

Magazines Canada

425 Adelaide St. W. Ste. 700

Toronto ON CAN M5V 3C1

Telephone: 416.504.0274

Facsimile: 416.504.0437

www.magazinescanada.ca

**Magazines Canada
Canada Post Strategic Review Submission**

Introduction

Canada Post delivery has been a central element of the Government of Canada's magazine policy for more than a century. And it is still so today. Recognizing the geographical challenges of distributing magazines across such a large country and the economic challenges of publishing in such close proximity to the largest magazine and entertainment industry in the world, Canadian policy has consistently relied on Canada Post's distribution network to ensure readers across Canada have access to Canadian content magazines.

It is a policy that is working. While Canadian-produced content makes up less than five per cent of our domestic film market, 16 per cent of music and about 30 per cent of books sold in Canada, Canadian consumer magazines have accounted for about 41 per cent of domestic market in recent years. The overwhelming majority of these magazines are distributed through Canada Post.

Canada's magazine readers and industry have a significant stake in the future of Canada Post. It is THE vehicle for delivery of our product to market.

For these reasons, Magazines Canada takes a great interest in the work of the Strategic Review Panel. We welcome the opportunity to provide these recommendations to the panel and look forward to working with the panel throughout the review.

Magazines Canada Recommendations

1. There should be a formal postal 'contract' between the federal government and Canada Post which outlines the responsibilities both financial and social that the crown corporation must discharge.
2. The 'contract' should include clear direction to Canada Post that it will provide delivery services for Canadian magazines to all regions of Canada at a reasonable cost.
3. Increased competition should be introduced into magazine delivery in Canada.
4. An independent adjudicator should be created to ensure compliance with the postal contract.
5. Lettermail rates should rise with actual delivery costs.
6. Rate increases should be transparent, timely and predictable.
7. Distance Related Pricing and other radical changes should be put on hold until all reviews have been completed.

Recommendation 1: Establishing a postal contract outlining responsibilities of Canada Post

The roles and responsibilities of Canada Post when it comes to magazines delivery are not clear. Canada Post is 100 per cent owned by the Government of Canada and yet its actions often conflict with federal magazine policy. Officials at Canada Post and at other government departments have differing opinions on Canada Post's responsibilities with respect to its cultural policy obligations.

The government has attempted to keep Canada Post at arms length while sending 'directives' in an ad hoc and non-transparent fashion. This has created uncertainty both for magazine publishers and for Canada Post.

One of the sources of uncertainty in the magazine sector is an absence of understanding as to who is setting policy, who is regulating, who is implementing and what the long term priorities are. Currently the government is acting as both shareholder and regulator with responsibilities shared between several government departments including Transportation and Heritage. The federal government has not executed either role particularly well.

Canada Post's Unilateralism

Many of Canada Post's actions run counter to federal cultural policy and Canadian Periodical Policy. It makes no sense for one government agency to be working to create and distribute Canadian content while another one undermines the effort. Yet, this is what is currently happening as a result of unilateral actions by Canada Post. Examples include:

- a) substantial postal rate increases which favour US magazines over Canadian;
- b) withdrawal of funding from PAP with no government plan for the future; and
- c) the implementation of Distance Related Pricing.

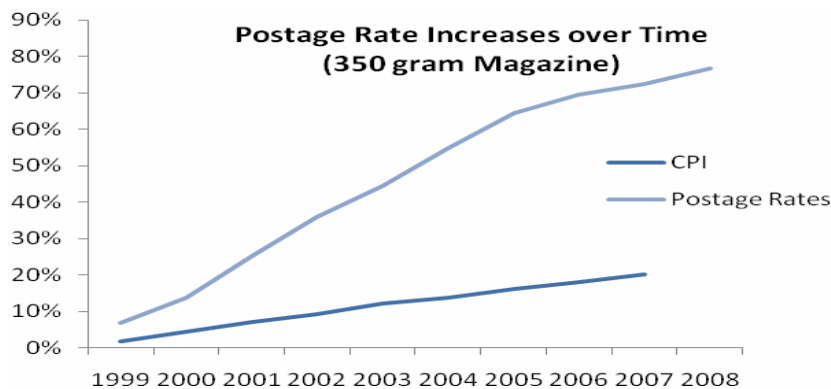
1. Rate increases

Significant rate increases have been a regular feature of Canadian magazines' interactions with Canada Post in recent years. Average mailing rates for all magazines using Canada Post have increased four times faster than inflation since 1999 (See Chart).

Canada Post rate increases on Publication Mail have been substantial. In the Publications Mail category, Canada Post has increased its revenue by \$50 million compared to 2003 while delivering 10 million fewer items. Rate increases have meant that Canada Post has managed to significantly raise its revenue on the backs of Canadian magazines while delivering fewer items in that product line. In fact, volume adjusted revenues in Publications Mail have increased more than in any other direct mail category since 2003.

In addition to delivering fewer items, many Publication Mail items are being delivered below Canada Post time specifications. Smaller magazines are reporting deliver times of over three weeks, significantly behind Canada Post's own targets.

The net effect of rate increases in that government support meant for Canadian magazines is being absorbed by Canada Post for its own benefit and not for the benefit of Canadian readers.



In the 1990s, the US won a case at the World Trade Organization and Canada Post was required to discontinue the practice of charging a lower rate for Canadian magazines than foreign titles. Canada Post complied by cutting its rates for foreign magazines to harmonize them with Canadian. But soon after, it steeply increased rates for all magazines.

While all magazines are paying more, the most culturally significant – those meeting the Government of Canada's eligibility requirements for PAP because of their high levels of Canadian content and readers' willingness to buy them – have been squeezed because Canada Post increases have led, in turn, to large reductions in PAP support.

As a result, while Canadian postal rates have gone up by 60 or even 80 per cent for some titles, US magazines are actually paying less for distribution in Canada than they did 10 years ago.

CPC Rates: 300 gram magazine	1996 LCP	2006 LCP	2006 NDG
Foreign	\$0.85	\$0.68	\$0.84 to \$1.08
Canadian No Subsidy	\$0.37		
Canadian with PAP	\$0.13	\$0.25 to \$0.36	\$0.30 to \$0.57
Canadian request with PAP	\$0.37	\$0.48	\$0.59 to \$0.76

Canada's subscription magazine distribution advantage is a cultural policy success in which Canada Post has played a key role. With competitive circumstances relatively the same and with new threats to the availability of Canadian written content resulting from the internet, this successful policy should continue.

It has been suggested that Canada Post could change its policy and pursue a totally commercial mandate without regard for the government's cultural objectives. The Government of Canada would pursue cultural policy objectives on its own. While technically feasible, this course would be less effective.

2. PAP withdrawal

Canada Post's announcement of its unilateral withdrawal from funding the PAP in late 2006 created an instant crisis in the magazine publishing industry. The latter's \$15 million yearly contribution makes up 25 per cent of the total program. Without Canada Post's contribution to the PAP, magazines could expect a 31 per cent increase in postage costs within a year, excluding Canada Post's regular rate increases.

Fortunately, the government of Canada stepped in and directed Canada Post to continue funding the PAP until April 2009. While this provided some short term relief to the publishing industry, it does not solve the funding shortfall created by Canada Post's abrogation, nor does it resolve the funding gap between the end of Canada Post's funding (April 2009) and the implementation of a new magazine policy (2010).

So, while federal policy explicitly endorses subscription delivery and mandates a requirement for distribution through Canada Post, the crown corporation refuses to support the program and is undermining distribution support through rate increases.

3. Distance Related Pricing

Canada Post intends to implement a new pricing structure in January 2009 called 'Distance Related Pricing' (DRP). Mailing rates would be modified to reflect the distance the magazine travels. Magazines mailed inside a city would have one rate, those mailed in-province would have a second higher rate and those mailed in Canada would have a still higher rate.

This issue is covered in more detail later in this submission. It is worth pointing out here, though, how directly contradictory this pricing approach is to Canada's magazine policy. DRP discriminates against magazine readers, publishers and the printing industry in smaller provinces with less urban dwellers. It is a strong disincentive to national distribution of Canadian magazine content. Canada's magazine policy, on the other hand, seeks to make national distribution of Canadian content easier and less expensive to rural readers and publishers.

Canada Post is running entirely counter to federal policy with its DRP strategy.

A postal contract

Magazines Canada believes that a postal contract will eliminate this conflict of policy positions and the uncertainty associated with them.

Magazines Canada recommends that a formal "contract" be put in place which outlines in greater detail the obligations and performance measures required from the corporation.

There are a variety of models that do not rely on ad hoc "directions" being given to a national postal agency. New Zealand, for instance, employs a Statement of Corporate Intent and Deed of Understanding that explicitly details what New Zealand Post will deliver. There are a set of financial goals but, notably, there are also social goals such as a minimum of rural postal outlets and a ban on additional fees for rural customers. Both the New Zealand government and New Zealand Post explicitly understand what those goals are. Moreover, these goals are reviewed on a yearly basis in a formal process and the results are publicly available.

The Canadian government as the sole shareholder of Canada Post has a responsibility to more clearly and transparently direct the corporation. Financial sustainability and perhaps modest profit making should be among CPC's obligations.

But Canada Post's responsibilities are not just economic. It has important social and cultural responsibilities which must be more clearly prescribed.

In announcing this "strategic review" the Government of Canada made clear its intention to have Canada Post continue as a crown corporation and "to act as an instrument of public policy through the provision of postal services to Canadians". Its long history of providing reliable and affordable access to Canadian magazines is undoubtedly part of this continuing public policy obligation. It should be clearly stated as such in a formal contract between the government and the crown corporation.

The "postal contract" should be publicly available and it should include all the requirements that the government has from all of its interested departments including Transportation, Heritage, Northern Affairs and others. The "Postal Contract" should be revisited every year and modified as the government sees fit. It should set out procedures to ensure the timely implementation of federal policy in the event of a dispute with the Board of Directors.

The "Postal Contract" should detail the goals that the Canadian government expects from Canada Post in terms of service standards and financial sustainability. Currently, Canada Post does this on its own, but the government should take its role as shareholder seriously and codify these goals.

Canada Post is currently being directed by the Multi-Year Policy and Financial Framework created in December 1998. The multi-year policy and financial framework emerged from the 1995 review of Canada Post. It specifies financial as well as some delivery targets. The framework is a good starting point for the "Postal Contract" but it needs to be updated on a yearly basis. It also needs to include the social responsibilities that Canada Post must discharge.

Recommendation 2: Clear direction to Canada Post on delivery services for Canadian magazines

The "Postal Contract" must include Canada Post's obligation, as a federal crown corporation, to implement, uphold and support federal cultural policy. Any "strategic review" of the Canada Post mandate would be incomplete if it did not require a convergence of federal policy and the responsibilities of the crown corporation engaged in the delivery of that policy. As an extension, the "Postal Contract" should reflect Canadian magazine policy.

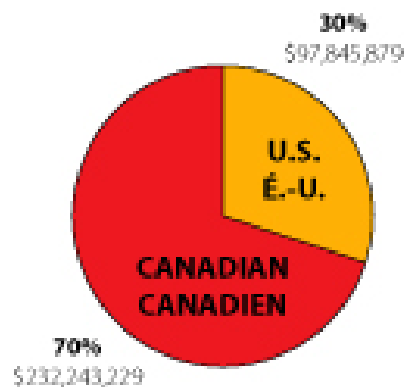
The case for inclusion of magazines

Canada Post delivery has been a central element of the Government of Canada's magazine policy for more than a century. And it is still is today. Policies to support

Canadian magazines pre-date Confederation. The most recent reviews of magazine policy have consistently re-confirmed the importance of Canada Post distribution of Canadian magazines. The landmark O’Leary Royal Commission on Publications in 1961 stressed the critical importance of federal support to magazine distribution. In 1972 the Task Force on Magazine Policy agreed and called for a continuation of favourable postal rates for Canadian magazines.

The federal government may, of course, alter policy at any time. But, until it does, Canada Post’s important role in providing access to Canadian titles for Canadian readers should continue and where, for the purposes of Canada Post’s mandate, there is a lack of clarity, it should be enshrined in the postal contract.

There is a strong case for continued support. As pointed out at the outset of this paper, the policy has worked. A combination of Canada Post delivery and support from the Department of Canadian Heritage’s Publications Assistance Program (PAP) has helped build an effective distribution channel for Canadian titles. Whereas the other major distribution channel – newsstand retail sales – is dominated by US titles, which take more than 95 per cent of revenues from magazines sales, fully 70 per cent of sales through subscription (Canada Post delivery) were for Canadian titles.



Consumer spending on subscriptions in Canada

The fundamentals of the North American market have not changed. Economies of scale continue to favour US magazines. American publishers can bring US titles to the Canadian market at greatly reduced costs since costs of producing the magazine have been covered by sales in the US. Their domination of Canadian newsstands provides substantial advantage in the promotion and marketing of their titles in Canada.

Against this juggernaut, Canada Post and PAP have provided Canadian readers with a reliable and affordable alternative.

Recently, there is growing concern that this success will not be maintained. Recent data suggests that Canadian magazines' percentage of the market is being reduced by US strength in subscription.

Case for magazines

- Compete to win acknowledges that culture is different and that geography is one of Canada's challenges
- This is allowable under trade law – WTO and with the US
- Culture is special
- Targeted, not wasteful

In particular, the amount of time it takes to deliver pieces of mail should be spelled out and independently verified as delivery times for magazines has been increasing. The corporation should also be required to keep costs in line to maintain competitive rates and generally improve efficiency.

The "Postal Contract" should also codify the social responsibilities that Canada Post is expected to discharge including rural postal delivery. Concerning magazines, the contract should stipulate:

- Magazines should be delivered without discrimination to rural readers
- Magazine publishers should be treated equally no matter where they are located in Canada
- Rate increases should be more transparent and predictable for all rate categories, not just Lettermailtm, as discussed below
- Contribution margin targets should be transparent and Canada Post should be accountable for its agreements with industry in this matter
- Canada Post's corporate policies should be consistent with the federal government's national magazine policy

Recommendation 3: Increased competition with Canada Post should be allowed

Canada Post's exclusive privilege to deliver the mail should be revoked. New entrants wishing to enter the mail market in Canada should be evaluated and licensed by the government. A postal license should give a company equal access to all areas of traditional letter mail.

In other countries, particularly Sweden and Norway, liberalization has not meant successful large scale competition between new entrants and the national post. New entrants have only emerged after significant government prodding and even then their reach was limited. The Canadian context would likely not be significantly different. Our country's vast geography would make it challenging for a new entrant to cover significant portions of the country.

However, liberalization could provide for the entrance of new companies that specialize in niche market delivery, like magazines. Such direct competition for the magazine business, or the possibility of such competition would do more to alleviate Canada Post's endless rate increases than any of the other measures discussed above.

One of the key steps to adequate competition is access for a new provider to superboxes, community boxes, condominiums and apartments. Only 35 per cent of Canadians receive door-to-door delivery – the rest of Canadians access mail through a community setting of some kind. Without access to these letterboxes, it would be extremely difficult to provide effective competition as most Canadians could not be reached otherwise. Canada Post currently controls all of these distribution nodes.

Given that most Canadian magazines already do all the sorting for Canada Post, it might make sense to have a reduced rate for delivering directly to post offices for distribution. By cutting out a link in the chain and providing competition on part of the process, private enterprise may be able to create a more efficient delivery mechanism.

In the case of expanded liberalization, the third party adjudicator would have to keep a keen eye out for monopoly manipulation on the part of Canada Post. It would be all too easy for Canada Post to manipulate its rates to drive out new entrants only to raise rates once the competition has been eliminated.

Recommendation 4: An independent, third party adjudicator should be created

By taking up its role as shareholder, the government should also create an independent third party adjudicator that can oversee Canada Post. Currently the Government of Canada is acting as both shareholder and regulator. It is providing direction and trying to assure that that direction is being followed. The confusion between the shareholder and regulator functions has merely complicated both roles.

Instead, an independent third party adjudicator appointed by the government should oversee Canada Post. The adjudicator would act as a trustee of the public. It would

assure the Canadian government that its “Postal Contract” is being adhered to in both letter and spirit. The adjudicator would be restricted to reporting only on areas specified in the “Postal Contract” and its role would primarily be one of reporting not of enforcing. However, this new office would require extensive access to Canada Post’s internal financial reporting and personnel in order to report adequately to the government.

The government should receive a yearly report and it should be alerted to any possible violations of its contract sooner if necessary. The adjudicator would also report on formal yearly meetings between Canada Post and industry associations, like Magazines Canada, to assure the government that Canada Post was acting fairly.

The adjudicator should also oversee Canada Post’s monopoly position to make sure it is not abusing that position as specified in the “Postal Contract”. The third party adjudicator must determine if postal rates are “fair.” That is to say that no particular postal category is paying relatively more because competition is lacking in that area.

Cost containment as well as rate expansion should be examined. While rates continue to increase, it is unclear whether Canada Post is adequately examining its own costs as specified in the “Postal Contract”. Insufficient competition would lead Canada Post to simply pass on its costs to magazines. Without adequate competition to keep the letter carrier in check, it can allow costs to balloon while placing the burden on its customers and not itself to try to keep costs in check.

The third party adjudicator would differ from the ombudsman in that it would not deal with customer grievances. Instead, it would report to the government on how well Canada Post is adhering to the “Postal Contract”. This role should be enshrined in the contract.

Recommendation 5: Lettermailtm rates should rise at the rate of actual Canada Post delivery costs

Currently, Canada Post is only allowed to increase its letter mail rates by two-thirds of the consumer price index (CPI). Over half of Canada Post’s revenues come from Lettermailtm and over half of its costs are incurred delivering Lettermailtm. Given that costs will increase in any event and will increase faster than the CPI, Canada Post is placed in an economically non-viable position in the long run as its costs will inevitably outrun its revenues. The solution so far has been for Canada Post to rapidly increase rates in other smaller categories like magazine mailings.

Furthermore, CPI is a poor reflection of the cost increases that a corporation like Canada Post experiences. Whereas the CPI is constructed using price changes in things like food and recreation that consumers use, Canada Post buys different commodities. For instance, both labour and fuel make up significant portions of the costs for Canada Post, but make up a much smaller amount for the regular consumer after which the CPI is modelled.

As such, the cost increases that Canada Post faces are likely much higher than those in the consumer price index. By restricting stamp price increases to two-thirds of CPI while in fact costs are increasing faster than CPI is to create a financial time bomb. There must come a time when increasing costs engulf revenues and force Canada Post to subsidize its Lettermail™ business with its other business lines.

Magazines Canada recommends that the CPC be allowed to increase their Lettermail™ rates by a more representative industrial price index.

Recommendation 6: Rate increases should be more transparent, timely and predictable.

Many Canadian businesses, including Canadian magazines, rely heavily on Canada Post to deliver their products to the homes of Canadians. Currently Canada Post announces its rates at most six months before they come into affect. However, magazines and other business regularly sell subscriptions for up to three years without significant knowledge of how expensive postal rates will be in the future.

Furthermore, rate increases are generally known internally at Canada Post one year in advance. Canada Post is willing to engage in long term planning in other areas like capital investment. Magazines Canada believes the corporation should engage in long term planning for rate growth and make that information available to customers. It has already proposed rates for the next three years in Lettermail™. Magazines Canada encourages Canada Post to expand its transparency to the Publications Mail category.

As well, the formulas for determining rates should be codified. Marginal contribution targets are one way that revenues can be fair and adequately cover Canada Post's costs without unduly burdening particular product lines. Magazines Canada believes that a marginal contribution rate of 25 per cent for Publication Mail is a fair one. It will make sure that postal rates cover Canada Posts direct costs and leave room to pay for its shared costs of postal infrastructure. A marginal contribution rate of 25 per cent for Publications Mail should be part of a new "Postal Contract".

In addition to marginal contribution targets, the third party adjudicator must evaluate whether Canada Post is doing enough to contain its own costs. Magazines, as with

most private businesses, cannot simply pass cost increases on to their clients without repercussion. In the case of Canada Post, postal customers have little choice but to swallow ceaselessly increasing postal rates. They have no other delivery avenue. Canada Post must be encouraged to take a hard look at its own costs. It should not be using its monopoly position to force its customers to cut their costs instead of examining its own.

Rates and costs taken together can be measured by way of “contribution margin.” Basically, it is the difference between the average revenue for all of the publications and the so-called “long-run incremental cost” to handle and deliver another piece of Publications Mail. For instance, the average revenue to CPC for a publication in 2005 was almost \$0.50 while the incremental cost per piece was about \$0.34, so the contribution margin worked out to \$0.16 a piece — or 32 per cent of the revenue.

The margin tripled in four years from 11 per cent (or less than five cents a copy) to 32 per cent in 2005. The margin is needed to pay for the network (shared infrastructure such as trucks and plants) of CPC. CPC executives appear to believe that increasing rates is the only way to increase margins. Magazine industry leaders believe cost containment is also an answer.

Magazines have contributed directly to CPC cost containment over the past decades and have picked up substantial costs along the way. For example, most magazines are fully sorted by the publisher – not by Canada Post as is the case with lettermail. The publishing industry absorbed the costs of sortation years ago and continues to find ways to save Canada Post money. A recent joint cost containment exercise identifies \$15 million in operational savings for CPC due to magazine pre-sorting.

Publishers anticipated less aggressive rate increases as a result of these efforts that have improved the “margin”. They were disappointed. CPC executives now believe the margin should be much greater.

Recommendation 7: Radical changes like Distance Related Pricing should be put on hold until all reviews are complete.

At present, magazines are being buffeted from all sides. Canada Post’s withdrawal from the PAP has accelerated Heritage Canada’s redesign of magazine policy in Canada. That redesign is expected to merge the PAP and the Canadian Magazine Fund into one entity. The Heritage Canada review of its magazine programs is occurring beneath the shadow of a 25 per cent funding shortfall caused by Canada Post’s withdrawal. The implementation of the Heritage magazine review process is not expected until 2010 while Canada Post’s contribution to the PAP will end in April 2009. Thus a funding gap will be opened in the second half of 2009 and 2010. There are no specific plans to date as to how that gap will be filled.

While the Heritage magazine policy review is occurring, the government has also ordered a strategic review of Canada Post. The results of the strategic review have the potential to significantly affect magazines' relationship to the Post. The strategic review board is expected to report at the end of 2008 although it is unclear what action the government will take based on their recommendations.

These two overlapping reviews have the potential to significantly affect the magazine industry. They also have the potential to significantly affect each other as postal rate changes could have a significant impact on PAP effectiveness. On top of the uncertainty that they create, Canada Post has informed the industry that irrespective of the overlapping reviews, it will also introduce distance related pricing (DRP) in January 2009. DRP has the potential to radically change magazine publishing in Canada by driving out national magazines in favour of regional/urban ones.

Canada Post should not be taking advantage of the transition period created by the various reviews to introduce distance related pricing which will unilaterally rewrite Canadian cultural policy. Magazines Canada believes that all Canadians, whether they live in a city or rural environment, should have the same access to Canadian content. As such, the introduction of distance related pricing should be indefinitely delayed.

Canada Post should not be permitted to engage in any more radical departures from the status quo while the overlapping reviews are underway. A formalized "Postal Contract" should be enacted so that Canada Post's responsibilities are well understood and it need not resort to unilateral action to test the limits of those responsibilities.

In the meantime, the review panels and boards should be given time to examine and report on their various mandates without being broadsided by changes unilaterally introduced by Canada Post.

Conclusion

Magazines Canada believes in the partnership formed through Canadian cultural policy between magazine publishers, the federal government, Canada Post and Canadian readers. The partnership has had its difficulties over the past several years. At least, in part, this is due to an inadequately transparent relationship between Canada Post and the federal government. We believe that all parties can gain from a more explicit contract between the two. By more closely aligning the cultural policies of the federal government and those of Canada Post, magazines can continue to flourish in Canada.

Magazines Canada Recommendations

1. There should be a formal postal 'contract' between the federal government and Canada Post which outlines the responsibilities both financial and social that the crown corporation must discharge.
2. The 'contract' should include clear direction to Canada Post that it will provide delivery services for Canadian magazines to all regions of Canada at a reasonable cost.
3. Increased competition should be introduced into magazine delivery in Canada.
4. An independent adjudicator should be created to ensure compliance with the postal contract.
5. Lettermail rates should rise with actual delivery costs.
6. Rate increases should be transparent, timely and predictable.
7. Distance Related Pricing and other radical changes should be put on hold until all reviews have been completed.

About Magazines Canada

Magazines Canada is the national trade association representing Canadian-owned, Canadian content consumer, cultural, specialty, professional and business media magazines. Members account for over 90 per cent of all Canadian magazines circulated in both official languages. Member magazines span a wide range of topics including business, news, politics, sports, arts and culture, leisure, lifestyle, women and youth. The association concentrates on government affairs, services to the advertising trade, circulation marketing and professional development. Visit magazinescanada.ca.

Contact

Mark Jamison
Chief Executive Officer
mjamison@magazinescanada.ca
416.504.0274 x223