

**For discussion
on 27 July 2015**

Legislative Council Panel on Economic Development

Review the Services of the Hongkong Post

Purpose

As requested by the Panel, this paper provides information on the following subjects:

- (a) a consultancy study commissioned by Hongkong Post (HKP) in 2008;
- (b) alleged abuse of HKP's mail compensation mechanism; and
- (c) proposed development of a postcode system in Hong Kong.

(a) Consultancy study commissioned by HKP in 2008

Study scope

2. In July 2008, following an open tender exercise, HKP engaged Hans Kok Business Consult BV (the consultant) to carry out a study at a fee of \$4.12 million with the objective of :

- (a) reviewing HKP in the context of local and international postal and courier service developments; and
- (b) proposing how to ensure the continued achievement of the Government's postal policy objectives of providing reliable, efficient and universal postal services at affordable prices to meet the needs of Hong Kong and its international postal obligations as well as financial viability.

3. The scope of the consultancy covered the following main tasks:

- (a) to assess the present global and local postal market developments and their impact on HKP;
- (b) to review and assess the current institutional, organisational, commercial and operational arrangements of HKP;
- (c) to develop recommendations on necessary changes permissible under the existing institutional and legal framework in the medium term; and
- (d) to propose the way forward for the continual achievement of the postal policy objectives and financial objectives of HKP in the long term.

Details of the scope of the consultancy are at **Annex A**.

4. The consultancy study was steered by a Project Steering Committee (PSC), which was chaired by the Deputy Postmaster General of HKP and comprised representatives from HKP, the Commerce and Economic Development Bureau and Efficiency Unit (EU) as members.

Deliverables and work schedule

5. The consultant was required to submit four deliverables in relation to tasks (a) to (d) as set out in paragraph 3 above respectively, an interim report and a final report in accordance with a specified schedule as set out in **Annex B**.

6. The consultant submitted the first versions of the first and the second deliverables to HKP on 14 August and 22 September 2008 respectively. However, the PSC found the two submissions falling short of the tasks specified in the consultancy brief and not up to the required quality standards (e.g. insufficiently researched, especially with regard to the analysis of the domestic market and the development of the postal sector in Asia, textual inconsistencies, factual errors, and poor proof-reading, etc.), and had provided comments on both deliverables to the consultant. At its meeting with the consultant on 6 October 2008, the PSC advised the consultant to focus on improving the first two deliverables before proceeding with the preparation of the remaining deliverables. This notwithstanding, the consultant submitted the third deliverable on the same day. Following several rounds of written exchanges between the two sides on the first and the second deliverables and meetings, the Consultant submitted version 7 of the first deliverable on 27 February 2009 and version 3 of the second deliverable on 19 December 2008.

Termination of the consultancy agreement

7. After review of these revised versions of the first and the second deliverables, the PSC concluded that the first deliverable (version 7) still did not meet the quality standards required under the contract. On 18 May 2009, Government notified the consultant of the termination of the consultancy pursuant to clause 16.1 of the consultancy agreement¹.

¹ Clause 16.1 of the consultancy agreement provides the following :

“The Government may, without prejudice to its rights and actions against the Consultant, terminate this Agreement forthwith upon giving written notice to the Consultant if:

- (a) the Consultant is in breach of any term or condition of this Agreement which:
 - (i) in the case of a breach of a term or condition capable of being remedied, the Consultant has failed to remedy the same to the satisfaction of the Government within 14 days of receipt of a notice to remedy from the Government; or
 - (ii) is fundamental to this Agreement; ...”

8. In the termination notice, the Government stated among others that despite several rounds of comments from the Government on how the first deliverable should be rectified, version 7 of the document was still unacceptable in a number of important respects, namely there were still inconsistencies and errors in the report, conflicting views and definitions, absence of justifications on quantifiable benefits for the “best practices”, and inability to demonstrate that market liberalization is a global trend. The Government pointed out that the consultant was required under clause 3.1 of the consultancy agreement to complete the consultancy services according to a prescribed time limit and to prepare the deliverables to the satisfaction of the Government under clause 7.1 of the consultancy agreement. As the consultant had failed to comply with the above-mentioned requirements and to remedy the breaches in accordance with the agreement, the Government decided to terminate the agreement.

Settlement of claim

9. On 8 January 2010, the consultant expressed an intention to claim damages from the Government in relation to the terminated agreement and requested the dispute be resolved by arbitration. The two sides eventually reached agreement on the terms of settlement on 14 December 2012, which should remain confidential as required under the settlement agreement.

Further review conducted by HKP

10. HKP has not since then engaged other external consultants to conduct a similar review. Instead, HKP has made continuous in-house efforts to deliver its mission of providing affordable and efficient postal services of a good quality and to improve the longer-term financial sustainability of the Post Office Trading Fund (POTF) through costs management and business development to meet evolving market needs. As a result of these sustained efforts, the operating loss of the POTF was significantly reduced to \$2.6 million in 2013-14 and the POTF achieved an operating profit in 2014-15.

11. Pursuant to the 2015 Budget Speech, HKP is currently reviewing its business operation with the objectives of enabling the department to further support the development of the logistics industry in Hong Kong and expand its service offerings in response to market needs. HKP will continue to build on its capabilities and enhance its service provision to the benefit of customers (in particular, local small and medium enterprises) and the community at large.

(b) Alleged abuse of HKP’s mail compensation mechanism

12. Compensation will be paid to the mailer under specified circumstances (e.g. confirmed loss of specified types of mail² after posting) in

² Such as Local Registered Mail, Local Parcel, Air/Surface Registered Mail, Air/Surface Parcel and Speedpost.

accordance with the service conditions of the relevant postal services. HKP has put in place a set of vetting procedures for processing mail compensation claims to ensure that such claims will only be approved if fully justified and substantiated by supporting documents.

13. Earlier this year, HKP has further enhanced these internal procedures by imposing more stringent documentary requirements (including invoice details) and stepped up cooperation with destination postal administrations in processing compensation claims involving outbound mail items. HKP staff are required to strictly observe the relevant internal procedures and vet compensation claims for the loss of mail items in a fair and impartial manner. An internal review mechanism has also been put in place for the processing of compensation claims to guard against possible abuse of the compensation mechanism.

14. HKP handles about 1.2 billion mail items annually, the great majority of which have been processed in a secure manner. Only a very small proportion (less than 0.001%) of mail items were lost. Also, in over 90% of the compensation cases for outbound mail items, the destination postal administrations or mail conveyancing agents were held liable for the loss hence also the compensation, i.e. the compensation was not paid by HKP.

15. HKP stays vigilant to guard against any abuse of the mail compensation mechanism. If the department comes across any compensation claim which is suspected to involve unlawful acts, it will be referred to the law enforcement agencies for follow-up action. If there is any instance of negligence of duties on the part of staff in the department, HKP will deal with the case in accordance with the established internal procedures.

(c) Proposed development of a postcode system in Hong Kong

16. The main objective of developing a postcode system is to facilitate the sorting and delivery of mail items with a view to enhancing the efficiency of postal operations. Currently in Hong Kong, even in the absence of a postcode system, mail delivery attains a very high performance standard. For example, over 99% of local mail is delivered on the following working day and 99% of inward airmail items is delivered within two working days after arrival in Hong Kong. To a large extent, this is attributable to the mechanisation of the postal sorting process in HKP.

17. The latest generation of mechanised letter sorting machines installed at the Central Mail Centre, equipped with an optical character recognition (OCR) function, is capable of reading printed addresses in English and sorting the mail to individual delivery beats. Upon the completion of the enhancement of the OCR system to read printed addresses in Chinese as well in the 4th quarter of 2016, the proportion of mail that could be sorted mechanically will further increase and the potential benefits of a postcode system for

enhancing postal efficiency will consequentially diminish.

18. We have studied the experience of other postal administrations in developing a postcode system. Typically, postcodes consist of five to seven digits, denoting all buildings covered by mail delivery by district and by street. In a vertical city like Hong Kong and given the efficient mail sorting process described above, merely assigning a postcode to each building would not bring additional benefits. If a unique and structured postcode were to be assigned to each of the three million local residential and commercial addresses, postcodes up to 15 digits may be needed. The alternative of assigning postcodes which comprise up to 8 random digits (including a checksum digit to detect input error) would, however, give no indication of the actual addresses. Neither solution is user-friendly.

19. As it is unlikely that the use of postcodes would appreciably enhance the efficiency of mail delivery in Hong Kong, we do not expect that the postcodes would be widely adopted by the public. In view of the foregoing, we assess that the benefits that could be derived from the introduction of a postcode system in Hong Kong in improving postal efficiency may not be commensurate with the substantial resource investment involved. We therefore do not have any plans to introduce such a system. HKP will keep the situation under review and will reconsider the need for introducing a postcode system should there be any major changes in circumstances.

Advice Sought

20. Members are invited to note this paper.

Hongkong Post
July 2015

**Consultancy Study on Hongkong Post : Scope of Consultancy
(extract from the consultancy brief)**

14.1 In view of the technical and unique nature of the postal services, both the HKP and EU consider it necessary to appoint a Consultant with suitable expertise and experience of the local and global postal businesses to conduct the review and deliver professional and practical recommendations. The scope of the Consultancy mainly covers the following tasks-

- (a) To assess the present global and local postal market developments and their impact on the HKP

The Consultant is required to provide an overview of the current global postal development, including the changing privileges and obligations of postal administrations, as well as the existing and emerging business practices and institutional forms. The Consultant can take reference from previous market studies conducted by HKP, to supplement his own research into the area. The Consultant should note that all information and statistics provided by the Government in connection with the Consultancy are for reference only. The Government gives no warranty, statement or representation, expressed or implied, as to the accuracy, availability, completeness, usefulness or future changes of such information and statistics. The Consultant shall conduct its own independent assessment of the information and statistics. The Government does not accept any liability for the accuracy, completeness or otherwise of such information and statistics.

The Consultant is required to analyse the situation of the domestic market as well. The analysis will not be restricted to multi-national operators on international courier and airmail services, but small local enterprises providing delivery/courier services for documents and parcels with the territory.

Having studied the global and local postal market development, the Consultant is required to review the performance of HKP and assess whether and, where applicable, how such development may impact on HKP's continued ability to achieve the postal policy objectives and its financial objectives in both the medium term (i.e. 3 to 5 years) and long term (i.e. 5 years or more).

- (b) To review and assess the current institutional, organisational, commercial and operational arrangements of the HKP

The Consultant is required to review and assess how the current

global and local postal developments have affected the HKP from managerial, operational, financial and corporate cultural points of view, and the risks inherent in HKP's existing major product portfolio, including local mail, international mail, courier services, retail business, logistics services.

The Consultant is also required to identify the strengths and limitations of HKP's existing institutional arrangement (as a government department governed by Post Office Ordinance (Cap 98) and operating under Trading Funds Ordinance (Cap 430)), as well as its current organisational, commercial and operational arrangements in coping with the challenges from overseas and local competitors, including but not be limited to the following-

- (i) human resources, procurement, funding approval, payment, and setting of postal charges, etc.; and
- (ii) opportunities and constraints on expanding its business having regard to the statutory requirements and obligations.

The Consultant is required to review and assess what impact these factors will have on HKP's sustainability and its future prospects, with reference to its ability of achieving the postal policy objectives and its financial objectives in the medium term (i.e. 3 to 5 years) and long term (i.e. 5 years or more).

- (c) To develop recommendations on necessary changes permissible under the existing institutional and legal framework in the medium term

Taking into account the findings under (a) and (b) above, the Consultant is required to propose, where appropriate, changes that can help ensure the continued achievement of the postal policy objectives and financial objectives of HKP. The changes proposed should include but not be limited to the following areas-

- (i) potential new business endeavours where HKP is capable and has comparative advantages; and
- (ii) organisational, commercial and operational changes which may further enhance HKP's efficiency and responsiveness to changes.

The changes proposed should be permissible under HKP's existing institutional and legal framework. Where relaxation of the existing privileges of statutory monopoly in letter delivery and social responsibilities of providing reliable, efficient and universal postal services at affordable prices of HKP is proposed, the Consultant is required to recommend appropriate alternative arrangements under the existing institutional and legal framework. Moreover, the Consultant is required to demonstrate how its package of changes helps to

achieve the postal policy objectives and financial objectives of HKP and is also beneficial to the public.

- (d) To propose the way forward for the continual achievement of the postal policy objectives and financial objectives of HKP in the long term

The Consultant is required to provide an assessment on whether the package of changes proposed under (c) above is sufficient for ensuring the achievement of the postal policy objectives and the financial objectives of HKP in the long term. The Consultant is required to advise on possible options for more fundamental changes, having regard to the development of postal business and metamorphoses of overseas former government postal services (such as deregulation, opening up of markets, merger and acquisition, corporatisation and privatisation, etc.). The changes referred to in the above sentence may include institutional changes and legal changes. The Consultant shall analyse the strengths and weakness of such arrangements in detail. The proposed changes and recommendations may lead to changes in the Post Office Ordinance (Cap 98), the Trading Funds Ordinance (Cap 430) as well as the legislation regulating the Hong Kong postal market and the performance of the postal services in the long term. However, the Consultant is not required to look into what specific changes shall be made to the legislation and other related laws. The Consultant is not required to make detailed recommendations on legislative changes or to draft the relevant legislative amendments.

For the recommended option, the Consultant is required to provide information including but not be limited to the following-

- (i) how the recommended changes could help the HKP face overseas and local competitions in the long term, and its additional benefits in respect of the tackling of administrative problems, sustainability and business development;
- (ii) what arrangements including institutional and legal arrangements, governance form, controls and other arrangements will be put in place to ensure members of public would continue to enjoy quality postal services at reasonable prices;
- (iii) changes including legal changes that will be introduced to maintain a level playing field for all market operators – for example, having regard to the justifications and feasibility of retaining/enforcing HKP's exclusive privilege in letter mail delivery and other special rights conferred upon HKP as a postal administration vis-a-vis its obligations; and
- (iv) what the challenges of implementing the recommended changes are vis-a-vis maintaining the status quo. The Consultant is

required to elaborate in full the pros and cons of retaining the trading fund mode of operation. If a major institutional change is recommended, the Consultant is required to identify and study HKP's options in deploying civil servants and non-civil servants to conduct business. The Consultant is required to give detailed analysis on possible staff reaction and public responses and how they can be addressed. The Consultant is also required to identify the political risks and possible public reaction and advise on what could be done to address such circumstances.

14.2 The Consultant is required to consult relevant stakeholders to collect their comments and opinions on its assessments under task (b) and the changes proposed under tasks (c) and (d), through focus group discussions and/or questionnaire surveys. The stakeholders will include but not be limited to the trade, the staff of HKP, the general public and such other party as specified by the Government Representative (as defined in paragraph 24 of this Consultancy Brief). The parties to be consulted and the consultation materials and process should be agreed with the Government Representative in advance.

**Consultancy Study on Hongkong Post :
Schedule for Submission of Deliverables
(extract from the consultancy brief)**

16. The Consultant is required to produce and submit the following deliverables (“Deliverables”) to the satisfaction of the Government Representative in accordance with the following work schedule-

<u>Deliverables</u>	<u>Deadline for Submission</u>
(i) the 1 st deliverable in relation to task (a) described in paragraph 14.1*	within four (4) weeks from the date of commencement of the Consultancy
(ii) the 2 nd deliverable in relation to task (b) described in paragraph 14.1*	within eight (8) weeks from the date of commencement of the Consultancy
(iii) the 3 rd deliverable in relation to task (c) described in paragraph 14.1*	within twelve (12) weeks from the commencement of the Consultancy
(iv) an interim report which includes findings, results and recommendations based on (i) to (iii), together with an executive summary	Government’s comments on the 1 st , 2 nd and 3 rd deliverables are expected to be provided in three (3) weeks from the date of receipt of each of the deliverables. The Consultant is required to submit to the satisfaction of the Government the interim report within two (2) weeks from the date of receipt of Government’s comments on the 3 rd deliverable.
(v) the 4 th deliverable in relation to task (d) described in paragraph 14.1*	within eighteen (18) weeks from the commencement of the Consultancy
(vi) a final report which includes findings, results and recommendations based on (i) to (v) above, together with an executive summary	Government’s comments on the 4 th deliverable are expected to be provided in three (3) weeks from the date of receipt of the 4 th deliverable. The Consultant is required to submit to the satisfaction of the Government the final report within two (2) weeks from the date of receipt of Government's comments on the 4 th deliverable.

* Please refer to Annex A for an extract of paragraph 14.1 of the consultancy brief.