, this difference in magnitude is sufficient to draw conclusions.



Symbols				
Pressure measures	0.01 - 0.10	0.11 - 0.29	0.30 - 0.40	≥ 0.40
Explanation	Toehold (Marginal Overlap)	Solid Foothold	Strong Foothold	Substantial Overlap (Clear Invasion)

Source: D'Aveni, 2001 and NNI Analysis

Figure 8. Competitive pressure between the four main players based on their total portfolio, including mail, express, logistics and financial services[10]

Clearly Deutsche Post is an unchallenged player in terms of competitive pressure. The next question is whether this system of market powers is stable or whether it may migrate to a different competitive configuration, assuming full liberalization of all of the European postal markets. First of all different stable competitive configurations exist, e.g. a small number of players of equal size and exerting more or less the same competitive pressure on each other. Another stable configuration may be one dominant, powerful player and a large number of small non-powerful players.

A number of additional questions have to be asked in studying the question what will be the end game in the European postal market. The first question obviously is whether there will be a truly pan-European demand for postal services in terms of decision-making, supply of post, negotiating power, etc. In 2004, approximately 90% of the postal deliveries are local-for-local and 10% is cross border. The structure of European market demand does not seem to be a driving factor for pan-European postal players.

Technology may be a driving factor, as infrastructures preferably should be pan-European to achieve lowest average costs. When restricted to (the declining market for) mail services only, this most likely is not a strong force. But the now wider portfolios of former incumbent postal operators can, as a result of the network character of its operations, its typical cost structure and cost dynamics, realize European economies of scale through proprietary infrastructures and shared service centers.

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[10] Source: see footnote 8

The ambition of several players to become a leading European mail, express and logistics company, is also a force that will shape the future competitive configuration. Deutsche Post, La Poste and TPG have all communicated their intentions to lead in the European postal consolidation process and have the cash flow to execute this strategy. Within these companies ambitions and strategy the current status and pace of liberalization in their home country has become an important ‘asset’ in their strategic arsenal. Deutsche Post and La Poste seem to have understood the value of this asset early on and have acted accordingly, towards their government. But with the legislative power increasingly moving to a European level, they will have to upgrade their negotiating power, e.g. with respect to mandatory service levels, from a national level up to the level of the European Commission. With the Express and Logistics activities gaining in importance in each of these players portfolio’s, it is to be expected that it in several years time it will be the logic of the open, scale-intensive logistics market that will drive the future structure of the European market. With economies of scale being crucial for market success, we believe that the future stable competitive configuration will more likely consist of 2 or 3 powerful players with perhaps some small players (which will be contained by the larger powers in their possibility to expand), rather than the current combinations of six large and nineteen small(er) companies.

7. A new phase in the process of liberalization

The foregoing illustrates that the non-liberalization and especially the asymmetric liberalization is in the interest of a number of firms, as this may support their expansion strategy and their strategy to compete *for* the European postal market instead of just competing within their market. More in general it can be stated that the liberalization of the European markets has entered a new phase in its development.

This new phase in the process of liberalization in postal markets starts when postal services become part of a larger portfolio and cash flow from postal services needs to be used to built new activities to compensate for the (foreseeable) decline in the growth and profitability of postal services. Whereas first liberalization of postal markets was needed to improve the operations of postal services, now non-liberalization is in the interest of firms who want to expand. Competition shifts from competition *in* markets to competition *for* markets, as all players realize that growth within the European mail market can only come from entering foreign markets. In this new phase incumbents use asymmetric liberalization as an instrument in the power play for markets, in the run-up to full liberalization. Each of the players benefits from promoting liberalization within the EU, as this provides an opportunity for growth, but as soon as a time table is set, their interest is in not complying to the arrangements made as this will put them in an advantageous position vis-à-vis companies in countries that do implement further liberalization. Without a mechanism for reciprocity, companies and their national governments will retain an incentive not to comply with European legislation on further liberalization of the postal market.

National governments of smaller countries should become aware, that their countries will not naturally get an equitable share in the distribution of benefits from a liberalized and integrated European postal market. They may enjoy lower prices, but the prices to be paid for that will be loss of power to set service standards to suppliers and loss of high end knowledge work through the loss of head quarters (with a multiplier effect on supply firms). To ensure fair and constructive competition between postal operators on a European scale they should implement a reciprocity rule, allowing national governments to block foreign companies from entering (segments of) their national postal market, be it through their own start-up or through mergers and acquisitions, in case the home market of the entering firm is closed. And even then companies from small countries are at a disadvantage given the differences in size of their home markets with those like Germany, England and France. The national governments of small(er) countries should make a conscious assessment and subsequent decision on the potential position of their postal operators in a liberalized and integrated European market. If the decision turns out to be that the transport and logistics cluster within a country will not be capable of capturing a leading position in the future European market, the government should actively support and stimulate the innovative ability of its national economy to develop new sources of national income and welfare in order to be able to absorb the free-falling production factors that will be deployed within this cluster.

8. Conclusion

In this paper we asked ourselves a number of questions: who will benefit from the liberalization of the European postal market, what will the end game of the European postal market look like and how can smaller states secure an equitable share of the benefits given the current fact of asymmetrical liberalization and differences in sizes of home markets. We may assume, on the basis of the historical process of liberalization of markets, that in the long run the full liberalization of the European markets will positively contribute to the welfare of all member states. With economies of scale being so important for postal services, and its related markets of express and logistics, the companies with large home markets such as Deutsche Post and La Poste are in the advantage conform the Stolper-Samuelson theorem. We therefore believe that the future stable competitive configuration will more likely be one in which 2 or 3 powerful players lead the market, with perhaps some smaller players serving purely local markets (and which will be contained by the larger powers in their possibility to expand). The current practice of asymmetrical liberalization supports this development, as it limits the growth of postal operators from smaller companies, thereby deteriorating their future competitive position in a liberalized and integrated European postal market. To create a fair playing ground between larger and smaller countries, the European Commission should implement a –temporary- reciprocity rule, allowing national governments to block foreign companies operating from a non-liberalized home market, to enter (segments of) their national postal market, be it through an owned start-up or through mergers and acquisitions. However, in the end there needs to be a fully liberalized European postal market. The proposed reciprocity rule is a fair measure since companies from small countries are at a disadvantage, even in case of reciprocity, because of their small home markets. The rule should be used to allow the smaller member states to speed up the innovation in their economies in order to absorb the free-falling production factors in case their national postal and logistics clusters cannot compete in an integrated European market. Also, the European Commission needs to view the future development of the postal services no longer as a stand-alone business, but as an integral part of the business of logistic services, since the dynamics of that industry define the dynamics of the postal services.

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