SESSION 2B: PRICING STRATEGIES

Discussion points

25 May 2023 – Dr Bruno Basalisco, Director, Copenhagen Economics

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(1) Ramsey pricing is always in fashion.. But is there enough demand to pull it off without subsidies or "graveyard / subsidy spirals"?

- Not even the regulator has all the exact data..
- Price cap approach to policy: "live and let live…"
- Assume that profits are equally distributed between letters and parcels (incl. packages)… yet are contribution margins significantly different?
- Reaching the optimal use of resources in the postal sector → loss of 6.3 bn SEK financial loss to be covered by other sectors (taxpayer?)
- Co-financing … → Economies of scope, i.e. recovery of the costs of shared assets
- "Direct subsidies […] will reduce incentives for the USP to minimize costs […]" → what about counterfactuals and the Net cost of USO calculation methodology? (incl. regulatory accounting safeguards)?

- Social marginal cost.. Negative externalities due to service provision .. What about positive externalities due to (universal) service provision?
- Compensation funds: several challenging experiences, no silver bullet

(2) Postal demand elasticities: new territory… a very competitive market

- Previously… research on USPS or Royal mail data often confined to letter mail (or US market dominant) product classes
- The firm-level elasticity observed was a close proxy for market-level elasticity
- In parcels… very storing competition: so the extensive margin is no longer reflecting just the buy / no-buy decision
- What about consumers that "multi-home" and may split their purchases between multiple providers, at the same time, or at different times.. How do we then interpret the extensive margin?
- Endogeneity of pricing.. Role of sales staff, any heuristics, how do they adjust pricing, could we learn from it and improve the model accordingly?
- Explanatory/control variables include subsector (19 of them): yet isn't most parcel shipment activity online retail? What are the sectors, do they explain demand?
- Tracked 24 hour product has a much higher elasticity: capturing
- - extent of competitive pressure? And/or
- - higher price point of this class of product (compared to untracked)? And/or
- - relevant customer segment?

- Commercial policy implication from the notably high parcel price elasticities – what would you tell a CEO in a board meeting?

(3) Inflation is the new black…

- Markets with declining demand (letter mail): nobody wins with inflation…
- - customers
- - postal operator
- - workers (retirees)
- - competitors
- - citizens (USO)

- Share of institutional costs recovered via competitive products: 3.7% decrease: in the share or in the absolute level?
- Elephant in the room: role of inflation on workforce pension liability (as mentioned in the paper)
- "demand elasticity is not considered in the price cap" …? Role of price setting by the regulated postal operator under the cap constraint, will it not (Ramsey)-price informed by the set of elasticities across products?

- US regulatory regime, highly granular level of scrutiny and degree of constraint from price cap mechanism → inflation rocks the boat, while the system cannot adjust so fast (despite CPI-U component)
- - "operate in an administrative environment beyond our control"

- UK Postal Act price control redesign and Ofcom implementation: simplify the price rules and allow for faster adjustment to shocks (demand side, i.e. volume.. But also supply-side i.e. inflation?). Could that work in US?
- - however, a safeguard cap is ultimately a political judgment and perhaps not one that US PRC is institutionally designed to be able to establish..

Thank you!