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China's Postal Services: Which Path Forward?

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EXECUTIVE SUMMARY

This report represents the first in a series examining the postal and delivery sectors of the world's major economies. It focuses on China's postal services, market dynamics and the extent to which the needs of household and business consumers are being met. China was selected as the first post to review due to its significant market presence and growing influence, with China Post revenue exceeding 97 billion yuan (US $15 billion), and delivering nearly 2.4 billion pieces during the first half of 2012.

While China Post has realized significant growth in both postal and non-postal revenue, it has largely ignored trends that have characterized the reform strategies of other national posts. For example:

- Service standards such as those published by postal operators in most industrialized countries do not exist for China Post, whose annual report instead publishes numbers of complaints received and the results of customer surveys on satisfaction and perceptions of improvement.
- Regulation by an independent regulatory authority, with delineated separation between operational and regulatory responsibilities.
- Draft regulations introduced in 2013 would impose new fees on private delivery operators, with no evident link to the proceeds contributing to either improvements in service quality or increased liberalization to expand consumer options.
- Deregulation of the postal monopoly.

Laws that create and protect postal monopolies have tended to result in decreased delivery performance and increased costs, to the detriment of the consumer. In addition, protectionist laws tend to reduce posts' competitiveness, potentially shortening their longevity. To avoid such an outcome, posts worldwide have opened their markets to outside competition and de-regulated the postal monopoly, generally resulting in more competitive and financially viable posts.

China Post decisionmakers seeking to consider policies that support economic growth and benefit consumers face a wide range of choices. Among these options, increasing transparency, adopting universal service quality metrics, pursuing liberalization and adopting innovations with demonstrated success in other postal systems could prove to be of the greatest benefits to consumers.

Details follow.

INTRODUCTION

Among the world's largest postal operators, China Post today stands at a prodigious crossroads. With annual postal revenues trailing only those of Germany and the United States, and a population density at the approximate midpoint between the two, it seemingly possesses unrivaled potential to harness market forces to leverage improvements:

- China Post revenue exceeded 97 billion yuan (US $15 billion) in the first half of 2012, up 24.4 percent over the previous year.
- China Post made nearly 2.4 billion deliveries in the first half of 2012, up 51 percent over last year, exceeding total delivery volume in 2012 and accounting for 48.2 percent of the revenue of the total postal industry, up 5.3 percentage points from 2011.
- In 2013, China expected to surpass the U.S. to become the world's largest market for express delivery.
- Postal Savings Bank of China, a subsidiary of China Post Group, has 39,000 outlets with 4.5 trillion yuan (US $722 billion) in local and foreign-currency deposits. It is the seventh largest bank in China by assets, and has the second-most branches.

While China Post has made significant progress through various restructuring and investments, the State Post Bureau, China's regulator for postal and express delivery services, has enacted rules and regulations that protect China Post from outside competition, and has not disclosed quantifiable statistics about performance standards for timely and accurate delivery.

BACKGROUND ON POSTAL SERVICE REFORMS IN CHINA

China's postal laws define the term, "universal postal services" to mean, "the postal services continuously provided for all customers within the territory of the People's Republic of China, according to the scope of business, service standards and fee change standards prescribed by the state."[1]

In the 1990s, with the understanding that modernization was needed to stimulate economic development, the Chinese government introduced new technologies and upgraded distribution and network models to their postal system. Postal rates were relatively cheap, but anecdotal accounts of lost letters were common. In addition to slow delivery, sending express mail meant waiting in very long lines.

To keep pace with both local and global private companies, China Post combined several thousand small processing units into 200-plus central offices. New sorting facilities were built, a new central computer system was installed and a separate transportation system for express mail was developed, among other improvements. These advances proved fruitful, with year-on-year revenue increases for both letters and parcels by over 20 percent.[2]

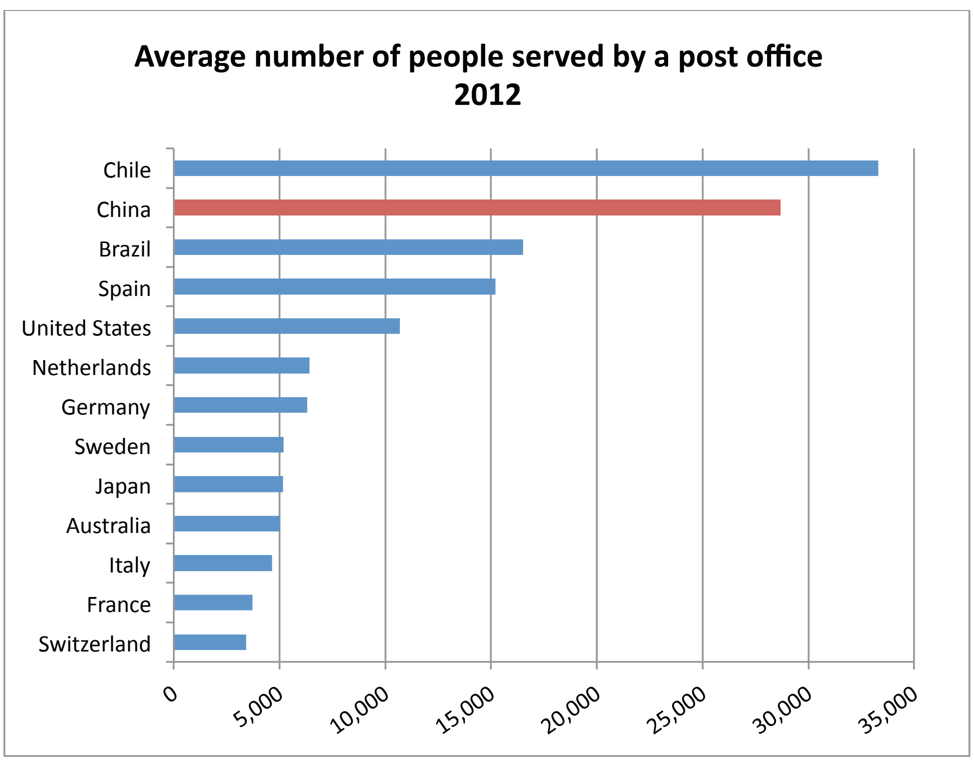
China next enacted postal reforms in the spring of 2009.[3] China Post was the last of the large state-owned businesses to undergo post-Mao restructuring, with the regulatory concerns only being separated from the operations in 2007. Though the government appeared to be adapting traditional principles of postal reform to support non-traditional postal development, a main practical effect of the 2009 law was to more tightly regulate the domestic express delivery sector. While there had been hopes that China's World Trade Organization (WTO) accession would lead to opening of the express delivery market, the effect of the postal law was to impose geographic limitations on foreign express companies.

[1] China Post Group, *Annual Report 2012*, p. 15.
[2] James I. Campbell*, Postal Law in China. 18th Conference on Postal and Delivery Economics* (Porvoo, Finland, June 2-5, 2010).

China Post plays an important role in the rural economy. With 70,000 postal branches and 38,000 financial services outlets, it is one the world's largest companies and a vital economic spine for rural Chinese.[4] Nationally, each permanent post office serves 28,700 Chinese, according to Universal Postal Union (UPU) estimates (See below: For purposes of comparison, that rate is 16,500 in Brazil, 10,700 in the United States, and generally about half of that in most European Union states). China Post averaged three deliveries per week in rural areas, down from five per week in 2010, also based on UPU estimates.[5]

The 2009 laws were very specific in some parts, and vague in others. For instance, they imposed registration and capitalization rules on domestic delivery companies, while also severely limiting the activities of foreign-owned firms by blocking them from the document delivery market and tightening the scope of operating in the domestic express sector — both thriving markets that hold value as important sources of revenue that offset the heavy fixed costs associated with building and operating a network for China. Under the new rules, big state-owned companies, such as Sinotrans, China Air Express and China Railway Express, also had to give up some delivery functions, despite their success. In addition, the vague wording of the law loosely defined the scope of the postal monopoly, leaving little clarity on what is open and whether it will continue to be open in the future.[6]

At the same time, the Chinese government keeps a tight lid on the quality of the domestic postal service that comprises its universal service obligation, publishing only vague service metric statistics such as consumer satisfaction surveys and reductions in reported complaints. Since the Chinese government tends to be reticent on the quality of its domestic post service, are hesitant to implement any more reforms, and local municipalities can be inconsistent with enforcing mandated regulations, understanding the path of reform going forward is difficult.



Source: Universal Postal Union data

[3] People's Republic of China, *Postal Law of the People's Republic of China*, Procedural Law Research Institution, (2009 Revised). Retrieved from http://www.procedurallaw.cn/english/law/200905/t20090526_224670.html.
[4] "Return to Sender: A new law restores state control to yet another area of China's economy," *The Economist* (April 30, 2009).
[5] Universal Postal Union, *Global or Regional Estimates,* http://www.upu.int/en/resources.html (March 11, 2014).
[6] "A new law restores state control to yet another area of China's economy," *The Economist* (April 30, 2009).

There is little indication of an appetite for opening the domestic postal market, but also few other suggestions of generating additional revenue through new surcharges to fund shortages. China Post currently earns a large percentage of its money from financial services, in particular, savings accounts. In addition, there is no sign of either leveling the playing field for experienced private companies to gain market access or to utilize the worksharing strategies that the United States Postal Service has employed to drive down operating costs.

2010 – 2014: CAPACITY AND GROWTH

With the 2009 reform, and with the financial services offered, China Post consistently shows a profit, and the expectation of continued growth. China's postal industry reaped business revenue of 97.34 billion yuan (US $15.45 billion) in the first half of 2012, up 24.4 percent year-on-year.[7]

Some of this can be attributed to better structuring and improved enterprise capabilities. The government estimates nearly 2.4 billion deliveries were made in the first half of 2012, up 51 percent year-on-year and exceeding the total delivery volume in 2010. And business revenue increased 9.7 percent in the January-June 2012 period, up 13.2 percentage points from the growth of the same period of the prior year. Postal business accounted for 48.2 percent of the revenue of the total enterprise, up 5.3 percentage points from the prior year.[8]

With all of the success, complaints with express delivery service, the continued growth of the market, and the sheer volume of packages appears to have started to show signs of strain on the system. Recent foreign and local press articles showed boxes piled high and buildings overflowing with packages.[9] In addition, complaints of individual workers stealing and selling consumers' personal information are starting to come to light.[10]

In October 2012, with authorities recognizing these concerns, the laws were amended to clarify illegal operators and allow the larger international firms more room to grow.[11]

These amendments stipulate that provincial postal administrations are responsible for the supervision and administration of postal services and markets within their jurisdictions, giving legal authorization for municipal administration. The previous postal law provided a two-tier postal administrative system at State Council and provincial levels, and the move adds a new administrative and regulatory layer.[12]

According to *China Daily,* in 2013 China expected to surpass the United States to become the world's largest market for express deliveries, sending warning signs of rapid development that could threaten service quality absent transparent metrics. Indeed, express delivery volumes grew more than 50 percent year-on-year in each of the past 28 months, according to the State Post Bureau.[13] The number of packages delivered by major courier companies grew 61 percent in the first half to 3.84 billion items. Couriers' revenue grew 34.5 percent to 63 billion yuan (US $10.36 billion).[14]

Xu Yong, chief consultant for the express and logistics website cecss.com, told Ecns.com that, "We see China's development in the express industry as 'too fast and unhealthy.' The country's express companies sacrifice profit and service quality to pursue volume." Chinese courier firms clear 16.4 yuan on

[7] "China's postal industry reports 24.4 pct rise in H1 revenue", English.news.cn (July 18, 2012).
[8] *Ibid*.
[9] "Leaks Prompt Postal Overhaul," http://usa.chinadaily.com.cn/china/2012-12/24/content_16044977.htm (December 24, 2012).
[10] "116 Delivery Companies' Permits Canceled in 2012," http://www.chinadaily.com.cn/china/2013-01/02/content_16076220.htm (February 2013).
[11] *China's Postal Law in Plain English,* www.allroadsleadtochina.com (May 19, 2009).
[12] "*China adopts amendment to postal law,*" http://www.ecns.cn/ (October 26, 2012).
[13] "*Postal industry urged to speed up transformation*," http://www.ecns.cn/business/2013/08-07/76294.shtml (August 7, 2013).
[14] "Nation to become largest express delivery market," http://www.ecns.cn/business/2013/07-23/74217.shtml (July 23, 2013).

average from every parcel, down sharply from 28.6 yuan five years ago. Meanwhile, delivery workers reportedly struggle with heavier workloads, lower incomes, and customers complaining about bad service.[15]

According to a survey conducted in March, 2013 by *Legal Daily,* eight out of 10 respondents said they were dissatisfied with the country's express package delivery service. Bad service and lost items were major problems in the industry, according to the survey. "In addition, express companies also sometimes conducted misleading promotions, engaged in unfair competition and operated without licenses," said Liu Junhai, a professor at Renmin University of China.[16]

The industry faces uncertainty, since China's economy is decelerating and people are reducing their spending. Analysts note it is critical for Chinese express companies to upgrade their development mode. Transport Minister Yang Chuantang said when interviewed, that Chinese postal and express companies have to aim high and work fast to catch up with international leaders. "Revenue from the domestic express industry is expected to triple by 2020," he said, "But we should first improve the quality of the service."[17]

Other leaders are in agreement that China's postal industry must quicken transformation, innovate services to adapt to market changes and catch up with consumption trends. Ma Junsheng, director-general of the State Post Bureau of China, observed that the rise of the e-commerce industry for postal services, such as track and trace services and online postage purchases, and increasing popularity of online shopping have forced the traditional postal sector to transform itself. "The postal industry is in a transition period and needs to progress to a modern, advanced stage," Ma said at a forum on postal reform and development in Beijing in August 2013. The postal industry is closely linked to e-commerce, logistics and international trade, and huge business opportunities will be created, Ma continued.[18]

CHINA POST'S FINANCIAL SERVICES

One area where China Post has realized important revenue-generation success is in consumer financial services. According to its website, Postal Savings Bank of China has 39,000 outlets, as of October 2012, with 4.5 trillion yuan (US $722 billion) in local and foreign-currency deposits and total assets of 4.7 trillion yuan (US $754 billion). Established in 2007 when the national postal service was split from its savings business, it is wholly owned by the China Post Group and is the country's seventh-largest bank by assets, and has the second most branches.

The China Banking Regulatory Commission permitted the bank to begin offering small-scale loans in 2006 and large-scale public credit in 2008. The credit business was a new field for the bank, having focused on small and family businesses in the past. This inexperience in corporate governance culminated in December 2012 with the arrest of Postal Savings Bank of China president Tao Liming on charges of bribery, improper fundraising and illegal lending. Tao's illegal practices coincided with unusual expansion in the bank's business, which had long held large deposit reserves for its savings business. The effect of the arrest was a delay of the bank's plan to list on the Chinese stock market by as much as three years.[19]

[15] *Ibid.*
[16] *Ibid.*
[17] *Ibid.*
[18] "Postal industry urged to speed up transformation," *op cit.*
[19] "Bribery scandal at major Chinese bank dashes IPO plans," http://www.wantchinatimes.com/ (January 11, 2013).

WHERE TO GO FROM HERE: OPTIONS FOR CHINA POST

Following the successes of other national postal providers, there are different paths forward that could benefit both China Post and provide the people of China with faster, better quality service. In the 19 major postal markets reviewed by the Consumer Postal Council, 12 were fully liberalized (and three partially liberalized) and ten had created universal service funds. Universal service funds take various forms and can be funded in various ways, with the common goal of providing revenue to subsidize service quality and frequency for postal consumers. In all but three countries (including China), universal service funds were created following liberalization, intended to be short-term mechanisms to support the transition.[20]

As noted in a 2013 report by the United States Trade Representative, the foreign investor community, "continues to monitor China's implementation of its 2009 Postal Law and related regulations, including a new permitting system introduced under the State Postal Bureau's (SPB's) September 2009 Measures for the Management of Express Delivery Business Permits."[21]

There is concern among those trying to provide service offerings to Chinese customers that China's regime does not treat foreign and domestic companies equally, despite China's WTO commitment to open the sector to foreign competition by 2005.

For example, as a result of additional regulation provided by the new postal law, foreign express companies were requested to apply for licenses based on geographic location on a city municipality by city municipality basis. This was not what foreign express companies expected from China's WTO commitments.

China's postal law also excludes foreign suppliers from the important document segment of China's domestic express delivery market. To be in line with China's WTO commitments and promote the competitiveness of the express sector, additional implementing regulations, including those related to the universal service fund requirement, and preferential administrative procedures should place foreign and Chinese companies on a level playing field.

The U.S. Postal Service, meanwhile, has utilized aggressive strategies for outsourcing delivery functions and worksharing to realize powerful reductions in operating costs. A 2009 report by research firm WIK Consult detailed the following balance between liberalization and universal service as its most prominent best practice, "Universal service should be ensured by relying upon market forces where the Member State may, with a high degree of confidence, rely upon postal operators motivated by normal commercial considerations to provide universal services which will meet or exceed the USO [Universal Service Obligation] set by the Member State."[22] These provide valuable lessons as to how China Post might proceed.

These strategies of liberalization and allowing outside competition have generally strengthened posts and their ability to compete. In addition, service levels have increased to the betterment of the consumer.

Below is an overview of three potential paths for China Post, with considerations and concerns for each of them. It should be noted that over the past two years China Post has implemented partial enhancements that relate to what is discussed below; however, inadequate transparency has made it difficult to determine China Post's execution and results.

Liberalization

Liberalization in a market can have a positive effect on both the quality of service and freedom to implement new revenue sources. But without clearly defined marketplace parameters, transparent service quality metrics, and precise

[20] Consumer Postal Council, *Universal Postal Service in Major Economies*, November 2013.
[21] United States Trade Representative, *China Trade Summary*, http://www.ustr.gov/sites/default/files/2013%20NTE%20China%20Final.pdf (2013).

implementation, improvements are not guaranteed. Argentina is an example of a fully liberalized market that has not necessarily led to better postal services for consumers. Indeed, it was considered to have "low to medium overall quality" by one study and "serious shortcomings" by another. However, the post's partnerships with Western Union and its wholly-owned subsidiary Pago Facil have proved profitable.[23]

On the other hand, Germany, a fully liberalized market, with all providers assuming universal service, has not needed to further fund Deutsche Post to ensure universal service.[24]

Revenue Generation

In the Asia-Pacific region, postal financial services generated the largest part of postal revenues. At over 60 percent of Asian postal markets, this is fast becoming a prominent trend.[25] Another source of revenue for postal services is in logistics services, albeit with reduced margins. Recognizing China Post's extensive network and financial services branches, it makes an ideal partner for international companies who rely on just-in-time shipment of goods, a key component of supply chain management. In fact, partnering with private companies seems to be a trend worldwide, either through providing "worksharing discounts" in the United States, or through contracts with outside service companies such as surface and air transportation, third-party logistics, facilities management services and postal technology providers.

Such value-added services have also provided new, diversified revenues for the likes of Australia Post and France's La Poste.[26] This includes tracking services and insurance. A subset of this offering is a wider variety of internet services, such as email and postage purchasing, among others. Chile has partnered with the U.S. firm Money Gram to offer international money transfer services.

Brazil is another fully liberalized country which has allowed the state-owned postal company to seek alternative revenue. Even with competitors, Correios do Brasil has one of the highest brand ratings in Brazil, which the postal operator was able to leverage to create a postal bank in partnership with Banco do Brasil, one of Brazil's largest banks, eliminating the need for creating its own postal savings bank. In just five years, it produced more than 1.5 million accounts and provides banking services to areas of the population previously not served. The main financial product is payment services, with 6.5 million transactions.[27]

Currently Correios do Brasil also provides other services, such as CorreiosNet Shopping, an online shopping center, direct marketing, focusing on the needs of foreign postal operators that want to send and distribute direct mail in Brazil, and online mail services. 2012 revenue was over 19.2 Brazilian reais (US $8 billion).[28]

Relaxing the Universal Service Obligation

Relaxation of services offered by the Universal Service Obligation can relieve some of China Post's burden. Some postal administrations have contemplated reducing delivery frequency in remote areas, using cluster boxes, or using third-party facilities as postal outlets. Although some may argue that reducing service obligations may harm consumers, quite the opposite may be true, taking into consideration alternatives such as electronic delivery methods that are now available.

Spain is an example of successfully relaxing the Universal Service Obligation. With a 10 percent combined market share for private providers, Correios, the state-run postal provider, has been able to eliminate delivering to rural customers with houses 250 meters from the main road, enabling it to exceed service quality targets. It has also allowed the postal operator to work with private postal and

[22] Alex Kalevi Dieke, et. al., *The Role of Regulators in a More Competitive Postal Market*, WIK-Consult (September 2009).
[23] The World Bank, Global Information and Communications Technologies Department, *The Role of Postal Networks in Expanding Access to Financial Services, Volume 1*, (November 2006).
[24] *Universal Postal Service in Major Economies, op cit.*
[25] *The Role of Postal Networks in Expanding Access to Financial Services, Volume 1, op cit.*
[26] *Universal Postal Service in Major Economies, op cit.*
[27] *The Role of Postal Networks in Expanding Access to Financial Services, Volume 1, op cit.*
[28] Correios, http://www.correios.com.br/eng/.

delivery operators for last-minute deliveries, which adds revenue. In addition, since the universal service fund is intrinsically linked to the liberalization process, with clear definitions and a transparent system for calculating cost, it ensures the fund's purpose of supporting universal service and not just favoring certain postal operators.

Canada Post in 2013 announced plans to eliminate door-to-door delivery entirely, while New Zealand Post announced that it would cut back delivery schedules to three times a week for most customers, in an effort to save costs. Clearly-articulated definitions of universal delivery service provide important parameters in both countries.

CONCLUSION

There are strong indications that the opening of China's postal and express delivery markets could benefit its household and business consumers. World-class foreign logistics expertise could also be leveraged for the economic benefits of Chinese markets. However, how and at what pace China is prepared to move is uncertain, especially with the lack of service transparency and protectionist policies of the China Post Bureau. Amid wide-ranging speculation on the future prospects of China's economy -- as to how severe the downturn is and how long it will last -- it would be imprudent to suggest a timeline.

However, regardless of the economic climate, it would serve China Post to learn from the successes and examples of posts worldwide and consider successful policies, which, if implemented in China, would enable it to support economic growth by bolstering its delivery services for the growing China consumer and business base. Additionally, as financial services become an even greater source of revenue generation, strengthening regulatory governance and internal controls should enable China Post to keep growth on track.

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