

Submission: PBT Couriers acquisition by NZ Post

Response to Statement of Issues Paper | 25 March 2024

➤ Introduction

He tina ki runga, he tāmōre ki raro.

In order to flourish above, one must be firmly rooted below.

This submission is made in response to the merger application made by NZ Post to acquire the courier business of PBT Group, and the subsequent Statement of Issues paper issued by the Commission. We remain opposed to the merger on the grounds that it will significantly lessen competition for courier services in Aotearoa, consolidate the industry further with a high likelihood of adverse market outcomes for customers, and increase the barriers to entry for new competitors.

We further note our ongoing concern with the redactions the Commission is applying to the precursor material for this merger. Many of the key indicators on which the impacts of the merger can be assessed – such as relative market shares, market value and much else – has been redacted and is therefore unavailable to consumers or other market participants to inform submissions. The unavailability of this information necessarily limits the specificity of this submission, and it is our view that the Commission has the balance wrong between commercial confidentiality and public interest. We will address this issue separately, outside of this merger application.

Our document is in two sections:

1. **The nature of the market** deals with the logistical and commercial arrangements that shape the national courier market, and which are germane to the discussions about competitiveness
2. **The barriers to entry** discusses the implications of the market structure and the likely barriers faced by new or expanding entrants, in the context of the proposed merger
3. **The incentives for poor behaviour** addresses what we see as the likely “rational actor” behaviour of a combined NZ Post/PBT Couriers entity if the merger is approved.

In summary, we ask that the Commission declines the merger application on the grounds that it will significantly lessen competition in the regional courier market; however, we note that the Commission has not declined a single merger application since 2018, leaving an open question about how it is managing to correctly discharge its regulatory responsibilities.

About us

Habilis New Zealand Ltd provides consultancy and advisory services to regional Aotearoa, including strategy development, economic and social impact modelling, business case and investment proposal development, stakeholder engagement and communications, and benefit and impact analysis. Our client base includes iwi, NGOs, local government and the private sector.

Habilis NZ Ltd is based in Tāmaki Makaurau.

➤ Overview

NZ Post asserts that the acquisition of the PBT courier business would not result in a significant lessening of competition in the national courier market. We disagree with this assessment, on the following grounds:

1. NZ Post has mis-characterised the nature of the courier market and the dynamics that give rise to scale effects and the resultant profitability of the larger operators. If the market is correctly characterised, then it becomes evident that the market does not function as NZ Post asserts.
2. As a result, NZ Post has mis-characterised the barriers to entry that exist for smaller operators, particularly those that are seeking to grow beyond a regional or market niche. These barriers are high – and growing higher over time – so the consolidation of courier companies through this acquisition risks creating yet another market oligopoly, with a small number of large operators able to generate super-profits at the expense of consumers, with little effective competition to constrain them.
3. Given the removal of some competitive constraints and the barriers to new entrants if the proposed merger is approved, it seems likely that NZ Post will have strong incentives to increase prices and decrease the quality of service, to the detriment of consumers and the country.

We deal with each of these issues in turn.

➤ The nature of the market

In the various materials provided by the submitters, there is a clear characterisation of the courier business as largely being the management of parcel pickup and delivery; this is a consistent thread through the documents.

However, these descriptions wave away the essential nature of the national courier market, which is composed of four components:

1. The local level pickup and delivery of items, largely staffed by contractors in vans
2. The logistics and distribution hubs from which the contractors collect and deliver items, a large number of which are then aggregated and repackaged for national shipping
3. The line-haul function that transports aggregated items the length and breadth of the country, to and from logistical centres
4. The IT systems that plan, support and manage the operations of the courier companies, and which provide various levels of information to customers.

Aotearoa is a long, thin, sparsely populated nation with occasionally challenging geography and a trend to urbanisation. As a result, the national courier market closely reflects both our geography and our demography; items are picked up and delivered in the cities and towns and smaller centres by local people running local businesses.

However, the distribution hubs and line-haul components of the national courier network are anything but small-scale businesses; they depend on very substantial capital investments in the largest trucks, investment in significant logistical centres, and further investment in sophisticated IT systems. These capabilities are well beyond the grasp of even the most aspirational individual contractor that's currently driving a courier van.

For this reason, the national courier market really consists of two mutually dependant and closely interlinked markets:

- The market for local pickup and local delivery, to and from distribution hubs of various sizes
- The market for logistics management and line-haul, supported by the required IT systems.

These two markets have very different dynamics, but both are material to the proposed merger, as both are required in order to provide a national service. Or, to look at it another way, there is no prospect of a new national competitor arising unless they are able to successfully navigate both markets.

Local pickup and delivery

In respect of the market for local pickup and delivery, the applicants are completely correct; there are low barriers to entry to new participants in this market. Vans and drivers can be obtained relatively easily with low capital costs to a new entrant, and there is a good deal of local knowledge in starting and operating businesses of this type and scale.

So we take it as read that few if any competitive issues for item pickup and delivery are likely to arise in this market due to the merger.

However, it is worth noting that the individual contractors are already price-takers in this market, and there is a long and sordid history of the contractual abuse of drivers within the industry, with people routinely working exceptionally long hours for less than minimum wage. This indicates there is a very large power imbalance between courier companies and the contracted drivers.

Accordingly, the Commission may wish to assess what the impacts of the proposed merger would be on the market for courier drivers, rather than just the market for courier parcels. After all, if the barriers to entry for individual contractors are low – which neither the Commission nor the submitters question – then the fact that courier drivers are subsisting on less than minimum wage would *prima facie* indicate an abuse of market power.

These people are not employees; a market clearly exists for independent contractors who wish to drive courier vans; yet one party (the drivers) is suffering adverse outcomes as a result of the market power of a small number of large courier companies. Surely this is a flagrant breach of the Commerce Act, and therefore something which the Commission should investigate with some alacrity.

In that context, it is difficult to see any positive impacts on the market for courier drivers from the proposed merger. One of the largest companies – NZ Post – will gain yet more scale, and with it yet more power over the prices, terms and conditions of contracts with the drivers. This may well result in NZ Post being unjustly enriched at the expense of the individual contractors, who will have even less market power and ability to negotiate than they do today.

We therefore recommend that the Commission widens its competition analysis to include the market for courier drivers, in addition to the assessment of the market for courier parcels. This is a legitimate market with both buyers and sellers, and a long history of contractually abusive behaviours from a small number of parties – and there is an obvious scenario where further industry consolidation has an adverse outcome.

Logistics and line-haul

In comparison to local pickup and delivery, the backbone of logistics and delivery between distribution centres has a very different dynamic. The ability of a company to operate in this market depends on high capital investments in trucks and machinery, in substantial warehousing space and staffing, and in the IT systems to efficiently operate the facilities and track activity. This is not a business for the faint hearted, nor for those with shallow pockets.

For that reason, the logistics and line-haul market is dominated by a few large and skilled operators – including PBT. Smaller courier companies are unable to afford this level of investment and may well lack the capabilities to operate businesses of this type and scale, as the skills and experience are fundamentally different to local pickup and delivery.

The smaller courier operators know these challenges, so they contract for logistical and line-haul services with large and experienced operators in order to provide a national courier offering. A market therefore exists between the smaller courier companies and the large logistics and line-haul companies.

This market shows signs of vibrancy. There are a number of service offerings, ranging from pre-purchasing empty space on line-haul trucks at one extreme through to obtaining a full virtual service at the other, where the operator dealing with the retail customer contracts to a third party for every step of the courier service.

However, logistics and line haul is a tough business, which depends heavily on scale. Many of the elements – from trucks to warehouses to IT systems – represent fixed costs when acquired in units large enough to provide national service. Other overhead costs – such as fuel and staffing – are the same for all participants, so there are few opportunities to differentiate or innovate.

And Aotearoa's geography and demography further constrain the nature of logistics and line haul operations; all market participants must travel the same distance over the same roads, paying the same fuel and wage costs, working within the same regulatory controls on driving times, to meet the same ferry sailings.

As one market participant noted, logistics and line-haul is a difficult market to make money in, but an easy market to go broke in. And this market dynamic forces a very high degree of optimisation in an almost Darwinian evolutionary process, requiring considerable expertise to navigate successfully and profitably. This and the high capital and operational costs means the barriers to entry are very high indeed, a subject to which we will return in the following sections.

Summary: the markets to be assessed

While the Commission has understandably focused on the market for courier parcels, we think there are two other markets that warrant investigation in the context of the proposed merger:

- The market for independently-contracted courier drivers, which is showing strong signs of an abuse of market power and unjust enrichment by the largest participants
- The market for logistics and line-haul services, which is showing signs of vibrancy but which must remain competitive for smaller courier companies to be able to operate effectively and compete in the market.

It is clear that the proposed merger could significantly impact both these markets.

➤ Barriers to entry

In their submissions, both NZ Post and PBT Couriers assert that the barriers to entry are low. As we note in the preceding section, this analysis does not hold water in the context of either the market for courier drivers, nor in the market for logistics and line-haul. The reason for this is simple: scale matters.

The chicken and egg problem

As noted at the outset, we are a geographically and demographically challenging country for national courier services; plenty of people clustered in low-density cities at the opposite ends of two sparsely-populated major islands, linked by an indifferent highway network and some unreliable ferries. This is not a recipe for easy or easily-profitable services.

So the very first barrier to entry for any entity wishing to setup a national courier business is the nature of Aotearoa itself. The geography and demographics will require a duplication of the logistical approaches and capital investments and operational costs already developed by the incumbents, simply because there are few if any opportunities to work in a materially different way. And these are very substantial investments of time and expertise and money.

Because of the nature of the logistical challenges and the resultant investment requirements, considerable scale is needed to enable any national courier business to succeed – by which we mean, produce an adequate return on investment for its shareholders. The putative new entrant needs to be able to fill warehouses and intercity trucks with sufficient courier items to be able to run efficiently, as the fixed overhead costs are significant. This is no small task.

In order to commence operation and be competitive in the marketplace, a new entrant would need to convince customers that it was capable of delivering a national service at roughly the same levels of price and service as the incumbents – which would dictate a minimum investment in logistics and line-haul to be credible. If a new participant was to enter the market without acquiring an incumbent, it is not clear where this starting volume would come from.

Hence the chicken-and-egg problem: to be able to acquire customers, the new operator has to invest in logistics and line-haul and IT systems; but to be able to invest the required capital and operational budgets, shareholders will wish to see that the customers will actually respond. There is no guarantee that if we build it, they will come.

From the point of view of investors, therefore, a risk mitigation plan is required. This typically takes the form of the acquisition of a smaller incumbent, which has enough of a customer base to act as a platform for further growth. And such an acquisition has the added effect of lessening the learning curve for a new operator, as the existing business already has the majority of the skills and experience necessary to operate effectively in Aotearoa.

In reality, given our limited population and constrained geography, it is extremely difficult to see how any investors could financially justify the creation of a new national courier business from scratch; the risks are too high for the very significant levels of capital and operational investment, and it is easier to generate better returns from other sectors both within Aotearoa and internationally. Yet – as we pointed out in our previous submission – a vibrant and competitive national courier market is a key infrastructural component for a large section of our economy.

The Commission's analysis needs to recognise that allowing the NZ Post/PBT Couriers merger to go ahead will not only have an adverse effect on customers and drivers, it will also result in a significant barrier to entry for any new market participant. There are few companies with the initial scale and relevant expertise to act as the platform for further expansion, and it happens that PBT Couriers is one of them.

And as we noted in our earlier submission, we are not opposed to the shareholders of PBT doing what is in their rational best interest: selling the company to a willing buyer. But we are of the view that allowing further consolidation in the logistics and line haul market will have a significant adverse effect on consumers and drivers. In this context, the adverse competition issue is not with the seller, but with the buyer.

➤ **Perverse incentives**

In the context of the rational behaviour of rational actors, the incentives for NZ Post following a merger approval need to be assessed.

Will there be lower prices?

As discussed above, the logistics and line-haul market is a heavy consumer of money and expertise; the merger application notes that NZ Post has recently invested around \$200 million in logistics hubs and IT systems. This is a substantial commitment of capital in anyone's money.

And as noted, these investments are very dependant on volume in order to produce an acceptable return for shareholders; NZ Post are clear that the primary driver for the acquisition is to increase the volumes through the shiny new logistics centres and IT systems, with the resulting payback benefits.

Clearly, these large investments were made without the foreknowledge of an acquisition of PBT Couriers' customers – so presumably, the business case for the new facilities and capabilities was justified on the existing volumes of packages. In other words, while the acquisition of the PBT volumes is a nice-to-have, it is not a need-to-have – or, at least, it shouldn't be. And if by some mis-chance the projections in the business case were inaccurate, then that's a problem for NZ Post's Board and shareholding Minister, and not something that could possibly rationalise a merger that reduces competition.

Assuming that NZ Post's business case projections were accurate, it is still hard to see how the acquisition will result in lower prices to consumers. The assertion is made in both the application and in subsequent submissions, but this seems rather akin to magical thinking; no mechanism has been proposed for how it might occur, nor undertakings offered for its implementation.

While it's an economic truism that the additional volumes should result in lower per-unit prices, it is not clear that these benefits would be passed onto consumers by NZ Post. And in fact that appears to have not been the case when NZ Post acquired Flieways; while we don't have access to industry data, the industry anecdote is that prices did not fall. Yet if we use the same logic – that greater volumes will result in lower per-unit costs, which will be passed onto customers – then Flieways prices should have reduced.

We commend asking this question of NZ Post and verifying whether the truism has proven to be the case with previous acquisitions to the Commission.

Will there be higher prices?

When it comes to the market for national courier parcels, there is a strong argument that prices may well rise as competitive pressures ease, assuming the merger is approved. This will likely be the case if the volume projections contained in NZ Post's business case for its \$200 million investment were optimistic.

As we don't have direct access to the data showing courier volumes and the trend over time, we have had to base this scenario on discussions across the industry and a certain degree of anecdote. However, it is obvious that courier volumes grew strongly through the COVID-19 pandemic, and have subsided since then.

If NZ Post constructed the business case for its \$200 million investment on the basis that volumes would continue at a similar or higher level to those experienced around the time of the pandemic, then those projections – and the return on investment they support – will be falling well short of reality. Again, we don't have access to the data to prove or disprove this scenario. However, there seems to be three possible scenarios:

1. NZ Post's business case projections for volume growth have proven to be pessimistic, in which case the price-per-unit will fall with the PBT Couriers acquisition, and there is the opportunity (if no articulated mechanism) for these savings to be passed onto consumers.
2. NZ Post's business case projections for volume growth are realised with the PBT acquisition, and the return on investment for the \$200 million in facilities and systems is achieved – to the relief of the Board and the shareholding Minister, as the PBT acquisition clearly didn't form part of the business case. But prices should remain at or about the current levels.
3. NZ Post's projections in the business case were still wildly optimistic, even when the PBT volumes are taken into account, resulting in higher per-unit costs and strong pressure to increase prices to customers, within competitive constraints.

Which of these scenarios is accurate is left as an exercise for the reader. However, it should be obvious that the majority of scenarios have prices remaining the same or increasing, while only one scenario sees prices falling. And even that scenario assumes that the impact of PBT's exit from the courier market and the resulting decrease in competitive pressure is negligible. This might again require some magical thinking.

It's important to note that all these scenarios are driven by the same factor: the scale and rationale for the \$200m investment in facilities and systems by NZ Post; none of these scenarios are primarily shaped by the competitive pressures in the sector. In effect, the price effects will be driven solely by a change in unit costs for NZ Post.

In this context, the removal of competitive pressure from PBT Couriers is material. While the business doesn't enjoy a huge market share, it will be exerting some competitive pressure for some customers for some products. As we have previously submitted, NZ Post has a strong incentive to rationalise the PBT product offering for logistical efficiency reasons, and it seems highly likely that the range of products will decrease post-acquisition. This alone will decrease competitive pressure, and decrease the likelihood of product innovation in the market.

Now, it's questionable how the other major incumbents in the market will react to the decrease in competition. There is a strong case that a rising tide lifts all boats, so the easing of competitive price pressure may result in all the majors realising higher margins, as there are fewer alternatives for customers.

The likely dynamic very much depends on the logistical investments needed to grow market share – which, again, is not something we can directly model, based on insufficient data.

However, as we've previously noted and as NZ Post has confirmed through the scale of its logistics and systems investment, increasing capacity – a precursor to increasing market share – is an expensive business that requires substantial lumps of capital; it is difficult to grow incrementally with small investments.

If there is underutilised capacity within the sector, then some competitive jostling for market share can be expected post-acquisition, which will serve to constrain prices. However, if all the major incumbents are at or near capacity and unable to economically justify further large-scale investment, then we can expect price pressure in the opposite direction: the rising tide of NZ Post seeking better returns on its very large capital investment will indeed lift all boats.

Given these scenarios and the likely incentives for the major market participants, it seems somewhat optimistic to expect consumer prices to magically fall if the acquisition is approved.

What about the drivers?

As noted above, we are of the view that a market exists for independent courier driver services, and that this market exhibits signs of abusive power and unjust enrichment. We commend this issue to the Commission for further investigation.

However, it is hard to see any good market outcomes for independent courier contractors in the merger being approved. The number of companies that drivers can contract to will decrease, the pricing power exerted by the major incumbents will increase, and the *prima facie* abuses of market power will continue, to the detriment of drivers and their whānau.

Logistics and line-haul

The situation with the logistics and line-haul market is less clear. The acquisition should not, in theory, alter the dynamic of this market, as it is only the PBT Couriers customer base that is being sold to NZ Post. However, NZ Post will clearly transfer the current PBT Couriers volume to its own networks in order to achieve better economies of scale, with largely unknowable effects on the wider logistics market.

This may require some further investigation by the Commission, as a vibrant logistics and line-haul market is needed to support the smaller courier companies, and potentially provide partners and suppliers to any new entrant wishing to establish a national courier offering. Any adverse effects on this market may well endanger the profitability or viability of the smaller companies, which in turn will materially reduce competitive price pressures on the major incumbents.

➤ Recommendations

As should be obvious from the foregoing, it's hard to see any benefit to Aotearoa New Zealand from the proposed acquisition proceeding:

1. There will be minimal logistical impacts but a significant risk of price increases in the local parcel collection and delivery market
2. There will be a further concentration of market power within a small number of large courier companies in the market for the supply of local delivery services by contractors, and the almost certain continuance of the continuing pattern of abuse of that market power
3. There will be a likely narrowing of choices in the logistics and line haul markets, with a serious risk of the erosion of price competitiveness for medium to smaller courier companies wishing to provide national services
4. There will be a steeper barrier to entry for any new national competitor, as the lack of available medium-sized acquisition targets will significantly raise the risk profile for a new entrant.

The test applied by the Commission is, of course, whether the acquisition will result in a substantial lessening of competition. One could make the argument that in each of these individual markets, the acquisition could proceed without triggering the "substantial lessening" threshold; however, as anyone who has sent a courier parcel from one end of Aotearoa to the other knows, all these sub-markets must operate efficiently for the item to be delivered on time, in one piece, and for a reasonable cost.

Taken in whole, therefore, the issues in each of the sub-markets very much breaches the threshold for a substantial lessening of competition in the key market of national business courier delivery. The proposed acquisition should therefore be declined.

We also note that this is an important matter for the nation. As the COVID-19 pandemic showed, there are times when efficient and cost-effective small parcel delivery becomes strategically important for everyone in the country, from individuals in rural locations all the way through to the largest corporates in the main centres. We therefore cannot afford to engender the preconditions for an oligopoly, where a small number of large companies can exert pricing power and stifle innovation – as has already happened in the grocery, electricity and banking sectors.

From our perspective, this acquisition is a step too far in the direction of oligopoly. It entrenches a major incumbent further, will decrease product choice and likely price, perpetuate the abuse of market power for courier contractors, and raise the barriers to entry further. These are all steps in the wrong direction to an efficient and well-functioning market in national courier services.

On the other side of the argument, the reasons given for the acquisition – that it will improve NZ Post's economies of scale following a \$200 million capital investment – are not strategically important to the country in any way, even when the public is a shareholder via the SOE structure. Producing a return on that investment is a problem for NZ Post's management, not an excuse for market consolidation.

We therefore recommend the Commission declines the acquisition.



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