Effect of minimum wage on competitors in the German postal market

Final report

Client: Ministry of Economic Affairs, DG Energy and Telecom

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List of Acronyms

BKartA	Bundeskartellamt
BMWT	Ministry of Economy and Technological Development of the Federal Republic of Germany
BNetzA	Bundesnetzagentur (Federal Network Agency)
DPAG	Deutsche Post AG
NRO	National Regulatory Office
USP	Universal Service Provider
VAT	Value added tax
Ver.di	Vereinte Dienstleistungsgewerkschaft (trade union)

Summary of main findings and conclusions

Introduction

The Ministry of Economic Affairs has asked ECORYS to analyse the effects of the minimum wage law for workers in the German postal sector on competitors of Deutsche Post AG (DGAG) and in particular on TNT's operations in Germany. The analysis was conducted in February-March 2008 and consisted of desk research, business case analysis and a range of interviews with postal operators and industry experts in Germany and the Netherlands to test the assumptions underlying the business case and to obtain information and opinions. The business case and the general lines of argumentation of this report have been discussed with Mr. Alex Dieke (Head of Postal and Logistics Unit, WIK-Consult, Germany), who shares our general conclusions.

Minimum wage in the German postal sector

Contrary to the situation in Netherlands, in Germany no universal minimum wage applicable to all sectors and all workers exists. The government can, however, and in certain conditions, order that minimum wages agreed collectively between employers and trade unions for specific sectors are mandatory for all firms working in this sector.[1] For the postal market, the trade union ver.di concluded an agreement with the recently established Postal Services Employer's Association (dominated by Deutsche Post AG and representing more than half of the workers of companies predominantly engaged in addressed mail delivery), setting the minimum wages for workers delivering mail on the one hand and for workers processing mail (collection, sorting and transport) on the other hand. These minimum wages were included in a law on minimum wages for the postal sector that has been approved by the *Bundesrat* (the upper house of the German parliament) on 20 December 2007.

The minimum wages (see Table 0.1) are substantially higher than what is currently paid by competitors in the German postal market. It is also considerably higher than the 7,50 euro/hour that the trade union ver.di was campaigning for since 2005 as a general minimum wage for all sectors, including the postal sector.

[1] Currently, five branches (including the postal sector) have sector-specific minimum wages.

Table 0.1 Minimum wages for mail delivery and mail processing in Germany

	Average wages for DPAG	Average wages of competitors	Minimum wage (average)	Minimum wage West-Germany	Minimum wage East-Germany
Mail delivery (postmen)	11.29	7.94	**9.60**	9.80	9.00
Mail processing	10.57	8.36	**8.30**	8.40	8.00
Office staff	17.11	16.22	**n.r.**	n.r.	n.r.

Source: WIK, *Arbeitsbedingungen im Briefmarkt*, 2007; minimum wages added by ECORYS

For which companies is the minimum wage legislation applicable?

The minimum wage legislation is applicable to all companies whose main business activity is the delivery of addressed mail. This means that for many of the largest of the 500-700 regional and local postal operators the minimum wage legislation does not apply, as their dominant business activity is the distribution of newspapers or periodicals (many German publishers have set up postal operators). This may apply to a substantial share of regional operators in Germany, but exact figures are not available. On the other hand, some of those firms (in some of the bigger cities such as in Munich, and Stuttgart) pay a wage level around the minimum wage (of EUR 9,80) because of the need to be competitive on local labour markets.

Process resulting in the minimum wage law

In general, our interview partners stress that the process resulting in the minimum wage legislation is regarded very sceptically in Germany, both by politicians and in the postal sector. It is generally accepted that the outcome is not what it should have been (the minimum wage should have been lower) and many regard the minimum wage agreement as a deliberate action instigated by DPAG to distort competition in their favour. The fact that the CEO of DPAG (Klaus Zumwinkel) recently had to resign because of alleged tax fraud made the outcome of the minimum wage discussions even less welcome.[2]

Having said this, all interview partners also stress that from a legal point of view all necessary steps have been taken and that the above mentioned emotions have little or no impact on the situation that has emerged.

Alternative minimum wage proposal by TNT and others

DPAG's main competitors TNT Post and PIN Group are not members of the Postal Services Employer's Association. They have recently set up their own "Employer's Association for New Letter and Delivery Services" (*Arbeitsgeberverband neue Brief und Zustelldienste*). The association has agreed other minimum wages with a trade union (the *Gewerkschaft Neue Brief und Zustelldienste*)[3] and requested the Ministry of Labour to make this minimum wage mandatory for all firms that provide *value-added* mail delivery services (7,50 euro/hour for postmen in western Germany and 6,50 euro/hour for postmen in eastern Germany).

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[2] "It resembles what could be expected in a *banana republic*, but not in Germany," can be quoted from one of our interview partners.

[3] This newly created union is regarded very sceptically by the association of German trade unions (DGB) and has a very small membership compared to, for example, ver.di. However, they have more members with the new postal operators than ver.di which focuses on DPAG.

Protest by TNT

TNT (and others) filed a law suit questioning the validity of the minimum wage law for their operations. A positive outcome of the TNT-law suit would mean that TNT would be allowed to implement its own minimum wage agreement.

In its decision of 7 March 2008 in the case against the postal minimum wage, the Berlin Administrative Court ruled that the postal minimum wage of € 9.80 violates the German constitution. In the opinion of the court the Minister of Labour and Social Affairs was not allowed to declare this wage generally binding.

This decision constitutes an important first step as the German State has directly filed an appeal against it at the Administrative Court of Appeal. This appeal process may take at least six months and can be followed by a second appeal to the Federal Administrative Court. As emotions run high in the German Government law changes to defend the reached agreement also cannot be ruled out.[4]

In parallel, TNT is in the process of launching an official complaint on DPAG distorting competition in the German postal market to the European Commission (DG Competition).

Impact of minimum wage law on competitors of DPAG

Importance of scale economies

Before addressing the impact of the minimum wage law it is important for the reader to understand that addressed mail delivery is characterised by the existence of substantial economies of scale and scope. This means that average unit costs go down if the mail volume handled through the network of a postal operator goes up. Scale economies are even more important in the growth phase of a postal operator than for well established postal operators, such as the incumbent (in Germany DPAG). In the start-up phase scale economies are less dominant and may be comparable with the incumbent.

Analysis shows that Royal Mail in their home (UK) market has a cost elasticity of around 0.6, meaning that a ten percent volume increase increases (average) cost by six percent.[5]

TNT's delivery network in Germany

For mail delivery TNT cooperates with a large variety of local and regional postal operators. TNT is currently able to deliver to around 90% of all German households. Of the households that are part of TNT's delivery network, ca. 30% is covered through their own network and ca. 70% is covered through subcontractors (who deliver mail on behalf

[4] If this would happen, this would probably give rise to opposition of the Commission as this type of legislation would effectively distort competition.

[5] LECG estimated the cost elasticity for the whole of Royal Mail at 0.57 (LECG, *Future efficient costs of Royal Mail's regulated mail activities*, study for Postcomm, excised version of 2 August 2005). There is broad consensus that mature postal operators (i.e. the incumbents) have in their home market a cost elasticity between 0.6 and 0.8 (see NERA 2004, *Economics of Postal Service: Final Report*, study for the European Commission, DG Internal Market and Services).

of TNT together with their own, usually local/regional, mail).[6] 20% of this 70% concern subcontractors belonging to the PIN Group, 50% are not related to the PIN Group.

Direct cost effect of applying the minimum wage law

The direct cost effect of applying the (higher) minimum wages is given in Table 0.2. According to TNT, the salary costs for delivery in their own network would rise with around 27%. For the subcontractors of TNT the increase is close to 20% for those that have to apply the minimum wage and 0% for those that do not have to apply the minimum wage. Assuming that 50% of the mail of TNT is delivered by subcontractors, that 50% of them need not apply the minimum wage, and that delivery costs represent ca. 50% of total costs, this results in a rise in the total (average/unit) cost with 9.1% rising to 9.6% in 2010 when also in eastern Germany 9.80 needs to be paid. TNT assumes that the effect of the price increase of its subcontractors is a bit higher than the five percent presented in the table and indicates that also the salary costs for mail processing may rise with 6-8%. TNT arrives at unit cost rises of 10-11%.

Effect on competitors

Shortly after the adoption of the minimum wage law, the main shareholder of the *PIN Group* (Axel Springer who raised its stake in PIN Group to 63.7% in the first half of 2007) decided to pull the plug. Some 40 of the 90 companies forming the PIN Group, including the Luxemburg-based holding company, filed for insolvency by now.[7]

Most recent news is that most interested buyers of the group as a whole have withdrawn from the sales process. A very limited number of potential buyers continue the negotiations (the French La Poste is mentioned to be one of them); whether this will result in the continuation of PIN as a group (this still is the intention, parts of the group would then go bankrupt but not the group as such) or in a break-up of the group with individual companies going to be sold to interested buyers or going bankrupt is difficult to assess at this stage.[8]

Although the minimum wage law contributed to the problems in the PIN Group, people interviewed by ECORYS say that PIN was also suffering from an inappropriate business model (too much mimicking the operations of DPAG, delivery in unprofitable remote areas, little innovation in operations were the main points raised).

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6 Figures from TNT (private communication). Note that for the 10% of the households that is not covered by TNT's network, customers are asked to send this part of the mail through DPAG.

7 Frederik Richter, *Thomson Financial*, based on information from Handelsblatt, 20 February 2008.

8 *Ibid.*

Table 0.2 Direct cost effect of applying the minimum wage law in Germany

	Average wages of competitors	New wage level (average)	Cost increase	Effect on total (average) costs (5)
Mail processing (all competitors incl. TNT)	8.36	8.36	0%	-
Office staff (all competitors incl. TNT)	16.22	16.22	0%	-
Mail delivery (2008-2009)				
Average of all competitors	7.94	9.60	+20.9%	+10.5%
TNT (1)	7.72	9.77	+26.6%	+13.3%
All competitors excl. TNT (2)	8.00	9.56	+19.5%	+9.8%
Total impact on TNT (maximum) (3)				+11.5%
Total impact on TNT (ECORYS estimate) (4)				**+9.1%**
Mail delivery (2010-…)				
Average of all competitors	7.94	9.80	+23.4%	+11.7
TNT	7.72	9.80	+26.9%	+13.5
All competitors excl. TNT (2)	8.00	9.80	+22.6%	+11.3
Total impact on TNT (maximum) (3)				+12.4%
Total impact on TNT (ECORYS estimate) (4)				**+9.6%**

Source: WIK (2007); (1) figures for TNT provided by TNT (note that TNT's own delivery network is mainly in the western part of Germany).

Note: (2) Calculated on an assumed market share of TNT of 20% of the total market captured by competitors of DPAG; (3) Based on 50% mail delivery by TNT and 50% through subcontractors assuming that the minimum wages would apply for all subcontractors; (4) Based on 50% mail delivery by TNT and 50% through subcontractors assuming that the minimum wages would apply for 50% of all subcontractors (in terms of outsourced volumes); (5) Salary costs for mail delivery constitute around 50% of the total cost; when mail volumes rise substantially above 600 mln per year, this percentage gradually reduces to 40-45%.

The effect on the 500-700 active *regional and local postal operators* is not straightforward. Approximately 100 of the larger operators are linked to German publishers and do not have addressed mail delivery as their main business activity. Hence, the minimum wage law does not apply to them.

TNT expressed the opinion that for political reasons publishers might not want to pay lower wages than the minimum wages in the law and may even decide to exit the market for this reason (to avoid getting accused of paying too low wages endangering their reputation). This opinion is not confirmed in other interviews. There are no clear signs that publishers are pulling out of the German mail market; some may pull out, but others have declared that they will continue. Also, the political climate has changed and many feel that the minimum wage law was a mistake that should not be repeated. Fear for

reputation damage does not seem relevant enough to force many publishers to exit the market.[9]

The local and regional postal operators whose main business activity is addressed mail delivery may run into problems because of the minimum wage law. It is unclear how many of them:

- Will be able to survive (note that in some of the bigger cities wages around the minimum wage of 9,80 is paid already);
- Will be able to re-arrange their corporate structure or be taken over by companies that do not have addressed mail delivery as their dominant business activity;
- Will actually run into financial problems and will ultimately cease to exist.

How to compensate the direct cost effect?

Given the existence of scale economies in the postal sector, the direct cost effect can be compensated through a rise in the (average) number of items delivered per postman per hour. Clearly, compared to the alternative of paying lower wages, there remains a permanent increase in the cost base and a permanent reduction in the potential operational result (EBIT).

Firstly, one option is to reduce the number of delivery days from five (and for some local operators six) days a week to for example three or two days a week.[10] In this case, at current mail volumes rather substantial cost reductions in delivery can be obtained. Although potentially possible (some years ago this model was already advised to a number of potential entrants in the German market), most interview partners consider this a very risky option given the degree to which customers are used to next-day delivery (note that until January 2008 most competitors operated a next-day delivery service based on the so-called D-license) and that there is competition for the delivery of (relatively time sensitive) transactional mail (such as bank statements) and hardly any for the delivery of low-priced direct mail (addressed advertising mail that generally is regarded less time sensitive). TNT is adamant that they do not see this as a real option.

Secondly, growth in mail volumes reduces the average unit costs and can compensate for the higher labour costs. Using a business case analysis, it was estimated how much growth in mail volume would be needed to offset the direct effect of the minimum wage law.

The results are shown in Table 0.3. In scenario B where there is a loss of ca. 26 mln (operational result, comparable with EBIT) at ca. 600 mln mail items delivered and where the total cost elasticity is around 0.7, mail volume should grow by 65% to offset the effect of the minimum wage law on the total profit of the operations in Germany (that is: to have the same level [-26 mln.] of profit/loss as without the introduction of the minimum wage law). If we assume a bit lower loss (-23 mln, because of slightly higher productivity in delivery), a cost increase of subcontractors of +5% (rather than +8.7%) and a total cost

[9] Opinion expressed by WIK, private communication.

[10] Note that Sandd and Selekt Mail in the Netherlands both deliver addressed mail two days per week and focus on direct mail (transactional mail <50 grams is still reserved for TNT).

elasticity of 0.61 (scenario G), mail volume should grow by 33% to offset the effect of the minimum wage law.

The scenarios give an indication of the volume growth needed to offset the introduction of the minimum wage law under different assumptions. The scenarios E, G, and I indicate that a volume growth of around 30-35% would be needed. Given the growth path that TNT is embarking on in Germany, this corresponds with a set-back of at least one year: *ceteris paribus*, it will take at least one year more to reach break even and to reach certain profit levels.

With scenario B, and to a lesser extent also scenarios D and F, offsetting the impact of the minimum wage law will be much more difficult and the operations of TNT in Germany will be still loss making in 2012. The scenario that TNT is working on is amongst these scenarios.

For ECORYS, it is difficult to predict which scenario is most likely to emerge in practice.

Table 0.3 Volume growth needed to compensate for higher wages for mail delivery

Scenario	Total cost elasticity	TNT's 'own' cost elasticity	Items/hour delivered (at higher mail volume)	Percentage increase needed
A	> scenario B	n.c.	n.c.	**> scenario B, C**
B	0.697	0.564	52.7	**65.3%**
C	0.616	0.448	53.1	**40.6%**
D	0.694	0.564	52.7	**54.4%**
E	0.613	0.448	52.1	**34.7%**
F	0.694	0.562	53.5	**49.7%**
G	0.614	0.447	53.9	**32.6%**
H	0.686	0.562	53.1	**45.6%**
I	0.603	0.447	53.7	**31.6%**
J	**< scenario H, I**	n.c.	n.c.	**< scenario H, I**

Note: see Chapter 3 for the underlying assumptions and a further explanation. N.c. refers to not calculated as scenarios A and J have not been put into concrete figures.

Thirdly, competitor postal operators may be willing and able to rearrange their legal structure and/or their operational process to circumvent the minimum wage law as much as possible. The main escape possibility is that companies whose dominant business activity is not addressed mail delivery but something else, are not bound by the minimum wage law, as mentioned above.

Finally, TNT could opt for paying wages based on the number of mail items delivered. Legally, this is possible in Germany, although for the smaller companies it is difficult to implement for technical reasons (systems should be in place to calculate how many mail items are exactly delivered by each mail deliverer). From a social perspective there has

been criticism in Germany to this type of wage system.[11] TNT says that they want to offer a socially acceptable salary structure and for that reason offer employment based on (regular, time-related) labour contracts rather than on mail items delivered (*stukloon*), also in the future (and that anyhow payments need to reflect the minimum wage of 9.80/hour).

Will TNT exit the German market?

Irrespective of any volume growth offsetting its immediate cost raising effect, applying the minimum wage law to TNT's operations in Germany implies a permanent upward shift in TNT's cost structure.

TNT is saying that losing the law suit will force them to exit the German Market. A number of arguments can be mentioned why competing in the German market is (increasingly) difficult:

- The minimum wage law substantially and permanently raises labour costs;
- The effect is that according to TNT in 2012 the operations will still be loss making;
- It is unclear what will happen if the current collective labour agreement ends on 1 April 2010;
- The VAT exemption of DPAG distorts competition in favour of DPAG for around 40% of the German mail market (for the 60% of the customers that have to charge VAT themselves there is a small advantage to use competitor postal operators rather than DPAG);
- DPAG is known for its consistent attempts to attack its competitors and its alleged anti-competitive behaviour. Recently DPAG raised the discount rates for large customers (from a maximum of 18-21% to a maximum of 23-26%) and reduced the mail volume requirements to obtain these discounts. Moreover, TNT claims that DPAG is giving 'loyalty bonuses' to customers that return to DPAG;
- The policy maker, the national regulatory agency (Bundesnetzagentur) and the Cartel Office (Bundeskartellamt) are not seen as actively promoting fair competition. The issue is that these organisations can only act if there is sufficient evidence before the start of an inquiry. Critics of the current-day situation therefore demand that the right should be granted to act pro-actively and, for instance, to look in contracts in order to see whether DPAG makes use of predatory pricing (unlawful return price discounts, price discrimination, etc.).

On the other hand, there are also reasons why TNT might not exit the German market. Various interview partners of ECORYS expressed this view presenting the following arguments:

- Even with the higher minimum wages they thought it would be possible to operate a profitable business in the medium term (this depends on the assumptions underlying the business case, see above);

[11] According to TNT, the German company Jurex (which went bankrupt in 2007) was the only company using a wage structure based on payments per mail item delivered – and this contributed to the negative image of competitors in the German mail market.

- The postal market in Germany is considered too important for TNT to exit, even with limited profit opportunities. It is one of the main postal markets in the EU and, moreover, a presence in the German market is of strategic importance to be able to fight back to DPAG in Germany if DPAG through Selekt Mail (or future acquisitions) fights TNT in the Netherlands;
- The partial bankruptcy of PIN is offering growth opportunities;
- There is a (theoretical) potential to rearrange the business model and the operational processes of TNT Post AG mitigating the effect of the minimum wage law and potentially increase efficiency in delivery;[12]
- Even if TNT is forced to implement the minimum wages (of 9.80 euro/hour), the wage level will still be considerably below the average wage level of DPAG.

According to ECORYS, obliging TNT to apply the minimum wage law would seriously harm their prospects in the German mail market, raising average unit costs with around 9% in a competitive market. The minimum wage law is detrimental to the development of competition in the German mail market and should according to ECORYS not apply to the competitors of DPAG.[13]

Whether TNT will be forced to exit the German mail market is a question that ECORYS is unable to answer: it remains speculation to which decision TNT will ultimately arrive when the current minimum wage of 9.80 euro will remain in place. This decision depends on the possibility of TNT to make an operational profit in the medium term, and herewith on the likeliness of the scenarios presented in this report to emerge in practice.

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[12] Officially, TNT is not considering the option to drastically rearrange their operational process in Germany, as mentioned above.

[13] Clearly, also TNT and other competitors should pay adequate wages given the level of education and experience that is needed for mail processing and mail delivery – for this purpose (alternative) minimum wages were agreed between the Employer's Association of which TNT is a member and a trade union representing employees of competitor postal operators (as discussed above).

1 Introduction

1.1 Purpose and background

The Ministry of Economic Affairs has asked ECORYS NL to analyse the effects of the minimum wage law for workers in the German postal sector on competitors of Deutsche Post and in particular on TNT's operations in Germany. The context for the study is the current debate in the Netherlands regarding the date for fully opening up the Dutch postal market for competition following the full liberalisation of the German postal sector since 1 January 2008.

1.2 Minimum wage

Germany is one of only five European countries without a general minimum wage applicable to all sectors. It is possible however, under certain conditions, to agree on a minimum wage at sector level. Today, there are five branches with this kind of sector-specific minimum wages: the postal sector (Postbranche), the main construction industry, the roofing industry (Dachdeckerhandwerk), the painting industry (Maler- und Lackiererhandwerk), and the demolition/wrecking industry (Abbruch- und Abwrackgewerbe).[14]

Political arena

On 20 December 2007 the "Bundesrat", the upper house of the German parliament in which the German federal states are represented, adopted a new law at the end of December 2007 to fix minimum wages in the German postal sector (Arbeitnehmer-Entsendegesetz für Briefdienstleister). The collective labour agreement – that has been made mandatory for the whole sector by the laws mentioned above – will be effective until 1 April 2010 and applies to firms that predominantly deliver, transport, and collect letters (addressed mail).

Prior to the "Bundesrat's" adoption of the new law on minimum wage in the postal sector, heated debates have taken place in the German political arena. SPD and CDU, who rule in an uneasy coalition, have been arguing about the introduction of a legally binding minimum wage for the sector for months.

Finally, in August 2007 the SPD and its coalition partner CDU reached an agreement on introducing minimum wages in the postal sector. Later on, the coalition partners agreed to do so by declaring the collective agreement on minimum wages concluded by the Postal

[14] http://www.eurofound.europa.eu/eiro/2005/07/study/tn0507101s.htm.

Services Employer's Association (Arbeitgeberverband Postdienste e.V., AGV Postdienste – a recently established Employer's Association dominated by DPAG and its subsidiaries) and the United Services Union (ver.di) as generally binding for the whole sector. Moreover, it was agreed that the details of this move would be discussed in the autumn of 2007.[15]

In autumn 2007, the CDU demanded that the agreement between DPAG and the ver.di union on minimum wages should not be declared binding for the entire postal services industry.[16] This position was a response to a lobby led by German publishers and supported by representatives of the CDU that DPAG's competitors, who pay lower wages, could be hit if a minimum wage of between EUR 8 and 9.80 was brought in for the whole sector, as wanted by the SPD.[17] One of the main arguments brought forward was that the employers united in the Postal Services Employer's Association were not employing 50% of all employees in the postal sector – a requirement to declare collective labour agreements generally binding for a whole sector.

Subsequently, the SPD accused the Chancellor in October 2007 of breaking her word when she raised these technical issues as a reason not to agree with the postal sector minimum wage.[18] Ultimately, under political pressure Angela Merkel agreed with a minimum wage applicable to all companies in the sector that are predominantly engaged in addressed mail delivery (including TNT Post AG and PIN Group, but excluding the publishers) – based on the fact that the Postal Services Employer's Association represents more than 50% of the employees of this group of companies.

Industry agreements

The Postal Services Employer's Association and ver.di trade union reached an agreement in September 2007 on the minimum wage for the industry, with postmen getting EUR 9.80 per hour in western Germany and Berlin, and EUR 9.00 per hour in eastern Germany. All other operational workers in the sector should be paid at least EUR 8.40 per hour in western Germany and Berlin, and EUR 8.00 in the east (see Table 1.1).

Table 1.1 Minimum wages in the German postal sector (addressed mail delivery)

Time period	Western Germany		Eastern Germany	
	Postmen	Other functions	Postmen	Other functions
1.1.2008 to 31.12.2009	9.80 euro	8.40 euro	9.00 euro	8.00 euro
Per 1.1.2010	9.80 euro	8.40 euro	9.80 euro	8.40 euro

Source: http://www.urbs.de/aktuell/unter67.htm

No competitor of DPAG's is member of the Postal Services Employer's Association. TNT Post, PIN Group and more than 30 other mail delivery companies have recently set

[15] Eurofound, Unions push for minimum wage in the postal sector, 21.12.2007. Note that the collective wage agreement was signed only after the coalition had agreed on minimum wages for the postal sector.
[16] ABC Money, Germany's CDU party against postal services wage deal applying to whole industry, 1.11.2007.
[17] Reuters, Germany inches towards postal sector minimum wage, 29.11.2007.
[18] Financial Times, Minimum wage deal for German post workers, 30.11.2007.

up their own association named New Letter and Delivery Service (*Arbeitsgeberverband neue Brief und Zustelldienste*) The association has agreed a different minimum wage with a different (newly created) trade union (the *Gewerkschaft Neue Brief und Zustelldienste*) and requested the Ministry of Labour to make this agreement mandatory for all providers of *value added* mail delivery (7,50 euro/hour for postmen in western Germany and 6,50 euro/hour for postmen in eastern Germany).[19]

The minimum wages (see tables 1.2 and 1.3) agreed between DPAG and ver.di are substantially higher than what is currently paid by competitors in the German postal market. It is also considerably higher than the 7,50 euro/hour that the trade union ver.di was campaigning for since 2005 as the minimum wage for all sectors, including the postal sector.

Table 1.2 Key employment conditions in the German postal sector: DPAG, DPAG subcontractor and competitors

	DPAG	DPAG subcontractor	competitors
Average wage per hour (in EUR)	11,40	8,00	8,44
Weekly labour (hours)	38,50	43,00	38,80
Holidays (days)	28,00	28,00	22,90

Source: WIK, *Arbeitsbedingungen im Briefmarkt*, 2007.

Table 1.3 Minimum wages for mail delivery and mail processing in Germany

	Average wages for DPAG	Average wages of competitors	Minimum wage (average)	Minimum wage West-Germany	Minimum wage East-Germany
Mail delivery (postmen)	11,29	7,94	**9,60**	9,80	9,00
Mail processing	10,57	8,36	**8,30**	8,40	8,00
Office staff	17,11	16,22	**n.r.**	n.r.	n.r.

Source: WIK *Arbeitsbedingungen im Briefmarkt*, 2007; minimum wages added by ECORYS.

1.3 Lawsuit and protest

In response to the adoption of the law for minimum wages in the German postal sector, TNT has filed a lawsuit against competitor DPAG on the January 21, 2008. The "Bundesverband der Kurier-Express-Post-Dienste (BdKEP)" and PIN Group have filed similar cases.[20]

In its decision of 7 March 2008 in the case of TNT against the postal minimum wage, the Berlin Administrative Court ruled that the postal minimum wage of € 9.80 violates the German constitution. In the opinion of the court the Minister of Labour and Social Affairs was not allowed to declare this wage generally binding.

[19] Thomson Financial, Agreement reached on minimum wages for postal workers in Germany, 5.9.2007.
[20] Private communication with TNT.

This decision constitutes an important first step as the German State has directly filed an appeal against it at the Administrative Court of Appeal. This appeal process may take at least six months and can be followed by a second appeal to the Federal Administrative Court. As emotions run high in the German Government law changes to defend the reached agreement also cannot be ruled out.[21]

In parallel, TNT is in the process of launching an official complaint on DPAG distorting competition in the German postal market to the European Commission (DG Competition).

In the meantime, TNT does not adhere to paying the higher minimum wages, but is applying their own (lower) wage levels (TNT pays their own minimum wage or higher wages dependent upon the situation on the local labour markets). In order to prevent any risk of getting accused of an administrative offence for paying wages below the minimum wage level, TNT is making reservations for the difference between the minimum wages and their own wage levels. To avoid making a criminal offence (by not paying the social security contributions on the wage difference should the higher minimum wages be paid as from 1 January 2008), TNT has authorised the German national health insurance, "Krankenkasse", to automatically collect the (higher) premiums at any moment in time (applicable if TNT would lose the law suit).[22]

PIN AG decided to pay the (higher) minimum wages as from 1 January 2008 to avoid running in these type of problems.

> The current investigation into the alleged tax evasion by DPAG's former CEO, Klaus Zumwinkel – seen as an architect of the minimum wage plan – will not affect the law case, reported TNT CEO, Peter Bakker. "Zumwinkel made the deal and then the cabinet said yes, and parliament said yes and now it's law…So far, everything has gone against us in Germany," Bakker comments on the minimum wage law.[23]

1.4 Activities undertaken and structure of the report

1.4.1 Activities undertaken

Desk research

We have carefully reviewed the extensive documentation (i.e. studies, acts, news items press articles) to ensure the correct representation of facts and stakeholder opinions. For this purpose we have focussed our document review on the following issues:

- The confirmation of the minimum wage as presented in the German legislation;
- The minimum wages as proposed by the competitors of DPAG for their operations;
- Collection of press statements on the issue of minimum wages by postal sector stakeholders and German politicians;

[21] If this would happen, this would probably give rise to opposition of the Commission as this type of legislation would effectively distort competition.

[22] Private communication with TNT.

[23] Financial Times, TNT in threat to quit Germany, 18.02.2008.

- The rights and obligations of the competitors in Germany pending the outcome of the law suit filed by TNT.

Interviews

We have conducted interviews with a number of relevant stakeholders. These stakeholders include regional postal operators in Germany, TNT, European Mail Network (EMN), Sandd, Selekt Mail (who did not want to comment on the situation in Germany), Bundesnetzagentur, and German industry experts. It proved not possible to meet PIN AG (at relatively short notice). The main purpose of the interviews was to test the assumptions underlying the business case and to obtain information and opinions.

Business case analysis

In order to make the analysis of the potential consequences of the minimum wage law as objective as possible, we have conducted a business case analysis. The target of the model is to point out to what extent wage levels and economies of scale determine the results (cost effects, profit and loss). The underlying assumptions are based on market information and have been tested in interviews with market players and industry experts. The assumptions have also been discussed at length with TNT. In the business case ten different scenarios have been analysed.

It should be stressed that the business case is a simplification of reality and that the main purpose is making a comparative static analysis. The focus is on showing the impact of changes in wage levels and volume growth on the business case, not on the description of the present day situation.

1.4.2 Structure of the report

In Chapter 2 we present the main regulatory developments that affect competition in the German postal sector. Subsequently, an analysis of the current competitive arena is provided with a focus on DPAG's main competitors at national level: TNT Post and PIN Group. Chapter 3 presents the business case starting with a clarification of the facts, general assumptions and parameters underlying the business case analysis. Next the results for the ten scenarios are presented and discussed.

2 Development of competition in the German postal sector

2.1 Relevant regulatory developments

2.1.1 Full liberalisation

Germany has fully liberalised the postal market per 1 January 2008 by removing DPAG's national monopoly on addressed mail delivery under 50 grams.[24] [25] As a consequence, DPAG is under pressure to find new sources of revenue. DPAG takes in approximately one quarter of its revenues from its letter business each year and 50-60% of its profits. DPAG has forecasted that domestic competition will trim earnings of its mail division by as much as 20% by 2009.[26]

DPAG argues that it faces a less-than-level playing field and unfair competition in European postal markets. While facing competition from abroad in the cities, Deutsche Post would be left to deliver mail to German rural regions, a costlier and more difficult service to provide.

Klaus Zumwinkel, former CEO of DPAG, has expressed concerns about the failure of the liberalisation of postal markets in Europe, the comprehensive and country-wide provision of postal services for Germany, job security at DPAG and the social standards offered by new postal service providers. Zumwinkel has urged the German government and parliament to work vigorously to create fair competitive conditions for the full opening of the German and European postal markets including the introduction of binding regulations for the long-term development of the sector.[27]

2.1.2 Reserved area and licence requirements 2007

Postal services in Germany are regulated in the Postal Act**,** which has become effective on 22 December 1997. The Postal Act provides the obligations for Deutsche Post to provide universal postal services, a definition of licensed services and conditions for licences to be granted by the national regulatory authority, Bundesnetzagentur (BNetzA).

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[24] Deutsche Post, Deutsche Post mulling free newspaper launch, 2.9.2007.

[25] Standard letters are two-thirds of the EU's 88 billion-euro postal market and offer twice the profit margin of packages and express mail. (source: Bloomberg, TNT gains most in two years on speculation about market opening, 30.11.2007).

[26] Bloomberg, German postal workers may win minimum wage, 21.08.2007.

[27] Deutsche Post, Deutsche Post concerned about unfair competition in Europe, 3.8.2007.

DPAG was the holder of the licence to provide services in the (now abolished) reserved area.[28]

Since the partial break up of the German postal monopoly in 1998, Germany's governing national regulatory authority, BNetzA, has granted some 1.000 business licences for delivering mail.[29] Table 2.1 provides an overview of the eight categories of licences distinguished in the German postal sector until 1 January 2008.

Table 2.1 Licence categories in Germany

Licence	Services that can be provided with this licence
A	>50gr. Or >2.5 times stamp price (= EUR 1,375)
B	Bulk direct mail (50+ letters) > 50 gr. (letters with identical content; NB no longer applicable)
C	Document exchange
D	High quality and value added services
E	Delivery to DP AG access points
F	Collection at P.O. Box premises of DPAG
G	Outgoing cross-border mail
H	Incoming cross-border mail

Source: Website Bundesnetzagentur

The sector regulator has stimulated competition by granting a "D-licence", which allowed competitors of DPAG to provide high-quality and value added services, even for mail items that are within the weight limit of the reserved area. The national regulatory office, Bundesnetzagentur, has succeeded in this aim given many applications for a D-licence (more than half of all competitors on the German mail market operated on the basis of a D-licence). However, to reduce the competitive pressure from competitors with D-licences DPAG took competitors to Court.

The D-licence has several variations (see par. 51, article 1.2 of the German postal law):

- Service with collection and delivery within the same day (D1);
- Time service delivery (mail collection after 17.00 hrs. and next day delivery before 12.00 hrs. for at least five days a week; D2);
- Day definite delivery (D3);
- Tracking and tracing (D4);
- Integration of logistical services (D5).

Since the full market opening earlier this year a D-licence is no longer compulsory for competitors to deliver mail below 50 grams. However, the national regulatory office still requires registration and specific requirements (e.g. employment conditions[30]) as required by the German Postal Act.[31]

[28] Until 1 January 2008, the reserved area consisted of the conveyance of domestic mail items weighing less than 50 gram (and with a rate less than 2.5 times the stamp prices) with the exception of high quality and value added services for this group of mail items, which services are not part of the reserved area.

[29] Deutsche Welle, Deutsche Post in uproar over planned market changes, 9.8.2007.

[30] German Postal Act, article 6 section 3.

[31] Private communication with TNT.

2.1.3 VAT exemption DPAG

DPAG has a value added tax (VAT) exemption with regard to all (addressed) mail services under the universal service obligation. In practice, no VAT exemption exists for bulk parcels (i.e. all parcels that are not over-the-counter parcels), where VAT is charged. The financial advantage of DPAG is estimated to amount up to EUR 500 million.[32]

PIN Group and TNT Post have long complained that the exemption given to DPAG is an unfair competitive advantage.[33] The VAT exemption has a great influence on the extension of the competition and the liberalisation of the mail-market in general. After raising the VAT-rate from 16 to 19 % on 1 January 2007 this advantage for DPAG has become even more important.

The VAT exemption of DPAG distorts competition in favour of DPAG for around 40% of the German mail market. For the 60% of the customers that have to charge VAT themselves (and hence can reclaim the VAT paid on postal services) there is a small advantage to use competitor postal operators rather than DPAG.

In October 2007, the German Ministry of Economy, Mr. Glos, announced plans to curtail the tax privileges of DPAG to improve the level playing field by limiting VAT exemption to postage stamps. This means that mass mailings without postage stamps and other postal services will no longer be exempt from VAT.[34] This announcement follows an earlier EU request to Germany, among other countries, made in July 2007 to change its legislation of VAT exemption for mail delivery charges, which is not compatible with the EU VAT directive.[35]

According to the Minister of Finance, Mr. Steinbrück (SPD), "all USPs in Germany that offers a universal service should be exempted from VAT. USPs that is 'cherry picking' and offering their services only in specific regions should not get this advantage".[36] [37] In February 2008, the Minister of Economy Mr. Glos (CDU/CSU) stated on German television that for the VAT exemption a distinction will be made between private and business customers.

Hence, there is no agreement yet at political level on the VAT issue. Linking a VAT exemption to the requirement to nationwide delivery of all universal services (as proposed by Steinbrück) would be detrimental to the development of competition, as competitors can only compete on the postal market if they operate another business model and a smaller network than the incumbent (only collection from business customers, use of pre-sorting techniques, less than five days per week delivery, delivering to 80-90% of the households rather than to 100%, or flexible labour contracts are options to keep the network small and to compensate for the lower economies of scale as compared to the

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32 WIK Consult; Wirtschaftswoche No.:8; 17.02.2007.
33 Financial Times, Berlin ponders mail VAT move, 10.10.2007.
34 Reuters, Germany plans to limit D.Post tax privileges-paper, 11.12.2007.
35 AFX Equitynext ProFeed, TNT CEO calls for equal treatment of postal services in Germany, 30.7.2007.
36 Handelsblatt, 10.10.2007.
37 Mr. Steinbrück confirmed his opinion in Handelsblatt No. 12 of the 17th of January 2008, stating that a new law on VAT exemption is being drafted.

incumbent postal operator). The proposal to link a VAT exemption to the universal service and at the same time to limit the universal service to the delivery of individual item mail (i.e. mail with postage stamps, as proposed by Glos), which is the case in the Netherlands, is very sensible from an economic perspective and does not distort the development of competition.

2.2 The competitive arena

2.2.1 Business model TNT Post and PIN Group

TNT Post AG - role of subcontracting

For mail delivery TNT cooperates with a large variety of local and regional postal operators. TNT is operating a five days per week delivery service (up to recently using the D-licence for its operations) and is currently able to deliver to around 90% of all German households for addressed mail and 100% of the households with regard to unaddressed mail.[38] Of the households that are part of TNT's addressed mail delivery network, ca. 30% is covered through their own network (ca. 6,000 employees) and ca. 70% is covered through subcontractors (who deliver mail on behalf of TNT together with their own, usually local/regional, mail, ca. 15-20,000 employees).[39] 20% of this 70% concern subcontractors belonging to the PIN Group, 50% are not related to the PIN Group.[40]

In 2006 TNT acquired the consolidator company PostCon. PostCon, based in Berlin, pre-sorts 1.3 million addressed mail items each day according to postcode regions for delivery nationwide (figures end 2006). At the end of 2006, PostCon's client base comprised about one thousand German companies, including half the blue-chip companies listed in the DAX index and other major customers such as Tchibo, Philips, Bosch, and the Merck pharmaceuticals group.

PIN Group

PIN Group offers 90% delivery to all letterboxes, of which 65% is covered through its own network, and 25% through subcontractors. The remaining 10% is covered by DPAG. PIN Group and its subcontractors are also offering a five day per week (in some cases six days per week) delivery service with a business model, according to one of our interview partners, to a large extent mimicking the business model of DPAG.

In the first half of 2007, Axel Springer AG, increased its stake in PIN from ca. 25% to 63.7%. This implied an investment of Springer of around 500 million.[41]

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38 According to TNT (private communication), the coverage of the network went down from 93% to 87% recently as a result of insolvency of a number of partners.

39 Figures from TNT (private communication). Note that for the 10% of the households that is not covered by TNT's network, customers are asked to send this part of the mail through DPAG.

40 Private communication with TNT.

41 Presentation by Steffen Naumann, Axel Springer, *Financials Capital Markets Day*, Berlin, 17 September 2007, slide 18.

Acquisitions

In 2007, TNT Post and PIN Group have made further acquisitions in Germany to strengthen their position for competing with DPAG after full market opening per 1 January 2008. For example, TNT Post has bought a 25.1% stake in the regional letter distribution company CPO CITIPOST Osnabruck GmbH & Co. KG., providing TNT with access to more than 320,000 households in and around Osnabruck.[42]

PIN Group acquired Arriva GmbH, the largest private mail firm in Baden-Württemberg, which covers 40% of all households in the state with more than 4,000 business customers.[43]

Direct mail

The German direct mail market accounts for around 40% of the addressed mail market in terms of mail volume (7 billion out of a total of 17,5 billion mail items in 2007). According to TNT, this segment is dominated by mail order companies that demand nationwide coverage due to the discount structure of direct mail delivery. VAT exempt, yet smaller market players in terms of mail volume, are financial institutions. Hence, the market is difficult to enter for local non-VAT exempted postal service providers since nationwide delivery is crucial. Competition is predominantly based on price with DPAG offering very competitive prices that seem to out rule competition (DPAGs list price is 25 cents per direct mail item below 20 grams).

Relative prices for direct mail and transactional mail: good or bad?

ECORYS agrees with the proposition that competitors can hardly compete with DPAG on the direct mail market segment. This is potentially problematic, as direct mail has a number of product characteristics that make it a suitable product for competitors: there is a continuous mail volume, mail volumes can be planned in advance and direct mail is regarded as less time sensitive than transactional mail (bills, bank statements, etc.).

On the other hand, prices for transactional mail are much higher and are, unlike in the Netherlands, open to competition.[44] Consequently, for transactional mail much higher margins can be obtained than for direct mail. PIN is not actively marketing the distribution of direct mail and is only delivering direct mail if their customers request them to do so.

Delivery five days a week

Interview partners confirm that the current five day per week delivery model is highly valued by customers in the German postal sector. As a consequence, this is unlikely to change in the short term but it might become a viable option in the longer term attributing to economies of scale (with for instance three times per week delivery rather substantial cost reductions in delivery can be obtained at current mail volumes of competitors). The German environmental movement is said to have started a political lobby for less than

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42 Forbes, TNT Post buys 25.1 percent stake in Citipost Osnabruck, 1.10.2007.

43 PIN Group, Deutsche Post rivals strengthen hands in Germany, 1.10.2007.

44 In the Netherlands the delivery of letters (including transactional mail) under 50 grams is still the monopoly of TNT. Interview partners indicate that with many customers, TNT has recently concluded three-year contracts on the delivery of transactional mail.

five day postal delivery.[45] Two/three days per week delivery was already advised to a number of potential entrants in the German market some years ago. TNT is adamant that they do not see this as a real option.

Market share development

The combined market share of the competitors of DPAG has grown steadily in recent years as can be seen in Table 2.2.

Table 2.2 Market share development of competitors in the German addressed mail market

Year	Total mail volume (million items)	Mail volume of competitors	Joint market share of competitors	Year on year mail volume increase of competitors
2003	16,641	Ca. 615	3.7%	-
2004	17,005	Ca. 900	5.3%	46%
2005	16,892	1,129	6.7%	25%
2006	17,295	1,485	8.6%	32%
2007 (expected)	17,576	1,823	10.4%	23%

Source: BundesNetzAgentur.

With regard to market share developments after the minimum wage law only limited data are available:

- DPAG reported to have won more than 50 corporate clients from troubled competitor PIN Group AG and TNT Post during the last quarter of 2007, Handelsblatt reported, quoting a company's spokesman. Most clients came from PIN Group;[46]
- Also TNT Post mentions that they have lost some customers to DPAG;
- TNT is using PIN for a stated 20% of its deliveries, in particular in some high density areas like Berlin. Given the financial problems at PIN, TNT is currently seeking for alternatives to fill possible future market coverage gaps (note that it is highly unlikely that strong companies like PIN Berlin are going to get bankrupt);
- Apart from causing problems for TNT's delivery network, the problems within PIN are also providing important opportunities for TNT, as the position of one of its main competitors has weakened substantially.

2.2.2 Reaction of DPAG to competition

ECORYS estimates that competitors in the Netherlands and in Germany could be able to jointly capture 20-25% of the addressed mail market. The International Herald Tribune mentions in an article in February 2007 that in Germany 20% of DPAG's business is at risk.[47] DPAG is fighting back, putting competitors on notice that access to its postal sorting and distribution network will come only if they meet the company's specifications for humble letters - "no bills on beer coasters", a spokesman, Hans Jürgen Thomeczek,

[45] Private communication with TNT.
[46] Hemscott, Deutsche Post wins more than 50 corporate clients from PIN Group and TNT, 3.1.2008.
[47] International Herald Tribune, Germany pushes its EU neighbours to end monopoly on letters, 2.2.2007.

said. "And since this will be business, and not a public utility, newcomers will have to pay for the privilege."[48]

To combat the regional competitors in their regional business, DPAG has increased its rebates on letter postage for large business customers as per 1 January 2008. The rebates were increased to 8-26% (from 3-21%), dependent upon mail volume and the level of pre-sorting (to be eligible for the rebate companies should pre-sort and inject (deliver) their letter post at different places of DPAG's network. In particular, small and medium enterprises are benefiting from this rebate as only a minimum of 500 postal, nationwide mail are required contrary to the previous requirement of 5,000 items. For regional mail the minimum is even set at 100 instead of 500 items.[49]

2.2.3 Mandate and actions of the postal sector regulator

The NRA, Bundesnetzagentur has the power to grant and withdraw licences, to settle disputes between postal operators regarding services provided and to act on the abuse of a dominant position. The NRA has a complete set of basis information-gathering and enforcement powers. These include requesting data from all postal operators (both the universal service provider and competitors)[50], setting rates for and cancelling unlawful rates by the universal service provider (but note that the NRA oversees the upper end of mail product prices, not the lower end) and enforcement of rulings (levy fines and seek judicial order).[51]

The policy maker, the national regulatory agency (Bundesnetzagentur) and the Cartel Office (Bundeskartellambt) are not seen as actively promoting fair competition. This is confirmed by our interview partners and in previous studies.[52] The issue is that the mentioned organisations can only act if there is sufficient evidence before the start of an inquiry. Critics of the current-day situation therefore demand that the right should be granted to act pro-actively and, for instance, to look in contracts in order to see whether DPAG makes use of predatory pricing (unlawful return price discounts, price discrimination, etc.).

The situation in Germany is in this respect comparable with the situation in the Netherlands where OPTA has little power and the competition authority (NMa) by default only the possibility to react (ex-post) to complaints from market players.

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48 Ibid.

49 http://mittelstanddirekt.de/c178/m246/um220/d3974/mdirekt_druckvorschau.html

50 In German the USP only has to submit periodic accounts to the NRA when it is time to adjust the rates or rate caps, i.e. every few years. Product accounts need to be submitted for all products which require ex ante approval by the NRA.

51 WIK, Main developments in the postal sector (2004-2006), 2006.

52 See for example De Bas and Van der Lijn, Development of competition in EU postal markets: the influence of the regulatory framework on the pattern of competition, Chapter 15 in Michael Crew and Paul Kleindorfer, eds., *Competition and Regulation in the Postal and Delivery Sector*, Edgar Elgar, 2008, p. 216-231.

2.2.4 Effect of minimum wage on competition

PIN AG and TNT Post argued to Germany's Ministry of Economy that 50,000 jobs are at stake, if the minimum wage agreement concluded by former monopolist DPAG and trade union ver.di is applied to the whole postal industry. Minutes of a meeting between DPAG's competitors and the Ministry of Economy in September 2007 state that "the entrepreneurs plausibly demonstrated that they would have to file for bankruptcy at minimum wages between EUR 8.00 and EUR 9.80 per hour."[53]

TNT to withdraw from Germany if minimum wages are extended to whole industry
TNT Post officially considers withdrawing from Germany all together if DPAG's minimum wages are extended to competitors active in addressed mail delivery.[54] "If the minimum wage is adopted in Germany then we will look at our options very thoroughly, everything is open. And we will include the winding up of PIN in our option finding or scenario thinking, once the fact is confirmed," TNT spokesman Pieter Schaffels said."[55] TNT said it may freeze or perhaps even abandon all current cooperation agreements it has signed with regional German mail distributors. TNT is "very much opposed" to that government proposal as it would "destroy whatever level playing field is left for us in Germany – if at all", the TNT spokesman said.[56]

However, various people interviewed by ECORYS were of the opinion that it is unlikely that TNT would exit the German market if the law suit would be lost, for the following reasons:

- Even with the higher minimum wages they thought it would be possible to operate a profitable business in the medium term (this depends on the assumptions underlying the business case, see above);
- The postal market in Germany is considered too important for TNT to exit, even with limited profit opportunities. It is one of the main postal markets in the EU and, moreover, a presence in the German market is of strategic importance to be able to fight back to DPAG in Germany if DPAG through Selekt Mail (or future acquisitions) fights TNT in the Netherlands;
- The partial bankruptcy of PIN is offering growth opportunities;
- There is a (theoretical) potential to rearrange the business model and the operational processes of TNT Post AG mitigating the effect of the minimum wage law and potentially increase efficiency in delivery;[57]
- Even if TNT is forced to implement the minimum wages (of 9.80 euro/hour), the wage level will still be considerably below the average wage level of DPAG.

Officially, TNT is not considering the option to drastically rearrange their operational process in Germany, as mentioned above.

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53 Hemscott, PIN and TNT Post say 50,000 jobs at stake if minimum wages applied, 1.10.2007.
54 This was also confirmed during our meeting with TNT Post on 12 February 2008.
55 Source: Forbes, TNT to look all options 'very thoroughly' if minimum wage adopted in Germany, 10.12.2007.
56 Source: Forbes, TNT not afraid of financial repercussions if it freezes operations in Germany, 5.12.2007.
57 Officially, TNT is not considering the option to drastically rearrange their operational process in Germany, as mentioned above.

PIN Group files for insolvency

Shortly after the adoption of the minimum wage law, the main shareholder of the *PIN Group* (Axel Springer who raised its stake in PIN Group to 63.7% in the first half of 2007) decided to pull the plug. Some 40 of the 90 companies forming the PIN Group, including the Luxemburg-based holding company, filed for insolvency by now.[58] At the end of January PIN Group announced to pay the minimum wage in order to have a good legal position for new potential investors.

For a proper interpretation of the situation in PIN Group, it is important to realise that under German law the State may pay the wages of the workers of insolvent firms for two months (and this is what is done with regard to the insolvent companies in the PIN Group). Also note that these firms still deliver mail and may not actually go bankrupt (some went in fact bankrupt).

Most recent news is that most potential buyers of the group as a whole have withdrawn from the sales process resulting in a break-up of the group with individual companies going to be sold to interested buyers or going bankrupt.[59]

> At the end of 2007 PIN Group said it will have to cut more than 1,000 of its 9,000 jobs in Germany due to Berlin's plans to put a floor under wages in the sector.[60] "As a result of the minimum wage, costs of the PIN Group in 2008 will rise by 35-45 mln euro," Chief Executive Horst Piepenburg said. Losses were estimated at about EUR 65 million and revenues only added up to EUR 280 million instead of the planned EUR 350 million.[61]

Although the minimum wage law contributed to the problems in the PIN Group, people interviewed by ECORYS say that PIN was also suffering from an inappropriate business model (too much mimicking the operations of DPAG, delivery in unprofitable remote areas, little innovation in operations were the main points raised).

Effect on regional and local postal operators

The effect on the 500-700 regional and local postal operators is not straightforward. Around 100 of the larger operators are linked to German publishers and do not have addressed mail delivery as their main business activity. Hence, the minimum wage law does not apply to them.

TNT expressed the opinion that for political reasons they might not want to pay lower wages than the minimum wages in the law and may even decide to exit the market for this reason (to avoid getting accused of paying too low wages endangering their reputation). This opinion is not confirmed in other interviews. There are no signs that publishers are pulling out of the German mail market; some have declared that they will continue. Also,

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58 Frederik Richter, *Thomson Financial*, based on information from Handelsblatt, 20 February 2008.

59 *Ibid.*

60 Source: Reuters, Germany plans to limit D.Post tax privileges-paper, 11.12.2007.

61 In the business case ECORYS estimates the direct labour cost effect at 31 million at current mail volume levels. The operational loss is probably substantially lower, as the 65 million loss figure probably includes investments (such as acquisitions) into developing the delivery network. Although these investments need to be recovered in the longer term, the business case excludes these costs and focuses on operational profit/loss.

the political climate has changed and many feel that the minimum wage law was a mistake that should not be repeated. Fear for reputation damage seems not warranted.[62]

The local and regional postal operators whose main business activity is addressed mail delivery may run into problems because of the minimum wage law. Exact figures are not available, but an expert estimate is that this applies to 75% of the 500-700, mainly relatively small, postal operators. A guesstimate is that of the entire group of local and regional postal operators some 10% may go bankrupt and cease to exist.[63]

[62] Opinion expressed by WIK, private communication. TNT estimates this figure at 15-25%.
[63] Opinion expressed by WIK, private communication.

3 Business case analysis

3.1 Description of the business model

In order to make the analysis of the potential consequences of the minimum wage law as objective as possible, we have conducted a business case analysis. The target of the model is to point out to what extent wage levels and economies of scale determine the results (cost effects, profit and loss). In the business case we analysed eight scenarios. We varied in:

- *The starting position* (operational result/EBIT of -26, -23 or -12.5 mln at a mail volume of ca. 600 mln mail items/year)
- *The cost increase in outsourced delivery* (+8.7%, +5.0% and linking the price for outsourced delivery to the actual cost of delivery that decreases when mail volume increases);
- *The total cost elasticity* (0.7 as high figure and 0.6 as low figure); made operational through using two sets of values for the cost elasticity for delivery and mail processing. Note that throughout the exercise we assume that the prices for mail delivery do not change.

In addition, two other scenarios are presented: a worst case scenario and an optimistic scenario. The results of these two scenarios have not been calculated, but are presented as compared to the worst and best of the scenarios under the eight scenarios referred to above.

It should be stressed that the business case is a simplification of reality and that the main purpose is making a comparative static analysis. The focus is on showing the impact of changes in wage levels and volume growth on the business case, not on the description of the present day situation.

3.2 Facts, assumptions and parameters

The model parameters and underlying assumptions are described in Annex 1. As some of the figures may be regarded as confidential (commercial) information, Annex 1 is not made publicly available.

The assumptions underlying the various scenarios are presented in Table 3.2.

The parameters and assumptions underlying the business case were discussed with various interview partners, including TNT and a German local mail delivery company. The plausibility of the parameter values was confirmed and various suggestions incorporated.

3.3 Scenario 2: Higher minimum wages

The direct cost effect of applying the (higher) minimum wages is given in Table 3.1. According to TNT, the salary costs for delivery in their own network would rise with around 27%. For the subcontractors of TNT the increase is close to 20% for those that have to apply the minimum wage and 0% for those that do not have to apply the minimum wage. Assuming that 50% of the mail of TNT is delivered by subcontractors, that 50% of them need not apply the minimum wage, and that delivery costs represent ca. 50% of total costs, this results in a rise in the total (average/unit) cost with 9.1% rising to 9.6% in 2010 when also in eastern Germany 9.80 needs to be paid.

TNT assumes that the effect of the price increase of its subcontractors is a bit higher than the five percent presented in the table and indicates that also the salary costs for mail processing may rise with 6-8%. TNT arrives at unit cost rises of 10-11%. ECORYS does not have detailed figures about the salary costs of mail processing and assumes that TNT is at the sector average. If TNT would be substantially below the sector average, the impact on total (average/unit) costs would be around +1%.

(Assuming constant prices and mail volumes, revenues do not change and the effect on the profit/loss position is identical to the effect on the delivery costs.)

Table 3.1 Direct cost effect of applying the minimum wage law in Germany

	Average wages of competitors	New wage level (average)	Cost increase	Effect on total (average) costs (5)
Mail processing (all competitors incl. TNT)	8.36	8.36	0%	-
Office staff (all competitors incl. TNT)	16.22	16.22	0%	-
Mail delivery (2008-2009)				
Average of all competitors	7.94	9.60	+20.9%	+10.5%
TNT (1)	7.72	9.77	+26.6%	+13.3%
All competitors excl. TNT (2)	8.00	9.56	+19.5%	+9.8%
Total impact on TNT (maximum) (3)				+11.5%
Total impact on TNT (ECORYS estimate) (4)				**+9.1%**
Mail delivery (2010-…)				
Average of all competitors	7.94	9.80	+23.4%	+11.7
TNT	7.72	9.80	+26.9%	+13.5
All competitors excl. TNT (2)	8.00	9.80	+22.6%	+11.3
Total impact on TNT (maximum) (3)				+12.4%
Total impact on TNT (ECORYS estimate) (4)				**+9.6%**

Source: WIK (2007); (1) figures for TNT provided by TNT (note that TNT's own delivery network is mainly in the western part of Germany).

Note: (2) Calculated on an assumed market share of TNT of 20% of the total market captured by competitors of DPAG; (3) Based on 50% mail delivery by TNT and 50% through subcontractors assuming that the minimum wages would apply for all subcontractors; (4) Based on 50% mail delivery by TNT and 50% through subcontractors assuming that the minimum wages would apply for 50% of all subcontractors (items of outsourced volumes); (5) Salary costs for mail delivery constitute around 50% of the total cost; when mail volumes rise substantially above 600 mln per year, this percentage gradually reduces to 40-45%.

3.4 Scenario 3: Economies of scale

Given the existence of scale economies in the postal sector, the direct cost effect can be compensated through a rise in the (average) number of items delivered per postman per hour. Clearly, compared to the alternative of paying lower wages, there remains a permanent increase in the cost base.

Growth in mail volumes reduces the average unit costs and can compensate for the higher labour costs. In the scenarios B-I it is estimated how much growth in mail volume would be needed to offset the direct effect of the minimum wage law.

Two values for the total cost elasticity were used in this exercise: 0.6 at the lower end and 0.7 at the upper end (meaning that when mail volumes would rise with 10%, the average

costs would rise with 6%, or 7%, respectively). Note that these values are relatively high (comparable to values for incumbents known from the literature) reflecting the notion that TNT Post is still developing its network in Germany (and is somewhere between the start-up and growth phase in its development).

If we deduct the costs involved with outsourced delivery the 'own' cost elasticity can be calculated corresponding to total elasticity figures of 0.6 and 0.7: the lower and upper values are 0.45 and 0.56, respectively.

The results are shown in Table 3.3. In scenario B where there is a loss of ca. 26 mln (operational result, comparable with EBIT) at ca. 600 mln mail items delivered and where the total cost elasticity is around 0.7, mail volume should grow by 65% to offset the effect of the minimum wage law on the total profit of the operations in Germany (that is: to have the same level [-26 mln.] of profit/loss as without the introduction of the minimum wage law). If we assume a bit lower loss (-23 mln, because of slightly higher productivity in delivery), a cost increase of subcontractors of +5% (rather than +8.7%) and a total cost elasticity of 0.61 (scenario G), mail volume should grow by 33% to offset the effect of the minimum wage law.

The scenarios give an indication of the volume growth needed to offset the introduction of the minimum wage law under different assumptions. The scenarios E, G, and I indicate that a volume growth of around 30-35% would be needed. Given the growth path that TNT is embarking on in Germany, this corresponds with a set-back of at least one year: *ceteris paribus*, it will take at least one year more to reach break even and to reach certain profit levels.

With scenario B, and to a lesser extent also scenarios D and F, offsetting the impact of the minimum wage law will be much more difficult and the operations of TNT in Germany will be still loss making in 2012. The scenario that TNT is working on is amongst these scenarios.

For ECORYS, it is difficult to predict which scenario is most likely to emerge in practice.

Table 3.2 Assumptions underlying the various scenarios (at volume level of ca. 600 mln mail items/year)

Scenario	Indicators at ca. 600 mln mail items	Other assumptions
A	Same as in scenario B	- Severe problems with national coverage as a result of bankruptcies of subcontractors; *and/or* - Income per mail item decreases because of competitive pressure from DPAG
B	-26 mln operational result (EBIT) 45.4 items/hour delivered Cost of outsourced delivery per mail item same as at ca. 300 mln mail items	- Selling price remains unchanged; - Cost of outsourced delivery: +8.7%; - Cost elasticity own delivery: 0.65; - Cost elasticity mail processing: 0.75
C	Same as in scenario B	- Selling price remains unchanged; - Cost of outsourced delivery: +8.7%; - Cost elasticity own delivery: 0.5; - Cost elasticity mail processing: 0.5
D	Same as in scenario B	- Same as in scenario B; - Cost of outsourced delivery: +5.0%
E	Same as in scenario B	- Same as in scenario C; - Cost of outsourced delivery: +5.0%
F	-23 mln operational result 47.25 items/hour delivered Cost of outsourced delivery per mail item same as at ca. 300 mln mail items	- Same as in scenario B; - Cost of outsourced delivery: +5.0%
G	Same as in scenario F	- Same as in scenario C; - Cost of outsourced delivery: +5.0%
H	-12.5 mln operational result 47.25 items/hour delivered Cost of outsourced delivery per mail item equal to own delivery costs (prices equal marginal costs and go down 13.2%)	- Same as in scenario B
I	Same as in scenario H	- Same as in scenario C
J	Same as in scenario H	- Total cost elasticity is < 0.6 - Income per mail item can increase because of price rises

Note: All scenarios (apart from scenario A and J) assume that income per mail item (the selling price) does not change the coming years. Other assumptions are that transport costs and delivery costs through DPAG both fully vary with volume (there is a cost elasticity of 1), that fixed overhead remains unchanged and that salary costs for overhead rise with 1.9% if volume rises with 10% (a cost elasticity of 0 and 0.19, respectively).

Table 3.3 Volume growth needed to compensate for higher wages for mail delivery

Scenario	Total cost elasticity	TNT's 'own' cost elasticity	Items/hour delivered (at higher mail volume)	Percentage increase needed
A	> scenario B	n.c.	n.c.	**> scenario B, C**
B	0.697	0.564	52.7	**65.3%**
C	0.616	0.448	53.1	**40.6%**
D	0.694	0.564	52.7	**54.4%**
E	0.613	0.448	52.1	**34.7%**
F	0.694	0.562	53.5	**49.7%**
G	0.614	0.447	53.9	**32.6%**
H	0.686	0.562	53.1	**45.6%**
I	0.603	0.447	53.7	**31.6%**
J	**< scenario H, I**	n.c.	n.c.	**< scenario H, I**