



Royal Mail's response to Ofcom's *"Review of postal users' needs"*

December 2012

Summary

Ofcom's User Needs report is produced by the regulator under its statutory duty in order to understand the reasonable needs of postal users. Royal Mail notes the research Ofcom has undertaken. While Ofcom put forward a number of hypothetical changes to the universal service, to solicit stakeholder opinions, it makes no proposals for changes to the current service itself.

We are pleased that the central conclusion is that Royal Mail is satisfying users' needs under the current universal service definition - with 9 out of 10 users happy with the current service provided.

Ofcom's research indicates that there is currently no need for fundamental change to the universal service. Despite the changes in the communications landscape, post remains important for personal communications and business communications, and continues to connect communities and businesses across the country. The postal service is playing a vital role in the development of e-commerce in the UK and the number of parcels handled by Royal Mail is growing at a significant rate. The research identified that one of the core user requirements is a range of services, enabling them to choose the most appropriate product or service for their needs. Customers have the right to choice, and the evidence shows they welcome this aspect of the universal service provided by Royal Mail.

In particular, the First Class next day postage service is the benchmark product for Royal Mail and for our customers. Ofcom's research finds that consumers value an affordable next day delivery service, along with the ability to choose the right product for their specific requirements. We believe First Class is that affordable next day service and this reinforces the case for making no change in this area.

We also believe the six day a week service should remain unchanged. As the volumes of parcels increases, a six day a week collection and delivery service will become even more important to our customers to provide them with the delivery flexibility they require. The Ofcom research showed more people are in on a Saturday and value the option of a collection and delivery on this day.

The minimum requirements of the universal postal service are contained in the Postal Services Act, including for example the need for six day a week delivery, and are a matter for Government and Parliament. The Government has made clear there are no plans to alter the minimum requirements of the universal postal service in this Parliament.

Royal Mail believes that no major changes should be proposed to the scope of the universal service in the UK. Royal Mail is the designated provider of the universal postal service, committed to providing the high quality USO that the Government has set down. We are honoured to provide the universal service and have the strategic aim to become the best delivery company in the UK.

The universal service should remain customer focused and evolve with changing needs

Successive research carried out by Ofcom, Postcomm and Royal Mail has shown that customers' needs are met by the current universal service provision. We believe that choice and simplicity are important factors to ensure that this remains the case and indeed Ofcom's research supports this view. To ensure any changes are right for our customers, before introducing them, we undertake consumer research and/or trials and public consultation.

A recent major change in relation to delivery flexibility for parcels was the introduction of Delivery to Neighbour which has been received positively by our customers. We have also just commenced a consultation on a major refresh of our consumer parcels portfolio, to make our services simpler and easier to understand, responding to customer feedback and changing market conditions.

We are creating a customer-focused company, committed to delivering high quality of service

We believe it is important to review and assess the ways in which we interact with our customers putting them at the centre of every transaction. Our strategy is to create a more customer-focused company, run on commercial terms, committed to delivering high quality of service standards and maintaining the universal service for all of our customers who need it.

Royal Mail has one of the highest regulated Quality of Service (QoS) targets of any major European country. Our current First Class QoS target is 93%; this means that for the c1.6 billion First Class USO items that were posted in 2011/12 more than 9 out of every 10 were delivered to the next day service specification. Potential hypothetical changes discussed by Ofcom would have the impact of reducing provision of the USO, for example: removing the use of airplanes in the transportation of mail would mean parts of the country no longer have access to a next day service.

We believe it is critical to provide our customers with products and services that they value and provide for their posting needs. UK stamp prices remain amongst the best value in the EU. In five of the six weight steps for First Class and Second Class mail, the cost of UK stamps are ranked in the bottom half of prices when compared with other European countries. In both the 21g to 50g and 51g to 100g weight band, the 50p price of a Second Class stamp is the lowest in Europe.

Retaining choice for customers is essential to keep mail relevant in an electronic world

With the increase in alternative communication methods, such as mobile phones, text, email and social messaging, choice is a major factor in keeping post relevant. Ofcom's research has shown that customers want choice in speed of service, product range and delivery flexibility, whilst continuing to benefit from a high quality of service. Choice within postal services is also vitally important for those groups in society – usually older, lower income and rural users – who still rely on post for a large proportion of their communication needs. Certain of the hypothetical changes considered by Ofcom would result in reduced choice for customers – for example, collapsing First Class and Second

Class postage to a single two-day service would remove access to a low cost next day delivery service that customers clearly value.

Our transformation programme will ensure our network can deliver the universal service our customers need

Royal Mail is implementing a major transformation programme, which is driving real improvements in cost efficiency and optimising the network. This is one of the largest operational transformation programmes of its kind in the UK; it is improving almost every aspect of our operation: collections, processing, sorting and delivery. The successful completion of this transformation programme is vital to ensure we can continue to deliver a high quality, sustainable and efficient universal service for customers into the future. Any major change to the universal service, which imposed further major structural change, would disrupt this programme. The transformation programme is a core element of the overall changes within Royal Mail to ensure the company can provide the universal service on a financially sustainable basis, and is able to earn a commercial rate of return. Furthermore, any potential cost savings that have been identified, through this review, are theoretical and desk-top and do not take into account the feasibility considerations that would need to be addressed. These considerations were highlighted by Royal Mail in the Section 55 information provision responses we provided to Ofcom.

The revenue impact of any change to the universal service needs to be fully thought through before recommendations for changing the USO are made

Royal Mail's finances have only recently begun to strengthen and return to profit. It is important that Royal Mail is allowed to deliver the universal service on a commercially sustainable basis. Ofcom's research represents only a partial evidence base, given it does not assess the revenue impact of change. It can not be taken as a complete platform of evidence, as any potential cost saving - which based on work to date are purely hypothetical and desk based analysis - *could* be more than offset by revenue impacts. As Ofcom states, any consideration of major change would require further research, analysis and consultation. We agree and therefore do not believe the findings of this research can be used to justify any major change to the universal service at this time.

In summary,

- The universal service should remain customer focused and evolve with changing needs
- We are creating a customer-focused company, committed to delivering high quality of service
- Retaining choice for customers is essential to keep mail relevant in an electronic world
- Our transformation programme will ensure our network can deliver the universal service our customers need
- The revenue impact of any change to the universal service needs to be fully thought through before recommendations for changing the USO are made

The remainder of this response expands on these themes.

The universal service should remain customer focused and evolve with changing needs

Royal Mail undertakes a number of surveys that look at customer satisfaction and brand. Some of the findings within these surveys are interesting to consider within the context of Ofcom's review of users' needs.

The first quarter 2012 results (Royal Mail Consumer CSI and Brand Tracker Q1 2012) show that: two thirds of people could not imagine life without Royal Mail; this was one of the highest figures in the survey, higher than most other well known brands. In the same research, when asked if Royal Mail is an important part of the UK's economy, more than two thirds (7 out of 10) of people agree it is. The same number consider it an important part of their local community. This shows the degree to which individuals value Royal Mail and the current services we provide.

Furthermore, when we looked at customer satisfaction we found that 74% of customers are satisfied with Royal Mail and state that it is their preferred and most trusted delivery company by a wide margin: c50% compared to c6% for next best operator.

We are pleased that Ofcom's research supports our findings, with its central conclusion that the current service satisfies users' core needs - 9 out of 10 users were happy with the current service. These findings strengthen past research undertaken by Postcomm (the previous postal regulator), which showed that 8 out of 10 customers were satisfied with the current service.

Although our surveys and Ofcom's research show positive results we are very aware of the need to continue to provide products and services within the universal service that users need and want. With this in mind we have been reviewing and modifying the current universal service offering to reflect what our customers are telling us they need. Before introducing changes to the USO we undertake consumer research and/or trials and public consultation.

Some recent examples are described below:

Flexible delivery options

We are working to improve delivery options, as we recognise that delivery flexibility is important for our customers, particularly as parcels continue to increase as a proportion of the mail mix.

Since October 2012, if we can not secure a first time delivery we will seek to leave the parcel with a neighbour, unless the recipient has chosen to opt out of our Delivery to Neighbour scheme. This initiative makes it easier for people who are out and about when the post arrives to receive parcels that are too large to go through the letterbox or require a signature. Royal Mail wrote to all 29 million addresses across the UK in August providing information about the new delivery initiative.

Feedback from households in the trial areas revealed that 92% of customers whose parcel was left with a neighbour were satisfied with the overall experience. 90% of neighbours who accepted an item expressed overall satisfaction. When questioned about their reasons for satisfaction, convenience and ease were top of the list.

Research by Consumer Focus also found that delivery convenience was improved for people whose undeliverable parcels were left with a neighbour as part of the trial. Its report, [*Everybody Needs Good Neighbours*](#), said: *“Both recipients and neighbours reported that items were collected quickly and conveniently, with no reports of loss or damage. Almost all consumers whose post was left with a neighbour, or who received post on behalf of their neighbours, believed they had benefitted from the delivery to neighbour trial.”*

If it has not been possible to deliver the parcel we provide a “Something for you” card, to explain that delivery was attempted and the item will be returned to the local Royal Mail Delivery Office. Customers then have a range of options, they can either:

- collect their parcel from their local Delivery Office;
- arrange by telephone a redelivery to their address on a more convenient day;
- request a re-delivery of the parcel to another local address, provided the alternative address is within the delivery area of the local delivery office, or
- request their item is forwarded to a local Post Office branch as part of the Local Collect service.

To further improve this service we have recently, enabled redelivery arrangements to be done online, and standardised the time parcels are held at delivery offices for collection to 18 days.

Simplicity and a range of products

Parcels are becoming an increasingly important part of the mail mix, as demonstrated by Ofcom’s research. Ofcom’s International Communications Report (2012) found that more consumers in the UK claim to receive large parcels than in the other countries surveyed. 34% of UK consumers claimed to have received a large parcel in the past month, higher than in any other country surveyed. 46% of UK consumers claimed to have received a small parcel, second only to France (53%). As well as having the highest proportion of consumers receiving parcels, the value of e-commerce per head of population in 2011 in the UK was higher than in any of the other countries surveyed.

Ofcom’s User Needs research found 57% of users envisage that they will always need post for parcels. Consumer research shows that our customers are looking for simplicity, clarity, product range and predictability when using our products and services.

Our current product range does not always fulfil these requirements. Currently, there are up to 15 weight bands for parcels and 23 different price points. In addition, our First Class service has a 20kg weight limit but our Second Class service is only available up to 1kg. Furthermore, while customers can gain a signature on delivery for First and Second Class services they can not do so with our Standard Parcels product.

As such, Royal Mail has been reviewing its USO parcels portfolio to create a clearer product set that better reflects users' needs. After having undertaken consumer research, we have recently announced plans to make a number of changes to our products so that they are clearer and simpler to understand. We will create a better structured and consistent product set that allows customers to make clearer choices about the services they need for their items.

Royal Mail's proposal includes the introduction of two broad parcel categories – small parcels and medium parcels. This will bring Royal Mail in line with other major postal operators, for example, in Germany, France and Italy. Parcels are priced by weight but the size of a parcel has an impact on the cost of collecting, transporting, sorting and delivering an item.

We have recently gone out to public consultation¹ on our proposals to simplify the USO parcels portfolio. We propose to make these changes from April 2013.

Transparency and clarity

Another key finding of Ofcom's research was the need for simplicity. In October this year we published a consultation to create a new domestic Postal Scheme. The Schemes are the Terms & Conditions for our USO products but they had not been reviewed for a number of years and lacked clarity and transparency. We undertook a complete rewrite to put the Scheme into plain English and provide a much more transparent and customer oriented document that clearly sets out all aspects of using the postal service and the T&Cs associated with doing so. We received positive feedback from both Ofcom and Consumer Focus. After only two consultation responses – both of which were positive about the changes – we have notified and published the new Scheme.

We are soon to consult on the Overseas Scheme, having undertaken the same process of producing a much more customer friendly document².

Christmas stamps initiative

In order to secure the future of the universal service we had to undertake some price rebalancing in April this year. Whilst the average spend on post remains low at 50p per week, we understand how important post is as a communication method for some of our customers, especially around Christmas time. In order to mitigate these necessary price increases, in March Royal Mail announced it would offer eligible low income individuals the opportunity to buy stamps for Christmas 2012 at 2011 prices. The initiative is targeted at customers on certain benefits – Pension Credit, Employment and Support Allowance or Incapacity Benefit. The initiative is running from 6 November until Christmas Eve and enables eligible customers to purchase a total of up to 36 First and Second Class stamps at last year's prices – 46p for First Class and 36p for Second Class.

¹ 7th December 2012 – Proposal to amend the Inland Letter Postal Scheme in relation to Universal Service packets and parcels, and compensation levels for loss and damage

² Due to consult on Friday 21st December 2012

The stamps can be purchased in any mixture of First and Second Class. The scheme is administered at all of the c11,500 Post Office® branches across the UK.

We are creating a customer-focused company, committed to delivering high quality of service

Our strategy is to create a more customer-focused company, run on commercial terms, committed to delivering high quality of service standards and maintaining the universal service for all of our customers across the UK. We will not be able to achieve this if Ofcom imposes additional major changes to our network through fundamentally changing the universal service obligation at this time. Our business centres around delivering a very high quality of service.

As discussed we believe it is critical to provide our customers with products and services that they value and provide for their posting needs. The UK's Universal Service is among the highest quality in Europe, including Royal Mail's next day target for First Class mail.

We believe it is important to review and assess the ways in which we interact with our customers putting them at the centre of every transaction. We have listened to our customers and are investing in training and resourcing in our UK-based call centres. This includes implementing a post call survey – results from October this year, showed that 81% of customers were satisfied with the overall call experience and 87% agreed that their issue had been resolved or appropriate information provided.

Customer feedback has resulted in us improving our website. We are making it easier to navigate so helping customers find what they need quickly and easily. Making sure the language we use is clear, simple and informative. Enhancing the search functionality to ensure it is more efficient for our customers to use. These changes will make it easier for our customers to access information about the products and services they need.

Keeping our customers informed is another area that we know is important. We undertake door-drops (providing relevant information to each household) where we think it will benefit our customers, some recent examples being Delivery to Neighbour; the local impact of the Olympics on our operations; and our Christmas stamps initiative for low income customers.

Retaining choice for customers is essential to keep mail relevant in an electronic world

Government introduced a new Postal Services Act in 2011 (PSA 2011), which reiterated the continued need for a postal universal service in the UK. At the time of the passage of the bill, the Secretary of State stated that: *"The Bill will maintain the universal postal service at its current levels-that means six-days-a-week delivery and collection at uniform, affordable prices. I would like to reassure the House that I have no intention of*

downgrading this service. ... I have therefore ensured that the Bill contains new and stronger protections around the service than is currently the case.”³

The postal service is playing a vital role in the development of e-commerce in the UK and the number of parcels handled by Royal Mail is growing at a significant rate. Under the universal service obligation, Royal Mail is set standards of service targets for parcels delivery. No other UK parcels service provider is required to meet regulated quality standards.

With the increase in alternative communication methods, such as mobile phones, text, email and social messaging, choice is a major factor in keeping post relevant. Choice within postal services is also vitally important for those groups in society, usually older, lower income and rural users who still rely on post for a large proportion of their communication needs. Currently a quarter of the UK population does not have access to broadband, with three quarters of adults 75 years and over without home internet access⁴. c900k homes and SMEs in the UK do not have full coverage from all four mobile phone networks for voice calls, c300k have no signal at all. Over a third of adults 75 years and over, do not have access to a mobile phone.

Certain of the hypothetical changes considered by Ofcom would result in reduced choice for customers, in particular:

Dropping a day collection and delivery

We believe that as the volumes of parcels increases, a six day a week collection and delivery service will become more important to our customers to provide them with the delivery flexibility they require, as the research showed more people are in on a Saturday and value the option of a collection and delivery on this day.

From Royal Mail’s perspective Saturday is a very important delivery day – for the same reason it is important to our customers – we are more likely to achieve successful deliveries on parcels and so provide our customers with the services they need.

The number of collection and delivery days is a requirement of the PSA 2011. As noted by Ofcom, to implement this change would necessitate a change to the PSA, which the Government has indicated it has no intention to change at present.

Users were concerned by a reduction on delivery days. In particular, there were concerns that “full time workers” would be impacted by the withdrawal of Saturday deliveries as, for many, Saturday is the most convenient day to use postal services and receive deliveries. Furthermore, small businesses were concerned about sending goods and services to their customers without a Royal Mail Saturday delivery, as they considered that in order to meet their customer needs they would have to use a courier, thereby increasing their overall costs.

³ Vince Cable, Postal Services Bill Second Reading (27 October 2010)

⁴ Ofcom’s Communications Market Report 2012

Indeed, reducing the number of collection and delivery days resulted in the highest dis-benefit of all the features of the USO tested for residential users.

Although the requirement for parcels is only five days because we deliver letters on a Saturday we also deliver parcels on that day. Users stated that they needed parcels to be delivered on a Saturday. This is true for all groups, including those customers that most rely on postal services – older groups, those in deep rural areas and disabled customers.

The next day service

The First Class next day postage service is the benchmark product for Royal Mail and for our customers. Ofcom's research finds that consumers value an affordable next day delivery service, along with the ability to choose the right product for their specific requirements. Other carriers charge significantly more for next day delivery and so removal of First Class postage would seriously impact customer choice. We believe this reinforces the case for making no change to the First Class and Second Class post products.

From its general research undertaken, Ofcom deduced that the benefit of “speed of service” was diminishing over time. Royal Mail notes that this lacked conjoint analysis and believes that the evidence in this case is not conclusive as mixed results were found. Residential customers are more likely to use First Class and most give speed as a reason for using this service. 2/3 of business customers also use First Class – again citing speed of delivery as the reason to choose this service.

Many other carriers offer next day delivery but at a very significant premium to the cost of First Class postage. The finding that if there were no First Class service users would still need an affordable next day service for what Ofcom's research characterises as “crisis mail” further supports the fact that the evidence in this area is not conclusive and certainly should not be taken as an indicator of potential change.

If users need a First Class service for “crisis mail” then Royal Mail would have to keep the network capability to provide for next day delivery, this would mean that the cost of maintaining the network would also be retained. It is unlikely that running a next day network for a small amount of “crisis mail” would result in affordable prices. Conversely, if the volumes were high then this would be no different to the current First Class service.

It is important to note that Special Delivery relies on the First Class network and so removal of next day delivery would remove our ability to provide our guaranteed service to all parts of the UK.

Users have stated that they need an affordable service, with choice – the current two tier service meets this need.

Predictable services – quality of service

Royal Mail has some of the highest Quality of Service (QoS) targets in Europe. Our current First Class QoS target is 93%; this means that for the c1.6 billion First Class USO

items that were posted in 2011/12 more than 9 out of every 10 were delivered to the next day service specification.

The high quality levels we meet give customers one of their key needs of predictability. This would be undermined if the hypothetical changes to QoS levels explored by Ofcom were implemented.

Due to the configuration of our network, a significant lowering of quality levels would reduce predictability in the service. Under the hypothetical scenario Ofcom put forward – removing Royal Mail’s use of inland flights to transport mail – our service delivery would not be consistent across the nation. Some areas would receive less than 70% next day service performance. Other areas, representing 3.5% of total mail, would see levels below 50%. Furthermore because Special Delivery depends on the First Class air network, the capability to guarantee Next Day delivery across the network would be removed. As a result, the achievable Special Delivery Next Day coverage would be 5% lower than currently and the international mail service specification would be 9% lower on import, 6% lower on export. In order to provide national next day coverage, it would be necessary to reintroduce some of the removed flights, in particular linking Belfast and Scotland and reduce potential cost savings.

Our transformation programme will ensure our network can deliver the universal service our customers need

The programme of transformation Royal Mail is undertaking, which is one of the largest of its kind in the UK, is modernising and improving almost every aspect of its operation: collections, processing, sorting and delivery. It is difficult and stretching but absolutely necessary if we are to give customers the services they need and to adapt the provision of the universal service to a changing communications market. Our modernisation programme is very challenging – its size and scale and the speed with which we are undertaking it mean that we do not have the capacity to introduce any further major structural change to the network in the short-medium term.

A key part of Royal Mail’s modernisation programme is the need to adapt our network – which has been configured around letters – to one that can handle ever increasing numbers of parcels, and so provide our customers with the services they require.

The traditional letter market is in structural decline. Ofcom’s and other research have shown that electronic communication, such as email, telephone or text is substituting for letters. Ofcom has found residential customers are now sending on average only 1.5 items per week compared with 3.5 in 2006⁵, additionally 45% of businesses spend under £10 per month on post. Royal Mail saw letter volumes decline by 9% in the 12 months to 23 September 2012⁵ – driven by e-substitution and the weaker economy.

⁵ Ofcom’s user needs consultation page 2

Conversely, parcel volumes have increased, driven by the trend towards ordering more goods on-line. Royal Mail saw parcel volumes increase by 5.6% in the 12 months to 23 September 2012. Parcels revenues now accounts for 37% of UKPIL's overall revenue.

We believe the changes that we are making through the modernisation of our network, including enabling our delivery offices with the equipment and route structure to optimise parcels delivery, will deliver a postal service that continues to meet customers' needs in the future and reflect the changing structure of the mails market.

The revenue impact of any change to the universal service must be fully thought through before recommendations for changing the USO are made

Ofcom acknowledges that Royal Mail's finances have been fragile over a number of years and have only recently seen improvement. As seen in our recently published half year results, the Group's financial position has strengthen in the first half of 2012/13, with each of our main businesses now seeing a profit.

Ofcom also notes the ongoing challenges that the business faces, especially in respect of continued e-substitution and increased competition both in the form of access and end-to-end competition. While Ofcom undertook a cost versus benefit analysis of changing certain aspects of the USO, it did not consider the revenue implications of these changes and how much this would offset any cost savings. To consider changes of the magnitude of the hypothetical changes considered by Ofcom, implications for revenue need to be part of the analysis. Ofcom's research does not look at revenue impact and is, therefore, not a complete platform of evidence and can not be used to justify any major change.

In order to illustrate this point, Royal Mail has undertaken a desk-top review of the revenue impacts of one of the biggest changes considered by Ofcom: replacing the first and second class service with a single-tier, two-day service.

Ofcom assessed this hypothetical scenario as a potentially high cost saving – that is £150m+ using their ranges from desk-top analysis.

In 2011/12 First Class USO revenue was c£1.3bn, with Second Class accounting for c£0.9bn. The amount customers use the First Class USO services shows how much they value it. If First and Second Class was replaced with a single tier service a proportion of the 1st Class revenue would be at risk to e-substitution.

If we model, on a high-level desk-top basis, removing First Class the revenue loss would be high, that is greater than £150m. This is assuming all stamp, meter and PPI mail would switch from First Class to Second Class. In reality, it is likely that a percentage of current first class mail would be lost to e-substitution, so having an even greater revenue impact. In this case it is likely that the price of Second Class would need to rise. The research has shown that there is ongoing need for an "emergency" next day service. Royal Mail would have to keep the network capacity to provide for next day delivery. The Postal Service Directive states that USO products have to be affordable and so if "crisis

mail” volumes were small these network costs would have to be attributed to other USO products.

Ofcom stated in its March decision document that the Second Class service was the backstop service for vulnerable groups. Having only a single tier service would have an impact on vulnerable users. As discussed they would have less choice. They would also see higher prices. The current Second Class service is a 3 day service, whereas Ofcom’s hypothetical scenario is for a 2 day service. This would result in higher costs than the current service, which would have to be reflected in the pricing.

In conclusion – now is not the time for change

Royal Mail believes that no major changes should be proposed to the scope of the universal service in the UK, at this point. We are committed to providing the high quality USO that the Government has set down and which Ofcom’s research as shown, our customers value. We believe the service we provide and the changes we are implementing, as part of our transformation, are essential to continue to meet the needs of users, in sending and receiving both letters and, as shown by the research, increasingly important parcels.

Ofcom’s research has shown that users’ needs are met by the current universal service provision – 9 out of 10 people are happy with the current service - with a range of services, choice, predictability and delivery flexibility being seen as key requirements for the USO.

The research indicates that there is currently no need for fundamental change to the universal service and certainly not to downgrade the service. Furthermore, before any change was considered the full revenue impacts of any proposed changes must be assessed.