

Review of the Projected Costs within Royal Mail's Business Plan

NON-CONFIDENTIAL VERSION

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Bad Honnef, 31 March 2016

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List of abbreviations

AR	Annual Report
BP	Business Plan
CAGR	Compound Annual Growth Rate
CEP	Central Efficiency Programme
CLA	Collective labour agreement
CMA	Communications Managers' Association
CPI	Consumer Price Index
CWU	Communication Workers Union
DO	Delivery office
EBIT	Earnings Before Interest and Taxes
Fcst	Forecast
FY	Financial Year
FYE	Financial Year Ends
GBP	Great Britain Pound (£)
GLS	General Logistics Systems
IR	Industrial Relations
MC	Mail Centre
MPU	Mail Processing Unit
ONS	Office of National Statistics
OPEX	Operating expenses
OPM	Operations Planning Model
P&RL	Processing & Regional Logistics
PDA	Personal Digital Assistant
PFW	Parcelforce Worldwide
POL	Post Office Ltd.
PPP	Purchasing Power Parity
RB	Reported Business
RDC	Regional Distribution Centre
RFS	Regulatory Financial Statements
RM	Royal Mail
RPI	Retail Price Index
RPIJ	Retail Price Index based on the Jevons (geometric) formula
T&T	Tracking & Tracing
UKPIL	UK Parcels, International & Letters
UPU	Universal Postal Union
USPS	United States Postal Service
VR	Voluntary Redundancy

Executive Summary

KEY FINDINGS

- WIK has reviewed Royal Mail's 2015 Business Plan and assessed the underlying efficiency initiatives and expected cost savings. The plans were compared to Royal Mail's past performance and the past performance of comparable postal operators. WIK has assessed whether Royal Mail's 2015 plans appear more or less ambitious than these benchmarks.
- In summary, WIK has found that:
 - Royal Mail's transformation programme and underlying efficiency initiatives are similar in design to those implemented by its international peers. They all include common features such as mail centre rationalisation, automation, and optimisation of logistics and delivery.
 - Royal Mail has been successful in reducing costs in some areas, including the management reorganisation programme and savings in non-staff costs. However, Royal Mail's performance in improving efficiency and reducing costs in frontline operations has been less successful than its peers. In addition, its future efficiency plans are also less ambitious than its peers, particularly in relation to delivery, which accounts for a large proportion of its total costs.
 - Most of Royal Mail's international peers have implemented strategies to increase the flexibility of their workforce to allow them to respond to volume fluctuations. This has enabled these operators to reduce staff costs faster and react more flexibly to changing demand. Royal Mail has not yet achieved the same level of workforce flexibility.
 - Royal Mail's poorer relative cost saving performance compared to its international peers is considered partly as a result of its decision to re-invest much of its efficiency driven savings in its workforce through higher pay awards.

OFCOM REVIEWS ROYAL MAIL'S EFFICIENCY

Ofcom has a duty under the Postal Services Act 2011 to carry out its functions in a way that it considers will secure the provision of a universal postal service. In discharging this duty, the Act requires Ofcom to have regard to the need for the provision of a universal postal service:

- to be financially sustainable, including the need for a reasonable commercial rate of return on the provision of the universal service; and
- to become efficient within a reasonable period, and then remain so.

In its Review of End-to-End Competition in the Postal Sector¹ Ofcom recognised a degree of uncertainty about Royal Mail's future financial position, particularly in the later years of the analysis it undertook. However, from the regulator's point of view this uncertainty was likely to be due to other factors than end-to-end competition, such as competitive developments in the parcels market and Royal Mail's progress on improving its efficiency. Ofcom therefore broadened its review to take account of these factors. As part of this work, Ofcom is reviewing the extent to which Royal Mail's 2015 Business Plan, and its underlying cost base, provide an opportunity for Royal Mail to achieve a reasonable rate of efficiency improvement while continuing to meet its existing universal service obligations.

WIK-CONSULT SUPPORTS OFCOM BY REVIEWING THE PROJECTED COSTS WITHIN ROYAL MAIL'S 2015 BUSINESS PLAN

In April 2015, Ofcom assigned WIK-Consult to review the projected costs within Royal Mail's 2015 Business Plan. WIK was specifically requested to:

- understand the extent of Royal Mail's costs and cost reduction plans,
- compare Royal Mail's cost reduction plans against international postal operators,
- assess the reasonableness of Royal Mail's cost reduction plans, and
- identify potential further efficiency improvements for Royal Mail to consider.

¹ Ofcom (2014), End-to-end competition in the postal sector, Final guidance on Ofcom's approach to assessing the impact on the universal postal service (<http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>).

The review of the projected costs within Royal Mail's 2015 Business Plan is based on two major sources of information:

- Extensive material on the 2015 Business Plan and previous business plans (since 2011), supplemented by meetings with Royal Mail, and visits to some Royal Mail sites.
- Detailed information on six international comparator postal operators with regard to their financial performance, mail operations and efficiency programmes based on desk research as well as site visits and interviews conducted with operational experts in 2015.

We compared Royal Mail's progress in cost savings and efficiency to six international peers: Deutsche Post (Germany), La Poste (France), PostNL (Netherlands), PostNord (Denmark and Sweden), and USPS (United States).

ROYAL MAIL'S CORE OPERATIONS ARE LESS AUTOMATED THAN OPERATIONS AT INTERNATIONAL PEERS

Royal Mail and its international peers face the same principal challenge: an ongoing decline in letter volume and the growing competitiveness of the parcel markets. All the postal operators that were considered offer nationwide postal services and are subject to universal service requirements. Their letter operations basically have the same structure and use similar technologies (albeit at different stages of development). The services they offer are comparable: they all collect, transport, and deliver letters and parcels. For these reasons, a benchmark exercise on mail operations and related efficiency programmes provides useful insights into the relative position of Royal Mail's current and projected efficiency in mail operations and on the reasonableness of Royal Mail's projected cost savings.

This assessment is focussed on the Reported Business. The Reported Business, as defined by Ofcom in 2012², forms a major part of Royal Mail's business division UKPIL in terms of revenues and costs. The Reported Business accounts for nearly 95% of UKPIL's total costs and nearly 80% of the costs of the Relevant Group (Royal Mail plc).³ It reflects costs allocated to Royal Mail's core universal service network i.e. excluding GLS, Parcelforce Worldwide and Royal Mail Estate Ltd. Around two thirds of the Reported Business' costs are staff costs⁴ of which [3<] originate from its core

2 See Ofcom's March 2012 statement, *Securing the Universal Postal Service - Decision on the new regulatory framework*, 27 March 2012, <http://stakeholders.ofcom.org.uk/consultations/review-of-regulatory-conditions/statement/> .

3 See page 9 of Royal Mail's regulatory financial statement, 2014-15, http://www.royalmailgroup.com/sites/default/files/Regulatory%20financial%20statements%202014-15%20-%202011.12.15_0.pdf.

4 See page 9 of Royal Mail's regulatory financial statement, 2014-15, http://www.royalmailgroup.com/sites/default/files/Regulatory%20financial%20statements%202014-15%20-%202011.12.15_0.pdf.

function Operations. [X] of Operations' staff costs stems from delivery frontline staff which is therefore the most important cost element in the Reported Business' total costs.

Comparing Royal Mail's current mail operations to its international peers, we identified the following major differences:

- There is less automated sorting, and more manual sorting/sequencing of letters in Royal Mail's delivery offices at the final sort stage.
 - For letters, Royal Mail has not yet attained the level of walk sequencing of letters by machine that some other operators have achieved (Royal Mail has achieved 82%⁵ whereas other operators are at 90% and more).
 - Large letters at Royal Mail, unlike at its international peers, are mostly sorted to delivery office level only rather than to individual walks (i.e. walk sorted) at Royal Mail's mail centres.
 - Parcels are still sorted manually in Royal Mail's core network while all international peers have implemented automated parcel sorters that are usually located in separate parcel sorting facilities.
- In logistics, Royal Mail has not franchised road transport on a regular basis despite this being common practice at most other postal operators.
- In delivery, Royal Mail has made relatively little progress in minimising indoor activities in delivery offices. Postmen/women of international peers spend at least 80% of their working time outdoors while Royal Mail's postmen/women spend about 60% of their working time outdoors. Moreover, international peers have managed to implement more flexible working time arrangements and significant changes in delivery work organisation.

ROYAL MAIL STARTED ITS TRANSFORMATION PROGRAMME LATER THAN ITS PEERS AND HAS NOT YET ACCOMPLISHED ALL ELEMENTS OF THE PROGRAMME

Royal Mail started its transformation programme in 2008, more than a decade later than some of its international peers. The start of the programme coincided with the beginning of accelerated decline in letter volume on the one hand, and the start of the dynamic growth in parcel demand driven by e-commerce on the other hand. For this reason, Royal Mail had (and continues to have) to implement a number of different measures at the same time. Most other postal operators started their transformation programmes

⁵ See Royal Mail plc, Annual Report and Financial Statements 2014-15, p.10, http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf.

much earlier and usually in an environment of growing letter volumes and less competitive pressure, and thus had the time to modernise the postal pipeline and increase efficiency and cost flexibility at a more gradual pace.

Unions are an important factor in the transformation process at all postal operators. Royal Mail's peers engaged intensely in developing cooperative relationships with employees and unions many years ago and this has arguably assisted the transformation process particularly in delivery. In addition, operators who began the transformation process earlier while letter volumes were still growing may have had more options available to them in negotiations with their unions (e.g. the introduction of a two-tier wage schedule). They were able to continue modernisation without compulsory redundancies and to protect vested rights for the existing workforce. By contrast, Royal Mail today faces more challenging competitive and market conditions, namely declining letter volumes, growing parcel competition and the need to invest and innovate in parcel delivery.

ROYAL MAIL PLANS TO REDUCE THE REPORTED BUSINESS' TOTAL COSTS BY [X] IN THREE YEARS

Table 1 Cumulated cost savings of Royal Mail's Reported Business excluding transformation costs (FYE 2016 to FYE 2018)

	Total	Staff cost	Non-staff cost
Total costs (Outturn FYE 2015)	[X]	[X]	[X]
Projected cost savings	[X]	[X]	[X]
% of cost	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X] ⁶	[X]	[X]	[X]
[X]	[X]	[X]	[X]

Source: Royal Mail, Reported Business Cost Matrix, total costs excluding transformation costs.

Note: Cost savings are related to Royal Mail's forecasted total costs FYE 2015. These figures are taken unadjusted from Royal Mail's Business Plan. Totals may deviate due to rounding.
Cost savings are related to Royal Mail's forecasted total costs FYE 2015.
[X]

Between FYE 2015 (forecast) and FYE 2018, Royal Mail's 2015 Business Plan expects to save a total of [X] in the Reported Business (excluding transformation costs). Overall, total costs in the Reported Business are expected to [X] over the Business Plan period (or by [X] per annum on average). [X]. Increases in staff costs in FYE 2016 are driven by the above inflation growth pay award for FYE 2016⁷, which was

⁶ [X]

⁷ These pay award costs are based on the pay deal agreed in December 2013 / January 2014.

agreed at 2.8% for frontline staff.⁸ As a result, Royal Mail's [£]. [£]. Altogether, the cost savings in the Reported Business [£].

During the Business Plan period, Royal Mail expects that cumulated transformation costs of [£] are needed to implement the efficiency projects and for voluntary redundancy payments. The cumulated transformation costs correspond to [£] in the Reported Business.

Table 2 Business plan targets for the Reported Business core function Delivery & Processing and RDC function in Operations

	Budget FYE 2016	Plan FYE 2017	Plan FYE 2018
Change in productivity	[£]	[£]	[£]
Change in workload (demand)	[£]	[£]	[£]
Change in gross hours	[£]	[£]	[£]

Source: Royal Mail, Operations Planning Model (OPM)

Note: The changes in productivity, workload and gross hours refer to the activities in Processing & Regional Logistics, Delivery and Regional Distribution Centres.

[£]. For the Business Plan period, Royal Mail is projecting total [£] per annum. This corresponds to a [£] during the Business Plan period. Gross hours reductions are expected to be realised partly by productivity gains, and partly through a reduction in demand.

ROYAL MAIL'S 2015 BUSINESS PLAN COMBINES EFFICIENCY AND COST SAVING INITIATIVES

The major source for forecast cost savings over the Business Plan period is a combination of efficiency initiatives, partly from projects already underway, and partly from new initiatives. The most important initiatives are:

- Mail centre rationalisation: Royal Mail is planning to close two additional mail centres⁹ [£] and to largely conclude its ongoing mail centre rationalisation programme.
- Letter automation: Royal Mail is investing in automation and IT to reduce processing costs.¹⁰ Royal Mail is planning to “fine tune” its processing activities

⁸ See the Agenda For Growth, Stability & Long Term Success, January 2014,

<http://www.cwu.org/assets/cwu/legacy->

[assets/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf](http://www.cwu.org/assets/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf) , p.17.

⁹ See Royal Mail plc, Half Year 2015-16 Results, 19 November 2015, p.7

([http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20\[WEBSITE\]_0.pdf](http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20[WEBSITE]_0.pdf)).

in mail centres so that the degree of automation will increase, which will result in higher proportions of letters sorted by machine, including more walk sorted large letters,¹¹ and improvements in its IT infrastructure.

- Logistics: Royal Mail stated that it will implement a number of logistics initiatives including national road and air network reviews, along with focus on fuel, maintenance, and fleet costs.¹² Alongside the reduction in mail centres, Royal Mail is planning to increase the efficiency of transport activities by network optimisation (removal of flights and optimising road transport). Additionally Royal Mail notes that among its forthcoming initiatives in this area is the improvement of improving driver behaviour¹³, which it expects [×].
- Delivery: Increased automation has not yet resulted in the expected cost savings in delivery in recent years. Therefore, Royal Mail's major challenge is to transform the benefits of increased automation into more efficiency and cost savings in delivery. Royal Mail aims to address this challenge with a bundle of measures to continue delivery optimisation. By signing the National Delivery Agreement with the CWU in 2014, which sets out an agreed approach for managers and CWU representatives in implementing delivery revisions, Royal Mail may find it easier to realise cost savings in delivery in the future.

In addition to projects related to the final stage of the transformation programme, Royal Mail started three additional efficiency programmes after its Initial Public Offering (IPO) in October 2013:

- Royal Mail has implemented "collections on delivery" i.e. postmen/postwomen collect letters from low volume post boxes along their delivery rounds not only in rural but also in urban areas. In some cases this has changed the time of collection from 5pm to 9am.¹⁴
- The parcel automation programme will increase the efficiency of parcel processing in mail centres.¹⁵ Royal Mail is investing in parcel sorters that will be

¹⁰ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 1.6.

¹¹ Ibid, paragraph 4.30.

¹² Ibid, paragraph 4.27.

¹³ See Operations Plan: Logistics, 1 April 2016, <https://www.myroyalmail.com/news/2016/04/operations-planlogistics>.

¹⁴ See <http://www.royalmail.com/personal/help-and-support/postboxes-faq>.

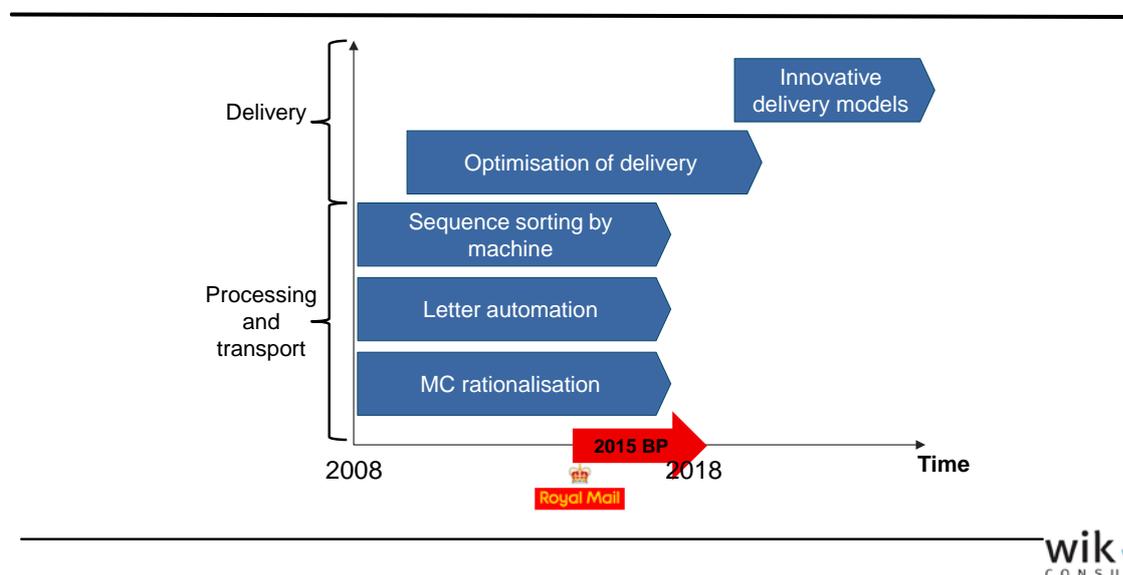
¹⁵ See Royal Mail plc, Annual Report and Financial Statements 2014-15, p.9, http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf.

installed in 20 of its busiest mail centres.¹⁶ This would cover around [X] of all parcels in outward sorting and [X] of all parcels in inward sorting.^{17,18}

- Royal Mail is streamlining its group and operational management structure. As a result of its management reorganisation programme, 1,600 management employees in total will be affected, leading to a planned net decline of 1,300 in group and operational management staff.¹⁹

In addition to efficiency-driven cost savings, Royal Mail is expecting to make some cost reductions in response to declining demand. [X].

Figure 1 Royal Mail's estimated progress in operational efficiency



Source: WIK-Consult.

Figure 1 illustrates the progress we estimate Royal Mail will have made after the implementation of the 2015 Business Plan in relation to its transformation programme. It shows that the company will have largely finished the major elements of the transformation programme which would result in more (productive) efficiency and some cost savings. The figure also highlights that Royal Mail is implementing a number of major steps at the same time, illustrating the complexity of Royal Mail's transformation programme. Other postal operators tackled these challenges consecutively rather than simultaneously.

¹⁶ See Royal Mail, Full Year 2014-15 Results, Presentation 21 May 2015 (<http://www.royalmailgroup.com/sites/default/files/FY%202014-15%20Results%20Presentation.pdf>).

¹⁷ [X]

¹⁸ [X]

¹⁹ Royal Mail plc, Full Year 2013-14 Results, 22 May 2014, p.11 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202013-14_DDA_0.pdf). See also Royal Mail Group, Continued efficiency programme, press release 25 March 2014 (<http://www.royalmailgroup.com/continued-efficiency-programme>).

WIK ASSESSES ROYAL MAIL'S PROJECTED COSTS COMPARED TO ROYAL MAIL'S PAST PERFORMANCE AND INTERNATIONAL PRACTICE

Figure 2 WIK approach for assessing Royal Mail's projected costs



Source: WIK-Consult.

The assessment is based on three criteria:

- The review of the underlying assumptions and their consistent application in the Business Plan;
- From a technical point of view we assess whether the planned efficiency initiatives are more or less ambitious in light of past achievements and compared to international peers; and
- From a financial point of view we discuss whether Royal Mail's cost saving targets are more or less ambitious in light of its past achievements in cost savings and compared to those achieved by its peers.

WIK CONCLUDES THAT, OVERALL, ROYAL MAIL'S COST PROJECTIONS IN ITS 2015 BUSINESS PLAN ARE NOT AS AMBITIOUS AS ITS PEERS' OR ITS PAST TARGETS

We have discussed Royal Mail's efficiency initiatives, cost projections and underlying assumptions of the 2015 Business Plan and have assessed whether they are more or less ambitious than Royal Mail's past performance in cost savings and relative to the performance of other postal operators.

Table 3 Summary results of WIK's assessment

	Less ambitious	Appropriately ambitious	More ambitious
Overall assessment	X		
Technical evaluation of planned initiatives compared to peers and past initiatives	X		
Financial evaluation of planned initiatives		X	
Business plan targets relative to past targets	X		
Business plan targets relative to past achievements	X		
Business plan targets relative to other postal operators	X		
Business plan underlying assumptions	Internally consistent		

Overall, Royal Mail's transformation programme and the related cost saving and efficiency initiatives in its 2015 Business Plan are broadly in line with similar programmes implemented by its international peers in the past. They all include common features such as mail centre rationalisation, automation, optimised logistics and delivery. Royal Mail's transformation programme started in 2008 and one core element, the mail centre rationalisation, will be largely finalised within the Business Plan period.²⁰ The duration of the implementation period is consistent with international practice. The transformation of the delivery organisation, another core element of the transformation programme, started later (around 2010) and is still ongoing.

Royal Mail's planned initiatives are technically feasible but, overall, less ambitious than its international peers in terms of scope

Our analysis concludes that Royal Mail has been successful in reducing costs in some areas, including the quickly achieved savings of the management reorganisation programme and savings in non-staff costs.

However, Royal Mail's plans to improve efficiency in delivery operations, which account for the major part of operating cost, are less ambitious than its peers in our opinion:

- Targeted cost savings in delivery are relatively low given that delivery costs account for [X] of total costs.
- The company relies on traditional ways of organising delivery and does not (yet) appear to be pursuing more innovative delivery models. For example, walk

²⁰ Based on Royal Mail's current plans.

sequencing is centralised less than at international peers, there is less separation of indoor and outdoor activities related to delivery, and the current state of mail flow control does not allow for the introduction of heavy and light delivery days (i.e. peak and off-peak working days). By introducing heavy delivery days, international peers have achieved lower average costs for second class (or other low priority) letters.

We consider Royal Mail's parcel automation programme is less ambitious than its peers [X].

Managing labour relations responsibly to achieve more flexibility for staff costs is pivotal to achieving further cost savings

The delivery reorganisation programme reflects the challenging relationship between Royal Mail and the unions. Royal Mail faces significant restrictions for specific actions resulting from the legal contract Royal Mail agreed with CWU in early 2014 based on the "Agenda for Growth, Stability & Long Term Success".²¹ The contract runs from January 2014 until March 2019. These restrictions ("Protections") limit Royal Mail's ability to realise more cost savings, although Royal Mail benefits from better cooperation from the unions for operational reforms.²²

- Royal Mail has committed to maintain a one-tier wage schedule (i.e. new employees have to be contracted under similar conditions as existing employees)²³ whereas Deutsche Post, PostNL and USPS implemented two-tier wage schedules²⁴ (allowing them to agree different conditions with new hires).²⁵
- By precluding outsourcing of business functions and franchising of core operational functions, Royal Mail has further reduced its leeway for cost savings, most importantly in transport and parcel delivery.
- Royal Mail has continued its commitment to avoid the use of compulsory redundancies which may restrict its ability to take the required hours out of the business.

²¹ See Legal Contract between Royal Mail and CWU, January 2014

(http://www.cwu.org/assets/cwu/legacy-assets/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf).

²² If Royal Mail felt that its business becomes financially unsustainable "the Company shall be entitled to notify the CWU at any time that any or all of the Protections will no longer continue". Legal Contract between Royal Mail and CWU, January 2014, Clause 10.4, p.9.

²³ However, we note that the Royal Mail Pension Plan closed to new entrants with effect from 1 April 2008 resulting in a two-tier scheme for pensions. See Royal Mail Group, Royal Mail Pension Plan, The Company's Decision, February 2008, (<http://www.royalmailgroup.com/sites/default/files/Company's%20Decision%20FINAL%20150208.pdf>).

²⁴ Deutsche Post introduced two-tier schedules in 2001, PostNL in 2003 and USPS in 2011.

²⁵ While pay terms and conditions are the same between old and new employees the pension scheme has been closed to new members since 2008 (so that Royal Mail is effectively operating two tiers in relation to pensions).

- Maintaining the existing full-time/part-time ratio and retaining permanent contracts leaves Royal Mail with few alternative ways of offsetting other restrictions in order to increase workforce flexibility.

Combined, we consider that these restrictions significantly limit Royal Mail's ability to increase cost flexibility in its postal operations and its potential for additional cost savings in a market environment that is becoming more and more challenging. In contrast, we conclude that international peers in Denmark, Sweden, the Netherlands and Germany appear to have been more successful at managing the relationships with their employees and unions and, at the same time, agreeing higher levels of efficiency and cost flexibility, allowing them to meet market challenges more effectively.

In light of the international benchmark, the outcome of the last negotiations could be rated as an unsatisfactory result as most of the international peers managed to achieve a two-tier wage policy and more flexibility in working time while the scope of flexibility at Royal Mail is still subject to further negotiation.

The projected savings in staff costs are based on the assumption that future pay awards [§<]. Any future pay awards are still subject to agreement between the unions (CWU and Unite) and Royal Mail, and, therefore, they are arguably within Royal Mail's control (shared with its employees). [§<]. [§<] We consider that the increased pressure from private shareholders to improve profitability, the competitive environment in the UK parcel market and ongoing letter volume decline will strengthen the bargaining position of Royal Mail compared to the pre-IPO situation. Moreover, Royal Mail's employees have the opportunity to participate in this improvement via their shares (12% of Royal Mail's shares are owned by its employees).

While the current agreements with the unions, including the agreed pay awards and the restrictions on flexibility (which we considered to be fixed for the Business Plan period), put Royal Mail in a more difficult position compared to its international peers, we conclude that Royal Mail's plans are still less ambitious than its peers. For example, we believe that Royal Mail could be more ambitious by implementing more flexible work arrangements, and this could result in greater cost savings due to less overtime payments.

Royal Mail appropriately evaluates cost savings for the planned initiatives

Our review of Royal Mail's financial evaluation of planned initiatives concludes that, overall, the value that Royal Mail considers it is capable of saving by its initiatives appears appropriate given the conditions Royal Mail faced when developing its 2015 Business Plan (in early 2015). While the financial evaluation of planned initiatives appears appropriate, we conclude that the choice of initiatives themselves could be more ambitious (see above).

[REDACTED]

[REDACTED]. [REDACTED] Royal Mail has achieved productivity growth between 1.7% and 2.5% per annum since FYE 2013.²⁶ [REDACTED] Royal Mail has been privatised, and one would expect Royal Mail to face stronger incentives to become more efficient and enjoy more commercial flexibility now.

[REDACTED]

In FYE [REDACTED] and 2014, Royal Mail did not fully achieve its productivity targets. The achieved productivity gains [REDACTED] were below 2% in FYE 2014²⁷ and increased to 2.5% in FYE 2015²⁸. For the first half of FYE 2016, Royal Mail reported an increase in productivity gains of 2.9%²⁹. [REDACTED].

However, in the financial years 2008 to 2012 Royal Mail managed to significantly reduce total costs in the Reported Business by 1.5% per annum on average. Staff costs, particularly, declined by nearly GBP 500m or 2.7% per annum. These achieved cost savings were much higher than those planned by Royal Mail for the Business Plan period.

Royal Mail's targeted cost savings in the Reported Business are less ambitious than the cost savings achieved by other postal operators

Overall, Royal Mail plans to [REDACTED] total costs in the Reported Business by [REDACTED] per annum on average. While non-staff costs are expected to [REDACTED] on average, staff costs are assumed to [REDACTED]. Our comparison of the performance in cost savings between Royal Mail and its international peers (for the period 2008-2014) indicates that Royal Mail's targeted cost savings in the Reported Business' operating expenditures are [REDACTED] than savings achieved by those international peers that face a similar decline in mail volume. In particular, Royal Mail is targeting [REDACTED] in staff costs.

In our view, the major reason for different performances in cost saving efforts between Royal Mail and its international peers is that, at Royal Mail, efficiency driven savings are offset (to a large extent) by higher pay awards. In this context, more cooperative industrial relations are crucial for a successful transformation process.

²⁶ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.42.

²⁷ See Royal Mail plc, Full Year 2013-14 Results, Presentation 22 May 2014, p.11, http://www.royalmailgroup.com/sites/default/files/FY%202013-14%20Results%20Presentation%202014-05-21%20_0.pdf.

²⁸ See Royal Mail plc, Full Year 2014-15 Results, Presentation 21 May 2015, p.12, <http://www.royalmailgroup.com/sites/default/files/FY%202014-15%20Results%20Presentation.pdf>.

²⁹ See Royal Mail plc, Results for the Half Year ended 27 September 2015, p.2, <http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20for%20the%20half%20year%20ended%2027%20September%202015.pdf>.

ROYAL MAIL COULD CONSIDER ADDITIONAL MEASURES FOR COST SAVINGS

Finally, based on international practice, we identify a number of potential measures Royal Mail could consider for further promoting its operational efficiency.

In the short run, the company could:

- Further increase the proportion of walk sequenced letters by promoting the centralisation of sequence sorters;
- Further promote parcel automation in mail centres and introduce more appropriate equipment to facilitate parcel sorting in delivery offices;
- Increase automation of unaddressed items;
- Continue reducing the time spent on indoor activities and allocate resources accordingly;
- Reconsider bundling addressed and unaddressed items;
- Introduce further measures to ensure resources are better matched to workload, e.g. using flex-time schedules.

In addition, in the long run (i.e. after the FYE 2019), Royal Mail could consider:

- Franchising road transport;
- Centralising mail preparation in delivery;
- Assigning indoor and outdoor delivery activities to different employees.

1 Introduction

1.1 Background and objectives

Ofcom has a duty under the Postal Services Act 2011 to carry out its functions in a way that it considers will secure the provision of the universal postal service. In discharging this duty, the Act requires Ofcom to have regard to the need for the provision of a universal postal service:

- to be financially sustainable, including the need for a reasonable commercial rate of return on the provision of the universal service; and
- to be efficient within a reasonable period, and then remain so.

Royal Mail Group Limited (registered number 4138203) ("Royal Mail") has been designated by Ofcom as the UK's universal service provider. On 2 December 2014, Ofcom published a Review of End-to-End Competition in the Postal Sector and declared that it would not be necessary, at that point, to impose additional regulatory conditions on any end-to-end letter delivery operators to secure provision of a universal postal service.³⁰ Ofcom did not consider the universal service was under threat, but recognised a degree of uncertainty about Royal Mail's future financial position, particularly in the later years of the analysis it had undertaken. From the regulator's point of view this uncertainty was likely to be due to other factors than end-to-end competition in particular competitive developments in the parcels market and Royal Mail's progress on improving its efficiency. Ofcom therefore announced that it was broadening its review to take account of these factors.

As part of this work, Ofcom considered it necessary to review the extent to which Royal Mail's 2015 Business Plan, and its underlying cost base, provide an opportunity for Royal Mail to achieve a reasonable rate of efficiency improvement while continuing to meet its existing universal service obligations. In this context Ofcom has assigned WIK-Consult to conduct a study on the "Review of the Projected Costs within Royal Mail's Business Plan". The study was carried out from April to December 2015. WIK was specifically requested to:

- understand the extent of Royal Mail's costs and cost reduction plans,
- compare Royal Mail's cost reduction plans against certain other international postal operators,
- assess the reasonability of Royal Mail's cost reduction plans, and
- identify potential further efficiency improvements for Royal Mail to consider.

³⁰ Ofcom (2014), Review of end-to-end competition in the postal sector. <http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>).

Alongside the present report generated by WIK-Consult for Ofcom, Ofcom will also be considering how Royal Mail's costs change in relation to volume changes and the relative efficiency of Royal Mail's delivery offices and mail centres. This analysis will be provided in reports by other contractors.

WIK-Consult has been working closely with Ofcom to review Royal Mail's projected costs and cost reduction plans. The scope of the assessment is to inform Ofcom as to whether, in WIK-Consult's opinion, Royal Mail's plans to improve efficiency are reasonable in the light of Royal Mail's past performance and compared to the experiences of international peers. In addition to examining operational facts and efficiency programmes launched by Royal Mail and its international peers, this study considers labour and employment policies related to the market environment in the analysis.

1.2 Approach and methodology

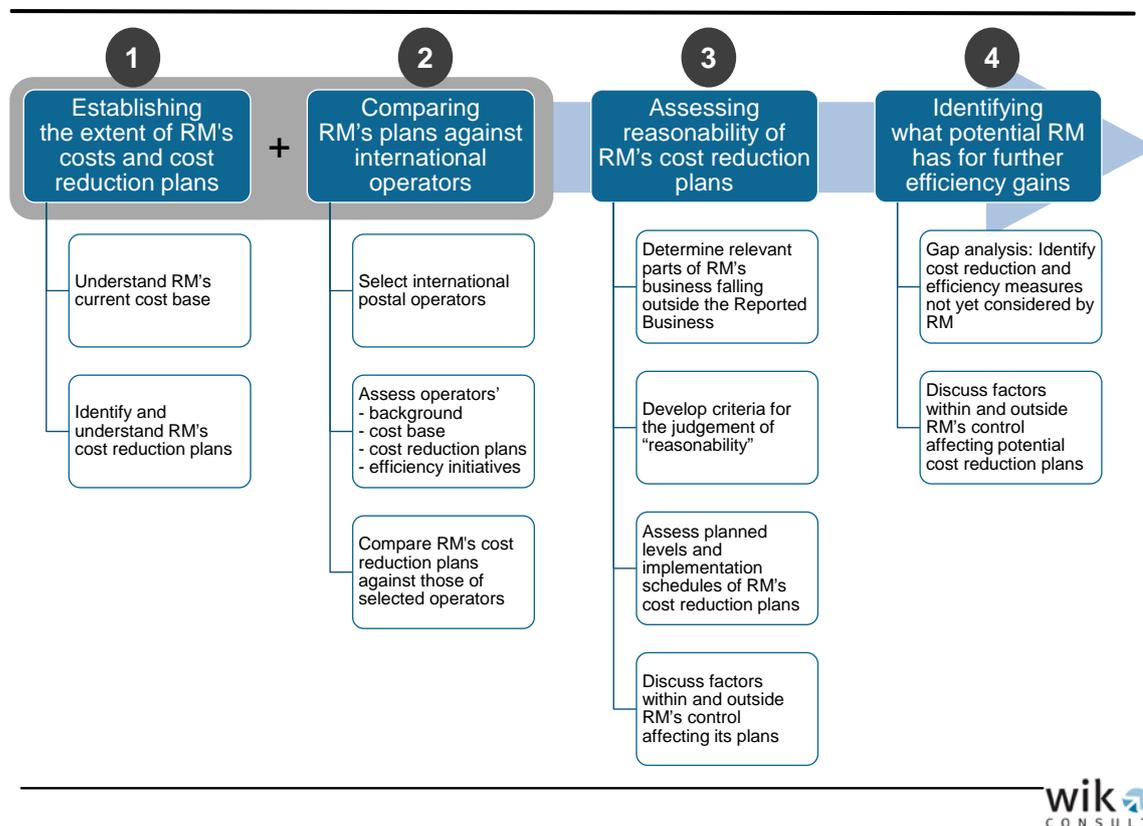
1.2.1 Overview

The main objective of this study is to establish whether Royal Mail's planned rate of cost reduction as set out in its 2015 Business Plan is reasonable. Royal Mail's 2015 Business Plan provides revenue and cost projections of Royal Mail Group, the Reported Business and, in more detail, on Royal Mail Operations³¹ for the three financial years (FY) 2015-16, 2016-17 and 2017-18.

For the review of the projected costs within Royal Mail's Business Plan we broke down the study into several elements. Figure 1-1 below provides an overview of our workflow with the core phases and their respective sub-tasks. We provide further details about the approach taken to each phase and the nature of the sub-tasks below.

31 Royal Mail Operations refer to activities of the "core network" (collection, transport, processing and delivery) within the Reported Business, i.e. sales activities and overhead.

Figure 1-1 Approach to WIK-Consult's study "Review of the Projected Costs within Royal Mail's Business Plan"



Source: WIK-Consult.

1.2.2 Phase 1: Establishing the extent of Royal Mail's costs and cost reduction plans

According to the USP Accounting Condition, Royal Mail has to provide a "Strategic Business Plan" of the Relevant Group (i.e. Royal Mail plc) to Ofcom for each financial year.³² This confidential Business Plan sets out Royal Mail's "performance and vision for the activities undertaken by the Relevant Group including a forecast of revenue, operating expenditure, capital expenditure, expectations of change in the postal market, details of future planned initiatives (e.g. projects to improve efficiency) and Royal Mail's view on appropriate quality of service targets."³³ Thus, the first major task in this project is to understand Royal Mail's 2015 Business Plan with a particular emphasis on its current cost base and its cost reduction plans.

³² See Ofcom, Consolidated Version of USP Accounting Condition as at January 2014 (http://stakeholders.ofcom.org.uk/binaries/post120713/USP_accounting_condition.pdf).

³³ Ibid, paragraph 1.1.2 (z).

The Strategic Business Plan is a forward looking instrument, but the cost projections depend on the current cost base. We have therefore analysed the current cost base in order to be able to assess Royal Mail's cost reduction plans. We have examined the different cost categories as well as different cost types within the Business Plan for the base year to the extent possible.

Royal Mail's 2015 Business Plan provides a detailed forecast of operating expenditures for the Reported Business and details of planned cost saving and efficiency initiatives. We identified Royal Mail's most important cost reduction plans and planned (or ongoing) efficiency initiatives by analysing the 2015 Business Plan and related publications (by Royal Mail, Ofcom and other stakeholders such as CWU). Additionally, in Summer 2015 we conducted visits at Royal Mail sites and held meetings with Royal Mail.

In Section 2 of this report we describe Royal Mail's underlying cost base and its cost saving and efficiency initiatives as reported in its 2015 Business Plan in detail.

1.2.3 Phase 2: Compare Royal Mail's plans against international operators

We compare Royal Mail's mail operations and its cost reduction plans to six international postal operators that offer a relevant comparison against Royal Mail's Reported Business and related cost reduction plans. In Section 3.1 we present the selected international postal operators and explain the reasons behind this selection. The selection of appropriate international postal operators was subject to final agreement with Ofcom.

At the outset of the study, we prepared a research template, made up of the indicators listed in Table 1-1 below. This research template served as a guideline for the collection of background information for each selected postal operator (including Royal Mail), as well as information on the current operational characteristics, cost structure, and cost reduction plans for each selected postal operator. Where possible, we compiled time-series data for selected indicators (e.g. employment data and financial metrics) from Annual Reports, from the year 2000 onwards.

Table 1-1 Research template: List of topics

Topic	Facts and figures (examples)
Country information	Population and population density Size and topography, GDP per capita
Postal market indicators	Letters per capita Market development (volume and/or revenue) Market structure (letters and parcels, separately) and market share of the selected postal operator Quality of service obligations (universal service obligation)
Company indicators	Legal form and ownership structure Year of corporatisation and privatisation (if applicable) Reporting structure: Definition of business segments (services included) Key financial information (time-series) <ul style="list-style-type: none"> • Revenues, total and business segments • Profitability, total and segment information (EBIT) • Operating expenditures, total and segment information <ul style="list-style-type: none"> ○ People costs ○ Non-people costs Volume developments (letters and parcels)
Mail operations	Brief description and highlighting specificities (deviations from the "standard" postal pipeline) Different sorting facilities for processing letters and parcels? Joint handling of letters and parcels in delivery? Size and density of the postal infrastructure: time-series information if available <ul style="list-style-type: none"> • Number of access points (e.g. postal outlets, street letter boxes, parcel lockers etc.) • Number of intermediary platforms (if applicable) • Number of mail sorting centres • Number of delivery offices • Number of delivery routes (on average) • Number of (potential) delivery points Role of outsourcing (collection, transport, delivery) Productivity/efficiency metrics (if available), e.g. proportion of letters sorted to delivery sequence by machine
Employment and labour policy	Employment data (time-series): total and per business segment (headcount, full-time equivalents) Brief description of the general labour policy and use of subcontractors in mail operations Name, scope and major characteristics of current collective labour agreement(s) Major changes in labour conditions in the last 10-15 years (e.g. changes in wage levels for new employees, working time and how to deal with overtime, number of holidays)
Cost reduction plans and efficiency initiatives	For each plan / initiative we collect information on <ul style="list-style-type: none"> • Targeted cost categories/activities (e.g. in collection, sorting, delivery or overhead functions (e.g. purchasing activities, selling activities, marketing, general administration)) • Short description of the plan • Implementation period • Effects on operational costs (staff / non-staff costs) • Effects on employment level • Factors affecting the implementation of the cost reduction plan (e.g. industrial action)

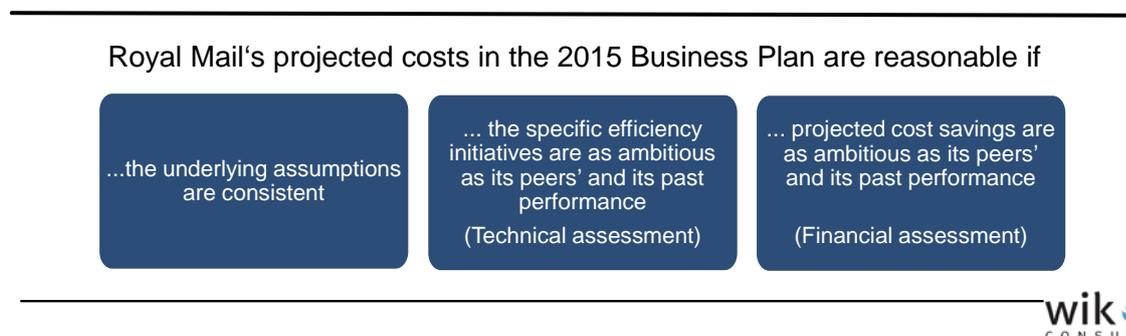
This research template formed the basis for the collection of information about Royal Mail and the selected postal operators, and informs the final step in this task. The research on international postal operators, is based on extensive desk research and interviews with seniors managers from postal operators and postal unions. The authors have been able to visit operational sites at most benchmark operators. The report does not contain any confidential information. We are most grateful for the time, information and expertise received from the organisations and individuals that have contributed to our study on the international operators. While gladly acknowledging this assistance, WIK-Consult remains, of course, responsible for the report, including any errors it may contain.

In Section 3 we present a structured comparison of Royal Mail's postal operations and cost reduction plans with those identified at the selected international postal operators.

1.2.4 Phase 3: Assessing reasonability of Royal Mail's cost reduction plans

In this phase, we assess Royal Mail's 2015 Business Plan with respect to its internal consistency and whether it is supported by evidence from Royal Mail's own performance in the past as well as the performance of international postal operators. The assessment puts emphasis on cost savings and efficiency initiatives that are relevant for Royal Mail's Reported Business.

Figure 1-2 WIK approach for assessing Royal Mail's projected costs



Source: WIK-Consult.

The assessment is based on three criteria:

- The review of the underlying assumptions and their consistent application in the Business Plan.
- From a technical point of view we assess whether the planned efficiency initiatives are more or less ambitious in light of past achievements and compared to international peers, and

- From a financial point of view we discuss whether Royal Mail's cost saving targets are more or less ambitious in light of its past achievements in cost savings and compared to those achieved by its peers.

In Section 4 we discuss Royal Mail's efficiency initiatives, cost projections and underlying assumptions of the 2015 Business Plan and assess whether they are more or less ambitious than Royal Mail's past performance in achieving cost savings and relative to the performance of other postal operators.

In Section 5 we complete and summarise the assessment guided by the following questions:

- Are the underlying assumptions consistently applied throughout the Business Plan?
- Are the planned initiatives more or less ambitious than Royal Mail's past initiatives and how ambitious are the initiatives in light of international practice?
- Are the projected cost savings of the planned initiatives in Royal Mail's 2015 Business Plan accurately estimated and appropriately ambitious?
- Are Royal Mail's 2015 Business Plan targets more or less ambitious than its past business plan targets?
- Are Royal Mail's 2015 Business Plan targets more or less ambitious in light of its past achievements?
- Are Royal Mail's 2015 Business Plan targets more or less ambitious in light of other postal operators' past performance?

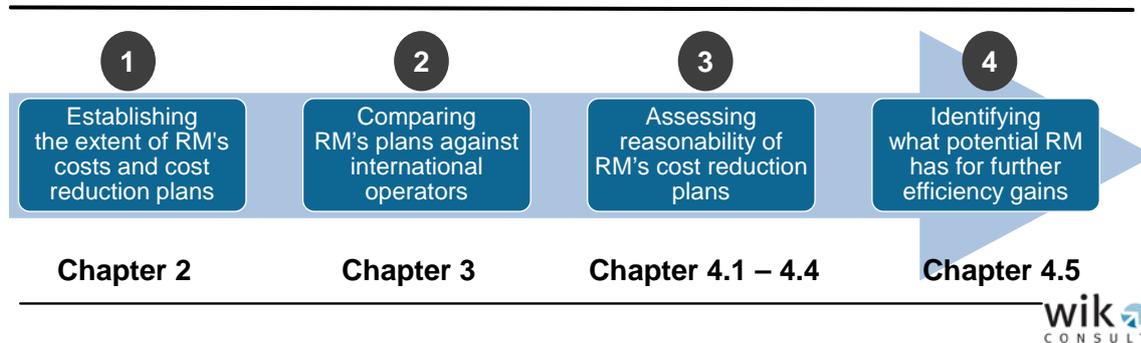
1.2.5 Phase 4: Identifying Royal Mail's potential for further efficiency gains

Section 4.5 of this study aims to assess whether there are further measures for cost reductions which are not considered in Royal Mail's 2015 Business Plan and to discuss the feasibility of such measures. This will be closely related to the identification of initiatives implemented by other operators not yet undertaken by Royal Mail and a discussion about how and in which parts of Royal Mail's business these initiatives could contribute to further cost reductions.

The identified set of potential measures for further cost reductions will be reviewed with respect to their feasibility. For this purpose, we take into consideration whether there are any factors that might limit Royal Mail's ability to implement these measures and to realise further cost savings. This includes a discussion of whether these factors are within Royal Mail's control (for example due to organisational structures) or whether they are outside of Royal Mail's control (for example, letter box specifications).

1.3 Structure of the report

Figure 1-3 WIK-Consult approach and report structure



Source: WIK-Consult.

The study consists of three parts.

- Section 2 describes Royal Mail's projected costs and cost savings as well as underlying assumptions based on the 2015 Business Plan.
- Section 3 explains the selection of the six comparator operators, and compares Royal Mail's current operations, major efficiency measures and employment and labour conditions to international peers.
- Section 4 presents the assessment of Royal Mail's cost reduction plans as regards Royal Mail's past performance and in light of the international benchmarks. Moreover, it discusses potential measures Royal Mail could consider to further increase its efficiency.

In Section 5 we compile the findings we developed in Section 4 to come to an overall assessment on the reasonability of Royal Mail's cost projections and its planned efficiency and cost saving projects.

2 Royal Mail's 2015 Business Plan

2.1 Introduction

To effectively monitor Royal Mail's financial performance, particularly with respect to the universal service network ('the Reported Business'), Ofcom has established a monitoring regime to track the level of efficiency improvement (among a number of other measures). Under the regulatory framework put in place by Ofcom in 2012,³⁴ Royal Mail must provide Ofcom with its Strategic Business Plan and annual budget for the Relevant Group (Royal Mail Group and the Reported Business) before the start of each financial year and when any update to the Strategic Business Plan has been agreed by Royal Mail.³⁵ The Strategic Business Plan "means Royal Mail's business plan setting out its performance and vision for the activities undertaken by the Relevant Group including a forecast of revenue, operating expenditure, capital expenditure, expectations of change in the postal market, details of future planned initiatives (e.g. projects to improve efficiency) and Royal Mail's view on appropriate quality of service targets."³⁶ Royal Mail's Strategic Business Plan also supports Ofcom's annual monitoring update on the postal market.

The 2012 regulatory framework was informed by Royal Mail's Strategic Business Plan ("Restructuring Plan") that was provided to Postcomm and Ofcom in 2011. Since then, Royal Mail has delivered four new business plans, in September 2012 ("Modernisation of Royal Mail Operations"), and also in 2013, 2014 and 2015. Among other information, Ofcom took account of Royal Mail's 2014 Business Plan as part of its review of the impact of end-to-end letter competition on the universal service.³⁷

The purpose of this chapter is to describe Royal Mail's underlying cost base, as well as its cost saving and efficiency initiatives as reported in its 2015 Business Plan in detail. It is split into three sections:

- description of the relevant cost base in Section 2.2.1;
- detailed description of Royal Mail's projected costs for the Business Plan period FYE 2016 to FYE 2018 (the Business Plan period) in Section 2.2.2; and
- detailed description on Royal Mail's projects to increase efficiency in its core network in Section 2.3.

³⁴ And updated in January 2014 (see <http://stakeholders.ofcom.org.uk/consultations/regulatory-reporting-framework/statement/>).

³⁵ USP Accounting Condition, as of January 2014, (http://stakeholders.ofcom.org.uk/binaries/post120713/USP_accounting_condition.pdf).

³⁶ Definition in the USP Accounting Condition (January 2014).

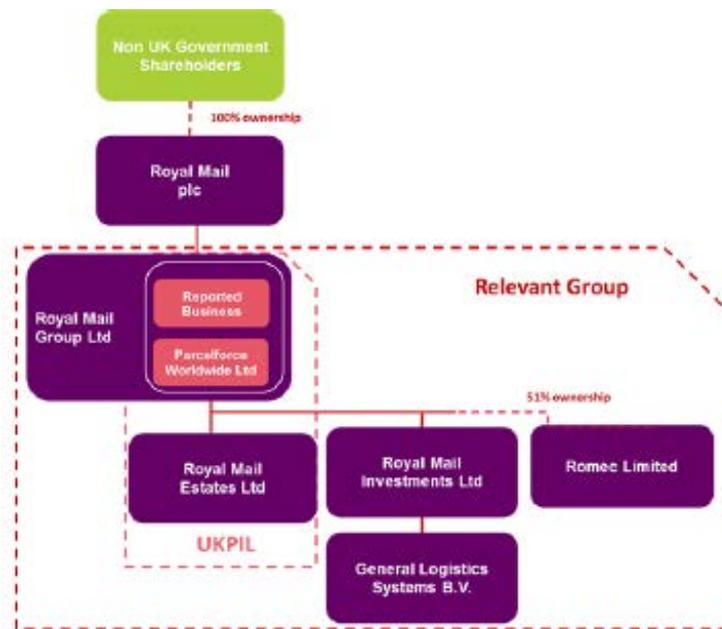
³⁷ Ofcom (2014), Review of end-to-end competition in the postal sector (<http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>).

2.2 Royal Mail's cost base and projected costs

2.2.1 Royal Mail's cost base

Royal Mail's 2015 Strategic Business Plan (BP) provides high-level revenue and cost projections for the Business Plan period. It covers Royal Mail Group broken down to UK Parcels, International & Letters (UKPIL) and within that the Reported Business, General Logistics System and others (including Royal Mail Investments Ltd. and Romec Ltd.). The projections refer to entities as reported in the Annual Report and Financial Statements of Royal Mail plc. The documents which form the 2015 Business Plan are dated from March and April 2015. However, Royal Mail has since published its Annual Report and Financial Statements 2014-15 and the Regulatory Financial Statements 2014-15 (FYE 2015). In this section, we present the cost base as reported in the BP 2015, i.e. where figures for FY2015 are presented, we refer to the forecast figures of FYE 2015 as they are presented in the 2015 Business Plan.³⁸

Figure 2-1 Royal Mail plc, UKPIL and Reported Business



Source: Based on Ofcom (2015), Annual monitoring update on the postal market Financial year 2014-15, p.8.

³⁸ Projected results and the actual outcome of FYE 2015 are compared in Section 4.4.1 in this report. The actual outcome refers to Royal Mail plc, Annual Report and Financial Statements 2014-15 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf) and Royal Mail Group Ltd., Regulatory Financial Statements 2014-15 (http://www.royalmailgroup.com/sites/default/files/RMG_Regulatory%20Financial%20Statements%202014-15.pdf).

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TO PROTECT ROYAL MAIL'S CONFIDENTIAL
INFORMATION

Redacted sections are as follows:

Section 2.2.1 (excluding the introduction) and Section 2.2.2
including Tables 2-1 to 2-6, Figures 2-2 to 2-10 and
Footnotes 39 to 66

2.3 Efficiency measures and cost saving plans

2.3.1 Overview

[X]. Royal Mail presented more than [X] new activities and [X] flow through projects in the BP 2015.⁶⁷ The projects and activities affect many parts of Royal Mail's Operations and to reach a better understanding it is important to put them into the broader context of the transformation programme that Royal Mail Group has been implementing since FYE 2008.⁶⁸ The start of the Programme was accompanied by the "CWU and Royal Mail Payment and Modernisation Agreement – April 2007/2009"⁶⁹ to ensure more flexible work patterns and technological progress.

The transformation programme has already affected all parts of Royal Mail's Operations, as set out below:

- Collections: Introduction of handheld scanners and the migration from bags to trays in the collection of letters.
- Automation: Upgrading of existing machines and introduction of new machines, including automated walk sequencing machines to sort letters into address delivery order.
- Logistics: Rationalisation of RDCs and adapting the transport network to the lower number of facilities.
- Mail centre rationalisation: Reduction of the number of mail centres from 69 before the transformation programme to 39 (FYE 2015). Some former mail centres have been transformed to larger delivery offices, so-called Mail Processing Units (MPUs), equipped with sequence sorters.
- Delivery: Introduction of foot delivery with High Capacity Trolleys and more use of shared vans (two postmen/postwomen share one van for delivery in urban and suburban areas) to increase the number of parcels delivered on foot and minimise the need for replenishment during the round. The introduction of automated walk sequencing machines may allow Royal Mail to increase the

⁶⁷ See Royal Mail, BP 2015 Operations 2015/16 Budget & Plan (OFCOM), presentation 30th April 2015.

⁶⁸ See Royal Mail plc (2013), Prospectus, Section 4.3 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

⁶⁹ See CWU and Royal Mail Payment and Modernisation Agreement – April 2007/2009, http://www.cwu.org/assets/_files/documents/jun_09/cwu__1245678663_PayAndModernisationAgreement20.pdf.

outdoor delivery span⁷⁰ of postmen/postwomen. Royal Mail states that 82% of the letters are now sorted into walk order by machine, an increase from 34% in 2010/11.⁷¹

Royal Mail reported in its 2013 prospectus that the Group made a gross investment of GBP 2,795m in the transformation programme between FYE 2007 and FYE 2013. The major part of this amount was spent on redundancy payments (GBP 875m) and to support the implementation of the transformation programme (GBP 515m incentive payments and GBP 312m project management costs).⁷² Between FYE 2008 and FYE 2015 Royal Mail reduced Operations' headcount by 28,800 which corresponds to a yearly decline of 2.9% on average.⁷³ Between FYE 2008 and FYE 2012 Royal Mail reported [§<] in Operations costs (net of inflation) of [§<] in total.⁷⁴

70 Delivery span means the proportion of daily worktime a full-time postman/postwoman is busy with delivery of mail (outdoor delivery).

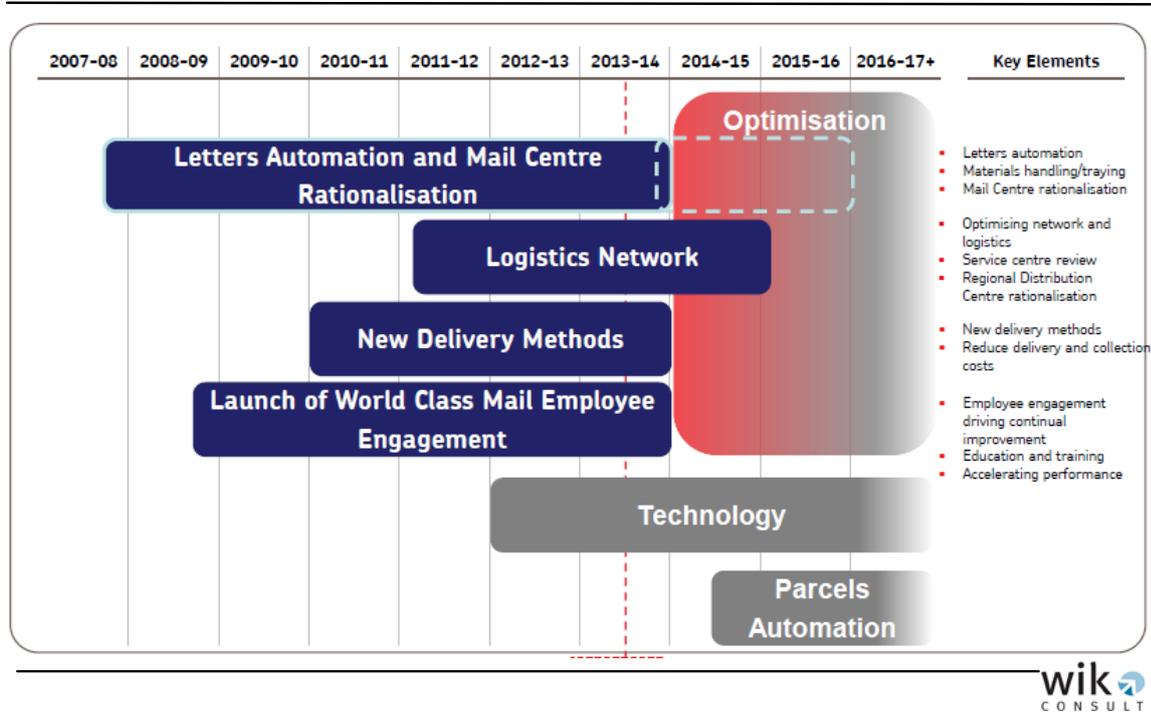
71 See Royal Mail plc, Annual Report and Financial Statements 2014-15, p.10 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

72 Royal Mail plc (2013), Prospectus, p.71 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

73 See Royal Mail plc, Annual Report and Financial Statements 2014-15, p.10 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

74 [§<]

Figure 2-11 Transformation programme: Key building blocks of Core Network Modernisation



Source: Royal Mail Group, Overview of efficiency and change initiatives in Royal Mail, Presentation for Ofcom, October 2013, p.16.

Royal Mail is planning to reduce its operational costs by nearly [X]⁷⁵ through a variety of specific projects and other activities. Many of the projects presented in the BP 2015 are part of the ongoing transformation programme within the core blocks of Letters Automation, Mail Centre Rationalisation, Logistics Network and Delivery (see Figure 2-11).

Additional investment programmes are the “Parcels Automation” programme and the IT transformation programme. Both programmes are driven more by competition and market demand than by efficiency considerations. For example, the major purpose of the IT transformation programme is, among others, to support Royal Mail’s parcel strategy and the modernisation of Royal Mail’s core network.⁷⁶

⁷⁵ [X].

⁷⁶ See Royal Mail plc (2013), Prospectus, p.107 et seqq. (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

Figure 2-12 Cumulated cost savings by programme

[REDACTED]



Source: Based on Royal Mail, BP 2015 Operations Planning Model.

Notes: The savings always refer to changes in staff and non-staff costs and does not include investment costs.

[REDACTED]

Figure 2-12 shows the expected cost savings mapped onto the core postal programmes: Delivery, Logistics, Automation, and MC Rationalisation. Below we examine each of the core postal functions and the relevant cost reduction projects in more detail. The related measures in automation, delivery, MC rationalisation and national/regional logistics account for more than [REDACTED] of total cost savings related to specific projects. The remaining [REDACTED] of cost savings ([REDACTED]) come from activities such as [REDACTED] and [REDACTED]. Additional savings stem from [REDACTED]. [REDACTED].

2.3.2 Mail Centre Rationalisation

The modernisation (including the introduction of new machines and the upgrading of existing machines at mail centres and delivery offices) and consolidation of mail centres is one of the core elements of Royal Mail's transformation programme. The number of mail centres was reduced from 69 before the transformation programme to 39 in FYE 2015 with operations moving from the closed mail centres to other sites. The closed mail centres have been put to new uses, including becoming larger delivery offices or have been disposed of. Royal Mail has also opened four new mail centres. The use of new, or substantially reconfigured, premises for mail centre operations means that sites can be designed specifically to handle parcels and letters rather than older and less suitable sites.⁷⁷

The projects related to "MC rationalisation" present the finalisation of a process started in FYE 2009. The plan is to finalise ongoing rationalisations and to close two additional mail centres in Portsmouth and Ipswich.⁷⁸ The total number of mail centres will then be 37 by the end of FYE 2018.⁷⁹

- Royal Mail plans to cease processing operations in Ipswich Mail Centre and in the Portsmouth Mail Centre [REDACTED].

⁷⁷ See Royal Mail plc. Prospectus, p.72 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

⁷⁸ See Royal Mail plc, Half Year 2015-16 Results, 19 November 2015, p.7 ([http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20\[WEBSITE\]_0.pdf](http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20[WEBSITE]_0.pdf)).

⁷⁹ [REDACTED]

- [REDACTED]
- London Strategy: The ongoing consolidation [REDACTED] has resulted in reduced property costs ([REDACTED]) and enables alternative utilization (e.g. parts of the Mount Pleasant Mail Centre area).⁸⁰

The planned additional cost saving initiatives related to Mail Centre Rationalisation are summarised in Table 2–7 below:

Table 2-7 Efficiency initiatives: Cumulated, nominal cost savings in Mail Centre Rationalisation during the Business Plan period

[REDACTED]

Source: Royal Mail, 2015 Business Plan Operations Planning Model and Reported Business Cost Matrix.

Note: Figures are taken unadjusted from Royal Mail's Business Plan. Totals may deviate due to rounding.

2.3.3 Automation

A key element of Royal Mail's transformation programme has been increased sorting and sequencing automation by introducing new machinery and upgrading existing machines at mail centres and delivery offices. In total, 995 new, refurbished or upgraded letter sorting machines have been introduced across the network and the transformation was completed by FYE 2014.⁸¹ These include machines for culling, facing and cancelling of letters, sorters for letters and large letters and compact sequence sorters. The remaining Automation projects are fine-tuning measures to further increase the proportion of letters and large letters sorted automatically, to improve capacity to automatically read addresses and to improve the control of mail flow and processes.

Royal Mail's planned Automation projects consist of three types of activities:

- The first, [REDACTED], new project is called "Parcel Automation". It has not been part of the transformation programme from the very beginning.⁸² This project includes

⁸⁰ See Royal Mail plc (2013), Prospectus, p.109 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf). See also The Guardian, "Royal Mail may reap £662m from planned sale of London sorting office", 11 November 2014 (<http://www.theguardian.com/business/2014/nov/11/royal-mail-662m-sale-9-elms-sorting-office>).

⁸¹ See Royal Mail plc (2013), Prospectus, p.72 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

⁸² Initial plans were mentioned in Royal Mail's 2013 IPO prospectus: "The proportion of parcels in the Royal Mail Core Network that would be suitable for automation will be dependent on the solution chosen. However, as a broad guide, approximately 80 per cent. of parcels handled by Royal Mail are deliverable on foot and would be expected to be suitable for small parcel sorting solutions.", p.80 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

the roll-out of next generation handheld scanners⁸³ for collection and delivery purposes and, more importantly, the installation of around 20 parcel sorters⁸⁴ in its busiest mail centres⁸⁵ to reduce the manual handling of parcels and to increase the productivity in parcel sorting. Royal Mail is planning to outward sort [X] and inward sort [X] of all parcels in this phase of investment.⁸⁶ In June 2015 Royal Mail selected Datalogic to implement the new Parcel Sorting System in UK mail centres.⁸⁷ Royal Mail has assumed that non-staff costs will [X] during the business plan period and staff costs will [X]. [X].⁸⁸

- The second type of projects refer to IT investments which Royal Mail stated would reduce processing costs⁸⁹ as they allow Royal Mail to [X].⁹⁰
- The third group of projects relate to optimising and improving large letter sortation⁹¹ [X].⁹²

Figure 2-13 Automation: Project cumulated cost savings

[X]

Source: Based on Royal Mail, 2015 Business Plan, Operations Planning Model.

The planned cost saving initiatives in Automation are summarised in Table 2-8 below. [X].⁹³

⁸³ In previous years, Royal Mail has introduced a light version of tracking & tracing on selected parcel products. "Light" means that the parcels are scanned after acceptance and on delivery. This information will then be shared with customers. We understand that Royal Mail is now going to implement a more sophisticated track and trace solution in combination with a newly introduced 2D bar code for parcels (See <http://www.royalmail.com/barcodeready>.) In June 2015 Royal Mail decided to purchase 76,000 Postal Digital Assistants (PDAs) of Zebra Technologies (see Royal Mail Group, Royal Mail selects Zebra Technologies to supply new hand-held devices, 10 June 2015).

⁸⁴ [X]

⁸⁵ See Royal Mail, Full Year 2014-15 Results, Presentation 21 May 2015 (<http://www.royalmailgroup.com/sites/default/files/FY%202014-15%20Results%20Presentation.pdf>).

⁸⁶ [X]

⁸⁷ See Datalogic, Datalogic selected by Royal Mail to implement new Parcel Sorting Systems in UK mail centres, 29 June 2015 (<http://www.datalogic.com/eng/media-center/news/datalogic-selected-by-royal-mail-to-implement-new-parcel-sorting-systems-in-uk-mail-centres-nd-4093.html>). The total investment accounts for c.29m EUR.

⁸⁸ See Royal Mail, 2015 Business Plan, OPM.

⁸⁹ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 1.6.

⁹⁰ [X]

⁹¹ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.30.

⁹² See Royal Mail, Summary descriptions of 42 projects, delivered 31 July 2015 to OFCOM.

⁹³ See Royal Mail, BP 2015, Operations Planning Model.

Table 2-8 Efficiency initiatives: Cumulated, nominal cost savings in Automation projects during the Business Plan period

[REDACTED]

Source: Royal Mail, 2015 Business Plan, Operations Planning Model and Reported Business Cost Matrix.

Note: Figures are taken unadjusted from Royal Mail's Business Plan. Totals may deviate due to rounding.
 Negative values = cost increase
 Positive values = cost decrease.
 [REDACTED]

2.3.4 Logistics

A large number of Royal Mail's projects and activities affect regional and national logistics, which can partly be seen as a consequence of Royal Mail's efforts in network consolidation. Additionally, Royal Mail is planning to reduce the number of flights used ([REDACTED]) and [REDACTED]. [REDACTED].

Another portion of predicted cost savings (more than [REDACTED]) depends on the changing of driver behaviour ([REDACTED]). There are no plans to franchise any transportation services beyond air transport.⁹⁴

Figure 2-14 Logistics: Project cumulated cost savings

[REDACTED]

Source: Based on Royal Mail, BP 2015 Operations Planning Model.

The planned cost saving initiatives in Regional and National Logistics are summarised in Table 2-9 below.

Table 2-9 Efficiency initiatives: Cumulated, nominal cost savings in Regional and national logistics during the Business Plan period

[REDACTED]

Source: Royal Mail, 2015 Business Plan, Operations Planning Model and Reported Business Cost Matrix

Notes: Figures are taken unadjusted from Royal Mail's Business Plan. Totals may deviate due to rounding.
 Negative values = cost increase
 Positive values = cost decrease.
 [REDACTED]

⁹⁴ As agreed in the current CLA there will be no further subcontracting or franchising, see Legal Contract between Royal Mail and CWU, January 2014.

[REDACTED]^{95,96}

2.3.5 Delivery

Delivery staff costs account for [REDACTED] of total staff costs in the Reported Business.⁹⁷ Measures to increase efficiency in delivery are therefore particularly relevant to Royal Mail's ability to reduce costs.

One important challenge is to transfer time savings from increased automation in mail preparation (sorting to rounds or into walk order) into longer outdoor delivery spans. This would allow for delivery rounds with more potential delivery points and therefore result in a reduced number of delivery rounds (on average) and thus less costs in Delivery. Royal Mail has a number of delivery-related projects dealing with measures to adapt and optimise indoor as well as outdoor delivery organisation with planned savings of [REDACTED], [REDACTED]. Royal Mail's project descriptions provided to Ofcom are fairly general so that single projects are not clearly separated from each other and overlapping of benefits is possible. However, Royal Mail argued that [REDACTED]⁹⁸ [REDACTED] we describe the five most important projects in more detail below based on Royal Mail's Investment Summary Descriptions.

- **Follow up opportunity:** To review the work organisation in delivery offices (indoor and outdoor) in light of the decline in letter volumes. [REDACTED]⁹⁹ [REDACTED].¹⁰⁰ This review followed the [REDACTED] between Royal Mail and CWU in 2014. Planned savings: [REDACTED] during the Business Plan period.]
- **Collection on Delivery:** This is one of the projects with the most visible impact for external stakeholders. The major change is that postmen/postwomen will collect letters from low volume postboxes during their delivery round. Around 12,000 postboxes in rural areas are already emptied by postmen/postwomen as part of their round, and the majority of those affected by Royal Mail's announced future changes will be in urban and suburban areas.¹⁰¹ Internally, work organisation of postmen/postwomen will be affected because the collections have to be built into their rounds in an optimal way.¹⁰² Royal Mail has now

⁹⁵ [REDACTED]

⁹⁶ [REDACTED]

⁹⁷ [REDACTED]

⁹⁸ See Royal Mail Response to Ofcom / WIK Business Plan queries dated from 8 January 2016, Answer to Question 4.

⁹⁹ [REDACTED]

¹⁰⁰ [REDACTED]

¹⁰¹ See Mail Online, Post boxes to be emptied before 3pm every day as Royal Mail brings forward half of collection times to the middle of the afternoon, 8 August 2014 (<http://www.dailymail.co.uk/news/article-2719980/Post-boxes-emptied-3pm-day-Royal-Mail-brings-forward-collection-times-middle-afternoon.html#ixzz3rqvGr81e>).

¹⁰² In some cases this has changed the time of collection from 5pm to 9am. See: <http://www.royalmail.com/personal/help-and-support/postboxes-faqs>.

implemented this initiative so that, overall, the collection of 45-50 thousand postboxes (c.40-45% of all postboxes) is done alongside delivery.¹⁰³ Royal Mail started implementing this initiative in September 2014.¹⁰⁴ Planned savings: [X].

- [X].¹⁰⁵ Planned savings: [X].
- [X]. Planned savings: [X].
- **High Impact Units:** This programme aims to increase the performance of [X] low performing DOs based on experiences and practices successfully implemented by high performing DOs.¹⁰⁶

Figure 2-15 Delivery: Project cumulated cost savings

[X]



Source: Based on Royal Mail, BP 2015 Operations Planning Model.

The planned cost saving initiatives in Delivery are summarised in Table 2-10 below.

Table 2-10 Efficiency initiatives: Cumulated, nominal cost savings in Delivery during the Business Plan period

[X]

Source: Based on Royal Mail, BP 2015 Operations Planning Model.

Note: Figures are taken unadjusted from Royal Mail's Business Plan. Totals may deviate due to rounding.

Negative values = cost increase

Positive values = cost decrease.

[X]

2.3.6 Management reorganisation programmes

The projects and measures presented in Sections 2.3.1 - 2.3.2 only refer to the Reported Business' core function Operations. Additionally, Royal Mail set up a programme to reorganise group and operational management. This programme called "Central Efficiency Programme" (CEP) was announced in March 2014, half a year after

¹⁰³ See for example: <http://www.royalmail.com/personal/help-and-support/postboxes-faqs>.

¹⁰⁴ See <http://www.royalmail.com/personal/help-and-support/postboxes-faqs>.

¹⁰⁵ [X]

¹⁰⁶ Royal Mail half year results to September 2015, November 2015

[http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20\[WEBSITE\].pdf](http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20[WEBSITE].pdf)

Royal Mail's IPO. According to this programme, in total 1,600 management employees would be affected, ensuring a net decline of 1,300 in group and operational management staff.¹⁰⁷ The costs of the programme were GBP 104m for redundancy payments in FYE 2014 which formed a major element of the transformation costs of GBP 241m in that year.¹⁰⁸ The transformation costs of GBP 241m were fully allocated to the Reported Business.¹⁰⁹ We would therefore expect that the Reported Business also benefits from the resulting cost savings. Royal Mail reported cost savings of GBP 42m in FYE 2015 (compared to expected GBP 25m) and c.1,400 leavers due to the management reorganisation programme.¹¹⁰ Expected cost savings of around GBP 80m per annum have been announced.¹¹¹ This is significantly more than the originally expected savings of GBP 50m in March 2014.

[redacted]¹¹²

The forecasted "Continued Efficiency Programme" savings allocated to the Reported Business' Operations amount to [redacted] for FYE 2016. In its half-year results for FYE 2016 Royal Mail reported savings of GBP 32m related to this programme¹¹³ [redacted]. Moreover, the company estimates that total savings of the programme will amount to GBP 40m at the end of this financial year.¹¹⁴

2.4 Summary

The Reported Business accounts for nearly 95% of UKPIL's total costs and nearly 80% of the costs of the Relevant Group. It reflects allocated costs to Royal Mail's core network i.e. excluding GLS, Parcelforce Worldwide and Royal Mail Estate Ltd.¹¹⁵

- Around two thirds of the Reported Business' costs are staff costs of which [redacted] originate from its core function Operations. Staff costs for delivery frontline staff

¹⁰⁷ See Royal Mail plc, Full Year 2013-14 Results, 22 May 2014, p.11 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202013-14_DDA_0.pdf). See also Royal Mail Group, Continued efficiency programme, press release 25 March 2014 (<http://www.royalmailgroup.com/continued-efficiency-programme>).

¹⁰⁸ See Royal Mail plc, Full Year 2013-14 Results, 22 May 2014, p.22 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202013-14_DDA_0.pdf).

¹⁰⁹ See Royal Mail Group Limited, Regulatory Financial Statements 2013-14, p.12 (http://www.royalmailgroup.com/sites/default/files/Regulatory_financial_statements_2013-14_1.pdf).

¹¹⁰ See Royal Mail plc, Full Year 2014-15 Results, 21 May 2015, p.12 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

¹¹¹ Ibid.

¹¹² [redacted]

¹¹³ See Royal Mail plc, Results for the Half Year ended 27 September 2015, 19 November 2015, p.9 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20for%20the%20half%20year%20ended%2027%20September%202015.pdf>).

¹¹⁴ Ibid.

¹¹⁵ See page 4 of Royal Mail's Regulatory Financial Statement, 2014-15, http://www.royalmailgroup.com/sites/default/files/Regulatory%20financial%20statements%202014-15%20-%202011.12.15_0.pdf.

account for [X] of total Reported Business' staff costs followed by frontline staff of regional logistics & processing which account for [X].

- Non-staff costs account for around one third of the Reported Business' costs. Major non-staff cost categories are Distribution & Conveyance Costs (terminal dues and costs related to mail transport), POL commissions and internal charges.

Table 2-11 summarises Royal Mail's planned cumulated cost savings for the Business Plan period (FYE 2016 to FYE 2018) as reported in the Reported Business Cost Matrix.

Table 2-11 Cumulated expected cost savings during the Business Plan period

	Total	Staff cost	Non-staff cost
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]

Source: Royal Mail, Reported Business Cost Matrix, total costs excluding transformation costs

Note: Figures are taken unadjusted from Royal Mail's Business Plan. Totals may deviate due to rounding.

* [X]

Royal Mail's 2015 Business Plan forecasts savings of [X] in the Reported Business excluding transformation costs between FYE 2015 (forecast) and FYE 2018. [X].

[X]

During the business plan period, Royal Mail has forecast that cumulated transformation costs of [X] are needed to implement its efficiency projects [X]. [X].

Royal Mail's projected cost savings are underpinned by a number of assumptions relating to key factors including changes in input costs, demand drivers and expected cost savings due to efficiency initiatives.

[X]. Royal Mail has estimated that the total cost of the Reported Business will decline by [X] per annum on average.

Royal Mail's projected efficiency measures mainly aim at accomplishing the current transformation programme, i.e. the rationalisation and modernisation of its mail centres, and to continue optimising its delivery operations. This is illustrated by the following measures:

- Royal Mail plans to close two additional mail centres¹¹⁶, [§] and finalise ongoing mail centre rationalisation programmes, e.g. in London.
- Royal Mail intends to “fine tune” its processing activities in mail centres to improve automation of large letters to walk sort level.¹¹⁷
- Royal Mail stated that it will implement a number of logistics initiatives including national road and air network reviews, along with focus on fuel, maintenance, and fleet costs.¹¹⁸ Alongside the reduction in mail centres, Royal Mail is planning to increase the efficiency of transport activities by network optimisation (reduction of flights and optimising road transport). Additionally Royal Mail notes that among its forthcoming initiatives in this area is the improvement of improving driver behaviour¹¹⁹, which it expects [§].

Royal Mail's major challenge is to transform the benefits from increased automation into greater efficiency in delivery. Royal Mail intends to address this challenge with a range of measures to continue the optimisation of the delivery operations. We understand that Royal Mail expects that the [§] it signed with the CWU in 2014 will help to facilitate the implementation of the Delivery initiatives.¹²⁰

In addition to projects related to the final stage of its transformation programme, Royal Mail has started three additional important efficiency and cost saving programmes after its IPO in October 2013:

- Royal Mail has implemented “collection on delivery”, i.e. postmen/postwomen collect letters from low volume post boxes along their delivery rounds not only in rural but also in urban areas.¹²¹

¹¹⁶ See Royal Mail plc, Half Year 2015-16 Results, 19 November 2015, p.7

([http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20\[WEBSITE\]_0.pdf](http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20[WEBSITE]_0.pdf)).

¹¹⁷ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.30.

¹¹⁸ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.27.

¹¹⁹ See Operations Plan: Logistics, 1 April 2016, <https://www.myroyalmail.com/news/2016/04/operations-planlogistics>.

¹²⁰ See Royal Mail / CWU (2014): Delivery Revisions. An agreed approach for managers and CWU representatives. Final agreed document September 2014.

¹²¹ See <http://www.royalmail.com/personal/help-and-support/postboxes-faqs>.

- The parcel automation programme should significantly increase Royal Mail's efficiency in parcel processing in around 20 of its busiest mail centres where parcel sorters will be installed.¹²² Simultaneously, the company plans to improve its track & trace technology for parcels.¹²³ The first measure will reduce manual sorting and increase the productivity (and the capacity) in parcel sorting and both measures will improve Royal Mail's competitiveness in the UK parcel market.
- [✂]

122 See Royal Mail's 2014-15 Annual Report, p.8, http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf.

123 See Royal Mail's 2014-15 Annual Report, p.9, http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf.

3 International benchmarking

For the international benchmark we identified six international postal operators (Section 3.1). This section describes the major differences between Royal Mail's postal operations and those of the comparators (Section 3.2). This is followed by a comparison of efficiency and cost savings programmes in Section 3.3 which presents a high-level description of the contents and timing of major efficiency measures and initiatives, highlighting the differences between Royal Mail and the other postal operators. It is self-evident that the efficiency programmes and cost saving efforts of postal operators affect the workforce. Vice versa, the bargaining power of employees and their representatives has an impact on the measures the operator can adopt to increase efficiency. For that reason Section 3.4 provides an overview of employment and labour conditions at Royal Mail and the comparators.

3.1 Selection of international postal operators

For the international benchmark we identified postal operators that offer a relevant comparison to Royal Mail's Reported Business. The Reported Business includes the services that rely on the universal service network such as domestic and cross-border letter and parcel services, including wholesale (access) services. It is a sub-set of Royal Mail's UK Parcels, International & Letters (UKPIL) business unit and has been defined by Ofcom for regulatory purposes such as regulatory cost accounting and assessing the financial sustainability of the universal service.

Identifying postal operators that are comparable to Royal Mail's Reported Business is challenging for a number of reasons:

- Firstly, countries differ in size, population and density. Given the applicable universal service requirements and commercial considerations, postal operations are often organised in different ways.
- Secondly, there are variances in institutional development across national postal operators, both in their timing and nature. While some are partly or fully privatised, others are state-owned enterprises. Different ownership structures may affect operators' strategic priorities, and their ability to raise capital from external investors where required.
- Thirdly, the market liberalisation process varies. Some countries opened their markets earlier, some at the latest possible date (in the European Union) and others have a legal monopoly (non-EU members).
- Fourthly, the demand for mail services has developed differently in national postal markets in terms of level and structure. However, digitalisation and competition

challenge the mail volume development of all national postal operators in letter and parcel markets.

- Finally, some national postal operators have formed their business divisions based on commercial considerations. For this reason, it is unlikely that publicly reported business divisions coincide with Royal Mail's Reported Business. Mail divisions often include international activities (e.g. in foreign mail markets) or supporting postal activities such as mail production services (e.g. mailing houses) or consulting services. Parcel operations are often assigned to other business divisions (i.e. separate from the mail division). Moreover, in many cases the mail divisions also manage retail networks (i.e. post offices and postal agencies).

Bearing this in mind, we identified national postal operators which are similar to Royal Mail in some relevant, but not in all, aspects. A comparison with postal operators facing effective competition in their domestic letter delivery markets or experiencing substantial volume decline offers insights into the role of competition in driving efficiency, and the methods employed by operators in responding to significant volume declines. In particular, to see whether operators have reacted differently or changed their approach when faced with a more severe challenge to their position is of interest in this context.

Ofcom and WIK-Consult decided to include six national postal operators in the international benchmark. These are:

- Deutsche Post (Germany)
- La Poste (France)
- PostNL (Netherlands)
- PostNord Denmark (formerly Post Danmark)
- PostNord Sweden (formerly Posten)
- USPS (United States)

We recognise that no postal operator is wholly comparable to Royal Mail's Reported Business. However, all postal operators, including Royal Mail, face the same challenges to varying degrees, especially in relation to the ongoing decline in letter volume. Their letter operations basically follow the same high-level processes and are based on similar technologies. However, there are differences in detail e.g. due to geography, the development and the density of delivery points.

How operations are structured may vary but the services on offer are similar: all operators collect, transport and deliver letters and parcels. Moreover, all of these postal operators are subject to universal service obligations, i.e. to ensure nationwide provision of a postal service of specified quality at affordable prices. Home delivery of mail is a common standard in most countries, particularly in Europe. For these reasons the benchmarking exercise provides useful insights and allows conclusions on the reasonableness and feasibility of Royal Mail's efficiency initiatives and cost saving plans as outlined in its 2015 Business Plan.

In the subsequent paragraphs we briefly present the background of the selected international postal operators compared to Royal Mail in relation to the selection criteria.

Table 3-1 Selected postal operators: Selection criteria

Operator	Letter volume decline	Parcel volume growth	Competition in letter delivery	Downstream access	Competition in parcel delivery	Privatised	Importance of industrial relations	Market size	Growth delivery points	Geography
	>5% p.a. (since 2009)	>5%p.a. (since 2010)	Market share end-to-end competition >5%		Market share operator (volume) >40%		Substantial	>20m households	Households >0.8% p.a.	Significant proportion of very rural areas
Royal Mail	Yes	No	No	Yes	Yes	Yes	Yes (2)	Yes	Yes	Yes
Deutsche Post	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No
La Poste	Yes	No	No	Yes	Yes	No	Yes (2)	Yes	Yes	Yes
PostNL	Yes	Yes	Yes	No (1)	Yes	Yes	Yes	No	Yes	No
PostNord Denmark	Yes	No	No	No	Yes	No	Yes	No	No	No
PostNord Sweden	No	Yes	Yes	No	Yes	No	Yes	No	Yes	Yes
USPS	No	Yes	No	Yes	No	No	Yes (2)	Yes	Yes	Yes

Source: WIK research.

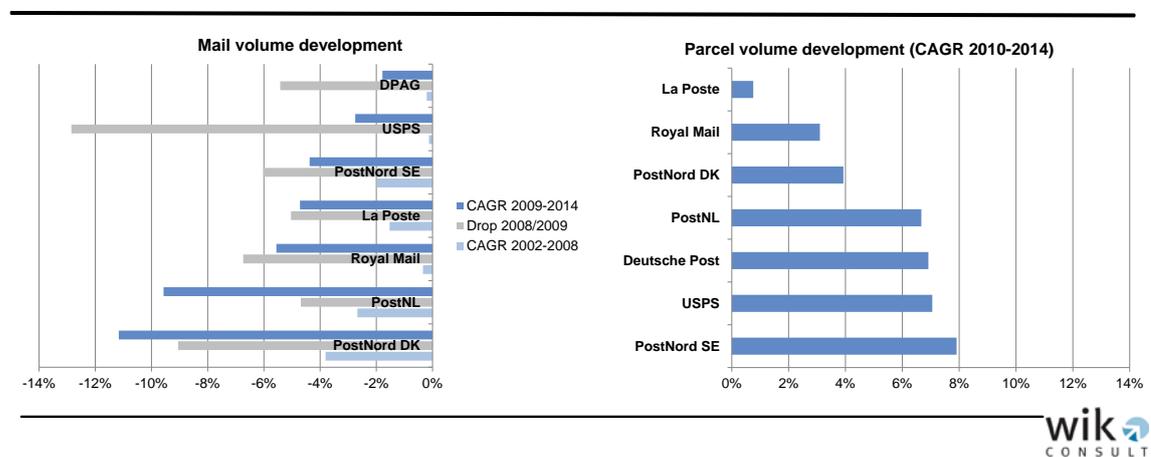
Notes: (1) The Dutch regulator recently decided to enforce downstream access for competitors of PostNL.
 (2) Labour relations are characterised by very formalised procedures and high degree of regulation at local and national level.
 Red-shadowed cells: Different to Royal Mail;
 Green-shadowed cells: Similar to Royal Mail.

Table 3-1 outlines the extent to which the selected postal operators are comparable to Royal Mail in each of the applied categories. We consider that there are at least high-level similarities between the selected postal operators and Royal Mail to a significant degree. Below we provide further information on Table 3-1, and the reasons for this selection of international operators.

Development of postal operators' demand (letter and parcel volume)

The decline in letter volume driven by the increased use of electronic communication channels (often referred to as e-substitution) is a general challenge for all postal operators. They are under pressure to reduce costs as letter volume declines.

Figure 3-1 Demand changes for letter and parcel volumes



Source: Based on annual reports and market reports of national regulatory authorities.

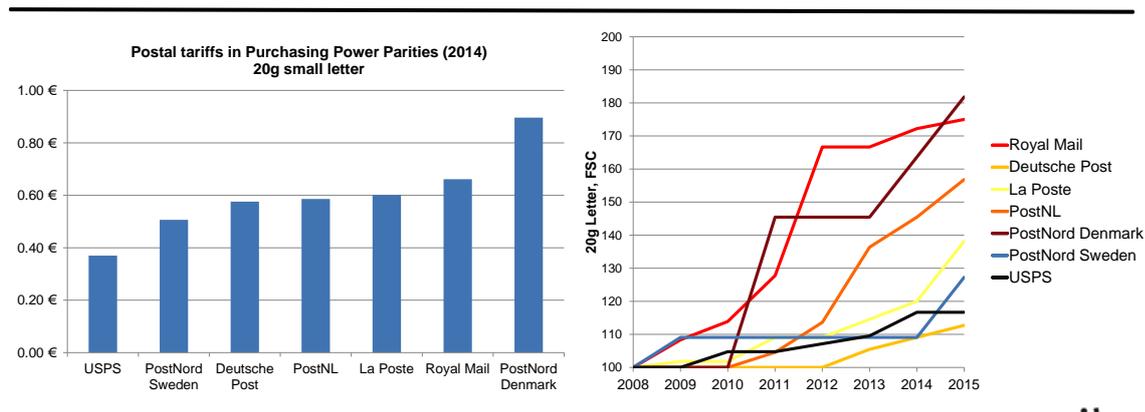
All postal operators have experienced letter volume decline since 2002 (see Figure 3-1). Volume decline was highest at PostNord Denmark and PostNL before 2008. The rate of volume decline has accelerated since the 2008 global economic recession. PostNord Denmark in particular saw a strong negative shock to volumes in 2008 (second only to USPS), and PostNL saw a similar effect. Since 2009, Denmark and the Netherlands have again experienced the greatest volume declines. The sustained high rate of decline in these two countries indicates that they are more affected by e-substitution than other countries.¹²⁴ PostNL lost more than 50% and PostNord Denmark more than 60% of their letter volume between 2002 and 2014. PostNL's demand for letter services is additionally affected by end-to-end competition in the Dutch letter market. Royal Mail, La Poste and PostNord Sweden have faced a mid-level letter volume decline of c5% per annum on average since 2008 while Deutsche Post

¹²⁴ In both countries the governments have successfully implemented far-reaching e-government initiatives which are a major driver for e-substitution (for more information on eGovernment initiatives, see European Commission, eGovernment in Denmark (2015) and eGovernment in the Netherlands (2015), https://joinup.ec.europa.eu/community/nifo/og_page/egovernment-factsheets).

and USPS have experienced much lower decline of 2-3% per annum during the same period.

The accelerated letter volume decline is reflected in increasing letter prices. This is illustrated by the development of the tariffs for single-piece letters (20g) since 2008.

Figure 3-2 Price development of single piece 20g letter, fastest standard category (D+1 at European postal operators and First Class at USPS)



Source: Based on postal operators' price lists.

Note: Purchasing Power Parity conversion into EUR based on Eurostat data.
Letter: 110mm by 220mm by 5mm, 20g or less.
PostNord Sweden: Tariff includes VAT (25%).

Figure 3-2 presents firstly the tariffs for letters of the fastest standard category (D+1 respectively First Class at USPS) in purchasing power parities¹²⁵ and, secondly, shows the price performance (indexed) at the selected postal operators including Royal Mail. PostNord Denmark has the highest price level for letters followed by Royal Mail. However, the overall price levels among the other European comparators are fairly similar. The right-hand chart clearly shows that the tariffs in the UK have increased most significantly, followed by PostNord Denmark (which surpassed Royal Mail in 2015) and PostNL, while Deutsche Post moderately increased the (regulated) tariff for 20g letters. It should be noted that in the UK and in Denmark stamped 20g letters for next day delivery are not subject to price regulation. Recently, PostNord Denmark announced it will increase 20g D+1 letter from DKK 10 to DKK 19 (GBP 1.89) by 1 January 2016.¹²⁶

¹²⁵ Eurostat (see <http://ec.europa.eu/eurostat/web/purchasing-power-parities/data/database>).

¹²⁶ See Post Danmark, press notice of 30 September 2015.

Competition in letter markets

The existence of additional letter delivery companies in a former monopolised market allows customers to choose between suppliers based on price and quality considerations. This typically limits the incumbent postal operators' ability to profitably increase prices and puts pressure on it to become more efficient in an environment where average costs would be expected to increase (all other things being equal).

In all countries except for the United States the letter delivery market is fully open to competition. End-to-end competition plays an important role in the letter delivery market in only three of the six selected countries: in Germany, the Netherlands and Sweden. Even in these countries the incumbent postal operators still have market shares of around 90% (in revenues). The other countries (Denmark, France, United States) are more comparable to the UK situation, however, for different reasons. USPS, for example, still enjoys a "mailbox monopoly"¹²⁷ which keeps potential competitors out of the letter delivery market.

The competitive situation in the UK letter delivery market changed in Spring 2015.¹²⁸ Whistl, a former subsidiary of PostNL, put its end-to-end delivery expansion on hold after losing its key investor who had planned to secure a 60% stake of Whistl. In May 2015, Whistl decided to suspend its end-to-end letter delivery service. In June 2015, Whistl decided to exit the end-to-end letter delivery market and to refocus on its core services (i.e. its downstream access business).¹²⁹ At the end of July 2015, PostNL agreed to a deal for a management takeover of its UK subsidiary Whistl and exited the UK postal market. The management buyout was completed in October 2015.¹³⁰ After the market exit of Whistl, Royal Mail appears to be the sole nationwide provider for end-to-end letter delivery services for the foreseeable future.

Access competition¹³¹ plays a substantial role in the UK and the United States, with a volume share of around 50% in both countries, and to lesser extent in France (more than one third) and Germany (around 10%).¹³²

¹²⁷ The "mailbox monopoly" means that solely USPS is allowed to access the letter box of each recipient. Parcel operators or newspaper deliverers must not deliver their items to the recipient's letter box.

¹²⁸ See CEP-Research, Clear road for Royal Mail as PostNL's rival final-mile delivery network deal fails, 30 April 2015.

¹²⁹ See Whistl, Update on E2E review, June 2015 (<http://www.whistl.co.uk/news/update-on-e2e-review/>).

¹³⁰ See Whistl, Completion of Management Buy Out of Whistl, October 2015 (<http://www.whistl.co.uk/news/completion-of-management-buy-out-of-whistl/>).

¹³¹ Access competition refers to upstream competition by consolidators that collect, sort and transport letters to the incumbent postal operator's sorting centres.

¹³² See Bender/Dieke/Junk/Thiele (2013), Downstream access in letter markets, WIK Discussion Paper No. 382 (German version).

Competition in parcel markets

All of our selected postal operators, including Royal Mail, have a substantial market share in their domestic parcel delivery markets and particularly in the delivery of parcels to consumers (B2C) which is the most dynamically growing segment driven by e-commerce. While there has historically been greater competition in the business to business (B2B) than the B2C segment, the substantial growth already seen in the B2C segment and its future potential has resulted in significant increases in competition not only by traditional European¹³³ and local parcel & express operators but also by large e-commerce players such as Amazon. Amazon is establishing its own delivery infrastructure in large markets including the UK, Germany, France, and the United States.

Privatisation

In addition to Royal Mail, two of the selected operators, Deutsche Post and PostNL, have been privatised (we define operators as privatised if the state owns less than 50% of their shares). PostNL and Royal Mail¹³⁴ are fully privatised while the German state indirectly holds around 20% of Deutsche Post's shares. All three companies are listed on the stock exchange. The privatisation process of Deutsche Post and PostNL started more than ten years earlier than Royal Mail's. PostNord and La Poste, as well as USPS are fully state-owned. PostNord arose from the merger between Post Danmark and Swedish Posten in 2009 and is joint-owned by the Danish and the Swedish states.

States often follow additional objectives (not necessarily only profit maximising) compared to private investors. Privatised and listed companies may therefore face more pressure to maximise profitability (e.g. by substantial cost savings) than companies that are fully owned by the state.

Industrial relations

At all of the selected postal operators, unions and industrial relations play a substantial role. The situation at Royal Mail, La Poste and USPS stands out because their labour relations are characterised by more formalised procedures and a high degree of regulation of labour relations at local and national level. More detail on the employment and labour policy of Royal Mail and the selected postal operators is provided in Section 3.4.

¹³³ Traditional European B2B parcel & express operators are e.g. Royal Mail's GLS, La Poste's DPD and Deutsche Post DHL and United Parcel Services (UPS).

¹³⁴ The UK government sold a 60% stake in Royal Mail at the IPO (October 2013) and 10% were given to Royal Mail's employees for free. A further 15% stake was sold by the government on 11 June 2015 and the final stake of 13% on 12 October 2015. Additionally, 2% of the shares were given to Royal Mail's employees, so that Royal Mail's employees now own 12% of the company.

Country characteristics

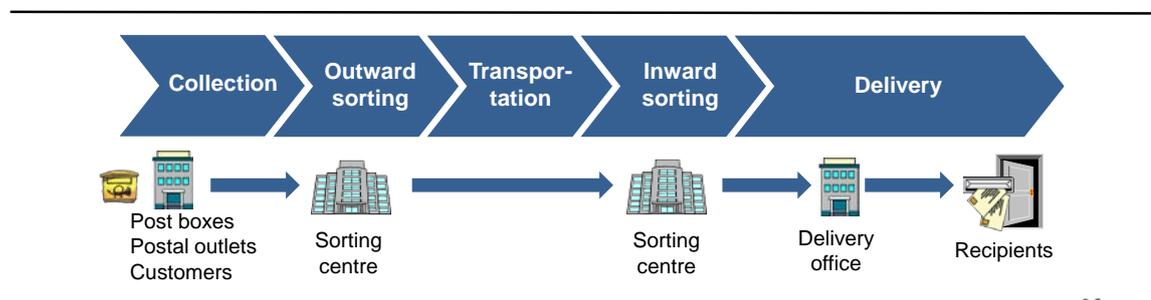
Finally, the postal markets of Germany and France are of a similar size to the UK postal market in terms of the total number of households. In terms of growth of delivery points and geography (significant proportion of very rural areas) France, Sweden and the United States are comparable to the UK. They all have a mix of very rural, rural, suburban and urban locations and a continuously growing number of households of more than 0.8% per annum.

In the following sections we compare current postal operations, their efficiency programmes and their employment and labour conditions with Royal Mail's in order to prepare the basis for our assessment of Royal Mail's 2015 Business Plan in the light of international peers' experiences.

3.2 Comparison of postal operations

The core structure of the postal pipeline is the same at each of the international postal operators including Royal Mail. Depending on the size of the country the use of additional transportation hubs (for air and road transport) can be necessary.

Figure 3-3 Stylised postal pipeline



Source: WIK-Consult (2013), Review of Postal Operator Efficiency, p.13.

While the core postal pipeline is the same for all modern postal operators there are differences related to two major aspects:

- Firstly, differences in the degree of automation in letter processing and the way that delivery is organised in detail; and
- secondly, the extent to which letters and parcels are processed in the same facilities and delivered jointly.

We compare the following aspects of postal operations between Royal Mail and its international peers:

- Collection on Delivery
- Separate letter and parcel sorting centres
- Automated sorting of parcels
- Walk sorting of large letters by machine
- Sequencing of letters by machine
- Centralised sequence sorting by machine in letter sorting centres
- Bundling of unaddressed items by machine
- Outsourcing road transport
- Minimising mail preparation in delivery offices
- Separate manual sequence sorting from outdoor delivery
- Centralised manual sequence sorting
- Major methods of delivery in urban areas
- Combined delivery of letters and parcels
- Peak and off-peak delivery days

(1) **Collection on Delivery:** The collection of letters from postboxes by postmen/postwomen during their delivery round is a widely applied practice at most of the selected European postal operators. In Germany, for example, this is often part of the rural delivery round (by van). Only PostNL does not apply this practice because of its special delivery model.¹³⁵ However, PostNL has fully franchised the collection of postboxes, similarly to what Deutsche Post has done in urban areas. Royal Mail has implemented Collection on Delivery for low volume boxes in urban and rural areas.

(2) **Separate letter and parcel sorting centres:** Both Royal Mail and USPS use a single sorting facility for letter and parcel processing. This is not a common practice at their European comparators. European operators have typically implemented

¹³⁵ See Section 4.3.4.

separate sorting centres for letter and parcel processing, partly at other locations (e.g. Deutsche Post and PostNL).

However, the situation at Royal Mail is more complex. Royal Mail operates two distinct networks in the UK: the Royal Mail core network (which forms the Reported Business) and the Parcelforce network. Through the Royal Mail Core Network, Royal Mail delivers parcels and letters, whereas Parcelforce collects and delivers “express” parcels.¹³⁶ In addition, Royal Mail has priced many of its higher weight single piece products so the equivalent Parcelforce product (such as express24 and express48¹³⁷) is cheaper as well as offering more value added services such as tracking. This has the effect of channelling much of the single piece products over 2kg through the Parcelforce network. In addition, any parcels over a maximum size of 610mm x 460mm x 460mm (including lighter weight products) will need to be sent via Parcelforce (or using other parcel delivery operators).

- (3) **Automated sorting of parcels:** In its core network Royal Mail is currently the only operator in our analysis that does not sort parcels by machine. This is surprising given the substantial parcel volume it processes (around 1bn items in FYE2015)¹³⁸. USPS and the selected European postal operators process nearly all parcels weighing up to 30kg or 31.5kg by machine. All the comparators except Royal Mail offer track & trace as a standard feature of their parcel products (i.e. without extra charge).¹³⁹ PostNord Denmark and Sweden, PostNL and partly Deutsche Post automatically sort parcels down to postal delivery rounds. At Royal Mail, barcoded parcels are manually scanned and all parcels are manually sorted to delivery offices.

In some cases postal operators have installed small parcel sorters in their letter sorting centres. These machines are used to walk sort thicker and/or larger mail items up to 2kg that cannot be sorted in letter sorters. PostNord Sweden and PostNL have invested, and are continuing to invest, in special machines for sorting this type of mail to delivery rounds (e.g. PostNord Sweden uses the machine produced by Fives Cinetics). These sorters usually have a much smaller footprint than the large scale parcel sorters that process bulkier parcels weighing up to 30kg.

¹³⁶ Royal Mail (2013), Prospectus, p.4 (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf). Parcelforce also has a product with a 48 hour service standard.

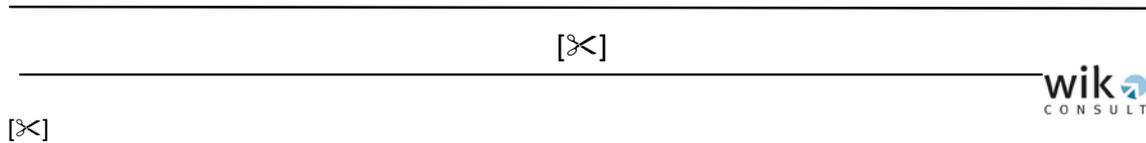
¹³⁷ See Royal Mail, Our prices, valid from 30th March 2015 (<http://www.royalmail.com/sites/default/files/Royal-Mail-UK-and-international-parcel-and-letter-prices-30-March-2015.pdf>).

¹³⁸ See Royal Mail, Annual Report and Financial Statements 2014-15 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

¹³⁹ In none of the countries (including UK) the universal service obligation requires a tracked parcel product. Tracking & tracing is a voluntarily offered feature.

- (4) **Walk sorting of large letters by machine:** The proportion of walk sorted large letters minimises the need for a manual primary sort step in the delivery office. All international postal operators walk sort their large letters to some degree.

Figure 3-4 Proportion of “manual” letters and large letters at Royal Mail



We understand that Royal Mail's proportion of large letters walk sorted to rounds is [X].¹⁴⁰ It appears that this [X] (see right chart in Figure 3-4). The proportion of “mechanised” large letters in delivery is [X] and [X]. In contrast, Royal Mail has assumed that the proportion of “mechanised and sequenced” letters is [X] (see left chart in Figure 3-4).¹⁴¹

Generally, it should be taken into account that at all postal operators, including Royal Mail, a certain proportion of large letters (for example periodicals and magazines) do not need processing at the inward mail centre because they have been pre-sorted to walks by the sender.

- (5) **Sequencing letters by machine:** All postal operators, including Royal Mail, use machines to sequence letters. Only Royal Mail and La Poste have not yet achieved the maximum proportion of around 90-95% of sequenced letters.¹⁴²

Some postal operators have experimented with sequencing large letters by machine (e.g. PostNord Sweden, Deutsche Post, PostNL). To our knowledge only USPS actually makes significant use of this technology in a subset of its mail centres¹⁴³ while PostNord Sweden and PostNL decided to not yet apply it for economic reasons.

- (6) **Centralised sequence sorting by machine in letter sorting centres:** Royal Mail has put one third of its walk sequencing machines at mail centres, and chose to

¹⁴⁰ See Royal Mail, Answer to Question 10 of the Request for Information made by Ofcom under s.55 of the Postal Services Act, dated December 4th, 2013.

¹⁴¹ Royal Mail reports to sequence 82% of letters (see Royal Mail, Annual Report and Financial Statements 2014-15, p.10 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf)). [X].

¹⁴² Royal Mail reports to sequence 82% of letters (see footnote 141).

¹⁴³ See USPS, Flats Sequencing System (FSS), Frequently Asked Questions, updated January 2014. USPS has deployed 100 FSS machines at processing plants with the highest flats volumes and the highest average number of flats per delivery point (https://ribbs.usps.gov/flat/documents/FSS_FAQs/FSS_FAQs.pdf).

install the remainder in delivery offices or MPUs.¹⁴⁴ MPUs are in some cases former mail centres which have been closed down as part of Royal Mail's transformation programme. La Poste also decided to install walk sequencing machines in delivery offices. [3<].¹⁴⁵ PostNL has located sequence sorters in delivery offices.¹⁴⁶ However, the situation at PostNL is different because it is centralising mail preparation activities and is therefore reducing the number of delivery offices successively. For this reason the number of delivery rounds covered by one delivery office at PostNL is much higher than at Royal Mail, meaning that the sorting capacity of its walk sequencing machines is better exploited.

- (7) **Bundling of unaddressed items by machine:** PostNord Denmark and Sweden are both very advanced in the handling of unaddressed items. They have mechanised the bundling of unaddressed items into a folded and wrapped collection of items.¹⁴⁷ Furthermore, the machine prepares walk bundles taking into consideration those addresses who do not want to receive any unaddressed advertising.
- (8) **Outsourcing road transport:** Royal Mail relies on its own drivers and own vehicles for road transport in the UK¹⁴⁸ and commissions transport companies in peak times only. However, Royal Mail's air transport is fully franchised.¹⁴⁹ The situation is similar at PostNord Denmark.¹⁵⁰ Other postal operators outsource transport to separate companies at least for road transport between their sorting centres because transport companies can often provide these services at lower costs than the postal operator itself. The cost difference results from a number of reasons, for example vehicle maintenance and allocation of unused transport capacity. Moreover, transport companies may have lower input costs, for example due to a lower wage level (e.g. in the logistics sector in Germany).¹⁵¹
- (9) **Minimising mail preparation in delivery offices:** A high degree of automation in small and large letter processing minimises the need for mail preparation at

144 See Royal Mail, Answer to Question 12 of Request for Information made by Ofcom under s.55 of the Postal Services Act dated from December 4th, 2013. Royal Mail reported that they installed walk sequencing machines in [3<] delivery offices.

145 Interview La Poste, 16 July 2015.

146 PostNL site visits, 24.-25. August 2015.

147 PostNord Sweden uses the folded flier to sell additional advertising space, Interview Peter Brännström, 22 June 2015.

148 See Royal Mail plc (2013), Prospectus, Sections 1.31, 2.3, 4.2 (A) (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

149 Ibid, Section 4.2 (A).

150 Interview PostNord Denmark, 12 August 2015, see also WIK-Consult (2013), Review of Postal Operator Efficiency, Section 6 (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

151 The ability to deduct VAT payments further drives outsourcing activities. The postal operators' ability depends on the scope of services that are VAT exempted which differs among universal service providers. In this report we have not analysed the scope of VAT exemption of each selected postal operator in detail and cannot make any statements on this aspect.

delivery offices. If all items are sorted, as a minimum, to delivery rounds in the letter sorting centre, the primary sort step (sorting of items to delivery rounds) can be skipped. If a substantial proportion of letters are already sequenced by machine, manual sequencing and thus the time span for indoor mail preparation can be reduced. The time allocated to outdoor activity can then be extended, which means that the length of rounds allocated to full-time postmen/postwomen can be increased (more addresses and stops). In the end, the total number of delivery rounds can be reduced.

Royal Mail started the modernisation of its delivery operations relatively late. The company reported that the time spent on indoor activities still accounts for c40% of the total working time of a postman/postwoman (down from 50% before modernisation through the transformation programme).¹⁵² The proportion of working hours for indoor activities is substantially lower at most of the comparator companies: around 20% at Deutsche Post and USPS where postmen/postwomen are still responsible for indoor and outdoor delivery activities. At PostNord Denmark and Sweden as well as PostNL the indoor time span is also minimal because these companies have assigned indoor mail preparation and outdoor delivery to different employee groups.

One important aspect influencing the indoor time span is how postmen/postwomen treat the bundles of letters that have been sorted into delivery order by walk sequencing machines. From an operational point of view, manually sorted letters and those letters already prepared by machine should be treated as separate bundles. In practice, postmen/postwomen prefer having one bundle of letters for delivery instead of two or more bundles.¹⁵³ The practice of postmen/postwomen at Royal Mail is to merge all letters plus unaddressed items in a sorting frame at the delivery office. In the end, each postman/postwoman has one bundle for final delivery only partitioned into walk segments e.g. streets.

Other postal operators' practice as to whether letters are manually sorted or already sequenced is mixed. At PostNord Denmark and Sweden postmen/postwomen mainly use separate bundles. At PostNL and at La Poste addressed letters are usually merged. This includes walk sequenced small "machine letters" and "manual" small and large letters. From an operational perspective bundling of "machine letters" and "manual letters" requires an additional, manual working step which extends the time span for indoor activities. In delivery, picking up letters from separate bundles requires more time per delivery point than picking up letters from one bundle. Moreover, the delivery method and the equipment of delivery vehicles matter: Picking up letters from trays optimally arranged in a car is different from picking up letters from several bags. These

¹⁵² Royal Mail site visits, 8-9 June 2015.

¹⁵³ Royal Mail site visits, 8-9 June 2015.

effects have to be weighed up against each other to decide which method is more cost efficient.

Royal Mail's practice of bundling unaddressed items with letters is unique. The practice of postmen/postwomen at other postal operators is to use separate bundles for addressed and unaddressed items when they deliver addressed and unaddressed items on one round.

- (10) **Separate manual sequence sorting from outdoor delivery:** As noted above another element in delivery modernisation taken by some operators is to assign indoor mail preparation and outdoor delivery to different employees. This is an element only practiced at PostNL and PostNord (Denmark and Sweden), and partly at Deutsche Post (only in very urban areas).
- (11) **Centralised manual sequence sorting:** If manual sequence sorting is separated from outdoor delivery, it is possible to further centralise manual mail preparation at a smaller number of delivery offices. These delivery offices can additionally be equipped with sequence sorting machines. The rationalisation of delivery offices is usually combined with the establishment of additional "depots" which are "pick-up only" and allow the deliverer to collect the pre-prepared bags for final delivery (standard practice at PostNL with part-time deliverers and rolling out at PostNord Denmark and Sweden mainly with full-time deliverers).
- (12) **Major methods of delivery in urban areas:** Royal Mail has modernised its delivery organisation in the last few years. The major change was to replace delivery by bicycle with more van/foot delivery ("Shared van").¹⁵⁴⁻¹⁵⁵ The "Shared van" method allows Royal Mail to reduce the need for replenishment of the delivery bags during the round but is more demanding with regard to route planning and coordination between the postmen/postwomen involved. In contrast, none of the comparator postal operators apply this specific delivery method and none has extended foot delivery in recent years. Only USPS uses a combined van/foot delivery method (but not shared between two employees) because of large distances between delivery offices and delivery rounds. The European postal operators rely on delivery by bicycle in urban and sub-urban areas with only a small proportion of foot delivery rounds. Additionally, the European operators have sought ways to increase the mail volume transported by each postman/postwoman by using tricycles or e-bikes (e.g. PostNord Denmark) to reduce the need for replenishments. The dominant delivery method in rural areas for all postal operators, including Royal Mail, is delivery by van.

¹⁵⁴ "Shared van" working is based on two employees sharing a vehicle to deliver the mail for two routes. This requires that both postmen/postwomen align their way of working.

¹⁵⁵ See <http://www.royalmail.com/personal/help-and-support/how-are-you-changing-my-deliveries>.

(13) **Combined delivery of letters and parcels:** We observe two models for combined delivery of letters and parcels:

- Combined delivery of parcels and letters in rural areas is established at Royal Mail (in very rural areas) and at its international peers except for PostNL.¹⁵⁶ Combined delivery of letters and parcels (in terms of specific parcel products with track and trace (T&T) and sometimes signature on delivery) is usually the case when mail is delivered by van. This is general practice at Deutsche Post, La Poste and PostNord Denmark and Sweden.
- PostNord Denmark and Royal Mail, both, additionally deliver small- and medium-sized parcels up to 3kg and 2kg, respectively, combined with letters nationwide i.e. also in urban and suburban areas. It is worth pointing out that PostNord Denmark delivers less than half of mail items per capita (around 100) than Royal Mail which may explain its decision to deliver both, letters and parcels, in urban areas. The combined delivery has also impacted on the delivery method to some extent. While Royal Mail's postmen/postwomen use high-capacity trolleys¹⁵⁷ in case of foot delivery or "shared van" delivery in urban areas, Danish postmen/postwomen rely on tricycles with integrated "high-capacity" trays.¹⁵⁸

(14) **Peak and off-peak delivery days:** This method implies a more complex approach to demand management. We understand Royal Mail has not yet established measures for levelling workload during the week to the same extent as its international peers. Deutsche Post, PostNL and PostNord Denmark have established a mail flow control that allows them to concentrate mail volume on certain days, resulting in changing volumes across their 5 or 6 delivery days per week.

- Deutsche Post, for example, does not deliver unaddressed and addressed advertising on Mondays.¹⁵⁹
- PostNL introduced its system of peak and off-peak days in 2012 by delivering D+3 letters only on Tuesdays, Thursdays and Saturdays while D+1 letters are delivered each working day. [X].¹⁶⁰

¹⁵⁶ PostNL recently announced the reintroduction of combined delivery networks for letters and parcels in rural areas, see PostNL, PostNL 2020 Committed to sustainable delivery the next phase, Strategy update, 3 November 2015, p.21.

¹⁵⁷ See <http://www.royalmail.com/personal/help-and-support/how-are-you-changing-my-deliveries>.

¹⁵⁸ Site visit and interview PostNord Denmark, 12 August 2015.

¹⁵⁹ See WIK-Consult (2013), Review of Postal Operator Efficiency, Section 5 (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

¹⁶⁰ See PostNL, Presentation held at the PostNL site visits, 24-25 August 2015.

- In 2008, Post Danmark (now PostNord Denmark) introduced a new delivery model, the “X/Y distribution model”. Letters for which overnight delivery is not required (D+4 letters and unaddressed items) are distributed every second day. The X/Y distribution model therefore allows second class mail to be concentrated on three delivery days instead of six.¹⁶¹ Which specific three days depend on whether the address is classified as X or Y address on the round. All items that need overnight treatment are delivered to each household six days per week. This organisation has resulted in delivery being organised in a way to ensure stable daily delivery volumes on Tuesdays to Saturdays (and thus full-time employment for postmen/postwomen). Recently, PostNord Denmark has introduced the “Small Saturday” (complementary to the “Big Friday”); this involved shifting 1.5m letters and magazines (which account for more than three quarters of the average daily volume) from Saturday to Friday and Tuesday/Wednesday.¹⁶²

The introduction of peak and off-peak delivery days needs a sophisticated approach to mail flow control. This requires a nationwide, highly-integrated IT system for collection and processing of mail volume data at a very granular level. We note that Royal Mail's IT systems are subject to one of the efficiency projects in its BP 2015. The same infrastructure would also support regular round revisions and round planning even at short notice (which necessarily requires a more flexible work organisation in general, see Section 3.4 for more detail).

The most common method of mail flow control is to store mail items not to be delivered the next working day in sorting centres (operated by La Poste, PostNord and Royal Mail) or alternative facilities (specific warehouses for addressed and unaddressed advertising items as used by Deutsche Post). A complementary instrument is to require timely forecasts of mailings from senders of bulk mail.

The examples highlight that the introduction of peak delivery days is only relevant if the postal operator has a substantial proportion of non-priority or second class letters and unaddressed items. Letters that require next day delivery have to be delivered each delivery day. Both, PostNL and PostNord Denmark, introduced slower letter service products combined with a pricing scheme incentivising the shift from next day to slower delivery services.¹⁶³ The Dutch and the Danish approaches are different in terms of customer orientation. PostNL offers its customers pre-determined delivery days which is particularly useful for advertisers to plan their campaigns. This is certainly driven by the competitive pressure PostNL faces in the Dutch letter market. PostNord Denmark, in contrast, primarily considers employment

¹⁶¹ See WIK-Consult (2013), Review of Postal Operator Efficiency, Section 6.2.2 (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

¹⁶² Site visit and interview PostNord Denmark, 12 August 2015.

¹⁶³ At PostNord Denmark the proportion of D+1 letters declined from more than three quarter to less than half of total letter volume.

conditions and wants to level the workload in a way that helps to keep full-time jobs for its staff.

Table 3-2 summarises the main findings emerging from the comparison of Royal Mail's core operations to the ones of its international peers. The status of application is illustrated by "Harvey Balls". An empty Harvey Ball indicates that the element in question is not applied, a half-filled Ball shows that it is partly applied and a filled one that the element has been largely implemented by the postal operator in question.

Table 3-2 Current postal operations: Status of application of selected elements

	Royal Mail	Deutsche Post	La Poste	PostNL	PostNord DK	PostNord SE	USPS
Collection on delivery	◐	◐	◐	○	◐	◐	n/a.
Separate letter and parcel sorting centres	○	●	●	●	●	●	○
Automate sorting of parcels	○	●	●	●	●	●	●
Sequence sorters located in mail sorting centres	◐	●	◐	●	●	●	●
Walk sorting of large letters by machine	◐	●	◐	●	●	●	●
Sequencing of letters by machine	◐	●	◐	●	●	●	●
Road transport outsourced	◐(1)	●	◐(1)	●	◐(1)	●	◐(1)
Separate manual sequencing from outdoor delivery (different persons)	○	◐	○	●	●	●	○
Major methods of delivery in urban areas	Van/foot (Shared van)	Bicycle/foot	Bicycle/foot	Bicycle	Bicycle	Bicycle	Van/foot
Combined delivery of letters and parcels	●	◐	◐	○	●	◐	◐
Peak & off-peak delivery days	○	◐	○	●	●	○	○

Source: WIK assessment based on WIK-Consult (2013), Review of Postal Operator Efficiency, updated by desk research, site visits and interviews.

Notes: ○ - not applied
 ◐ - partly applied,
 ● - largely applied.
 n/a: information not available
 (1) Only outsourced on an overflow basis.

Royal Mail's current mail operations reflect the later start of its transformation programme. Consequently progress made by Royal Mail is limited compared to the current operations of most of its international peers which generally started their modernisation earlier.

3.3 Comparison of efficiency programmes

3.3.1 Introduction

In Section 3.2 we compared the current postal operations of Royal Mail and the comparator postal operators. The differences identified are partly the result of individual strategic decisions and partly the result of differences in timing and intensity of efficiency and cost saving programmes. In this section we analyse the latter in more detail.

We differentiate four categories of efficiency programmes:

- (1) Mail centre rationalisation: Consolidation of mail centres and/or construction of new mail centres;
- (2) Automation: Modernisation of sorting machines and roll-out of machines to sequence sort letters;
- (3) Logistics: The reorganisation of the network structure with less mail centres and delivery offices also affects national and regional transport relations which postal operators seek to organise in a cost-minimising way; and
- (4) Delivery: Reorganisation of delivery operations including optimisation and improving flexibility in delivery operations by centralisation of mail preparation and separation of indoor and outdoor activities.

The four categories indicate that the basic measures implemented by postal operators to improve efficiency and reduce costs are very similar in their nature. Differences in the timing relate to individual circumstances / drivers¹⁶⁴ such as:

- Demand conditions;
- Competition in the letter delivery market;
- Corporatisation and privatisation; and

¹⁶⁴ See also Section 3.1 for more detail.

- Available technological options (processing technology, automatic reading capabilities, data processing and optimisation tools, system integration etc.).

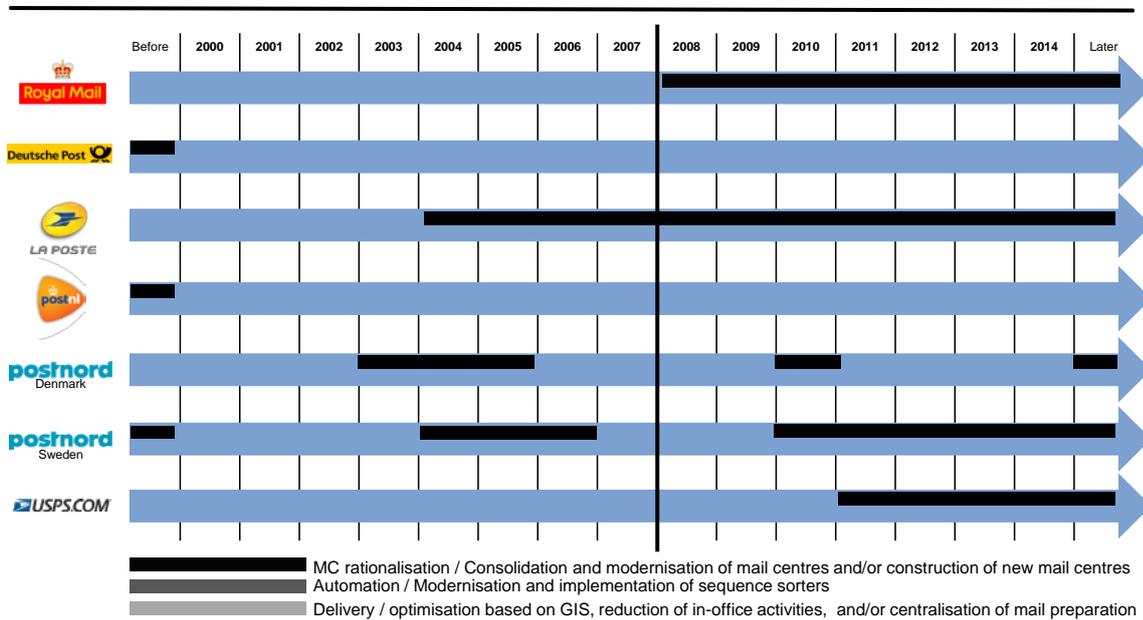
In addition to cost savings and efficiency improvements in mail operations, postal operators also seek to make cost savings in overhead and management functions. This is addressed in Section 3.3.6 later in this chapter.

In the following sections the programmes are compared in a qualitative way. Cost savings related to specific measures are usually not available for most international peers and are therefore not included.¹⁶⁵

3.3.2 Mail centre rationalisation

The reduction of the total number of mail centres is a central element of cost saving programmes. Figure 3-5 shows for Royal Mail and its international peers when the mail centre rationalisation programmes mainly took place and, for programmes established after 2000, how long the operators needed to manage the mail centres closures and, if applicable, the construction of new modernised mail centres.

Figure 3-5 Efficiency and cost saving programmes of Royal Mail and the international postal operators: Mail centre rationalisation



Source: WIK research.

¹⁶⁵ Instead we compare the overall performance of Royal Mail and the international peers in terms of cost savings as an element of the assessment in Section 4 of this report.

Between 2008 and 2014 Royal Mail reduced the total number of letter sorting centres from 69 to 39 (see Table 3-3). It is going to close two further mail centres in FYE 2016.¹⁶⁶ All international peers apart from USPS started the consolidation of letter sorting centres earlier:

- Deutsche Post reduced the number of sorting centres between 1992 and 2000 by replacing 328 facilities with 82 new standardised letter sorting centres that are still in place.
- PostNL did the same between 1997 and 2000, when they halved the number of sorting centres.
- PostNord Denmark halved the number after 2000 and closed an additional sorting centre between 2008 and 2014. [X].
- Both PostNord Sweden and La Poste reduced the number of letter sorting centres by more than 50% from 2008 to 2014 and 2004 to 2014, respectively.

Table 3-3 Development of letter sorting centres

Postal operator	Mail centres	
	2008	2014
Royal Mail	69	39 (Plan: 37)
Deutsche Post	82 328 (1993)	82
La Poste	97 (2003) 51 (2010)	42
PostNL	6 12 (1997)	6
PostNord Denmark	4 (8 in 2000)	3
PostNord Sweden	13	7
USPS	675	320 (2013)

Source: WIK-Consult (2013), Review of Postal Operator Efficiency; updated by desk research and interviews with postal operators.

Notes: Royal Mail / Reported Business' figures refer to FYE 2008 and FYE 2015.

Today the reasons for consolidating letter sorting centres have changed compared to those of more than 15 years ago. For example, both Deutsche Post and PostNL

¹⁶⁶ See Royal Mail plc, Half Year 2015-16 Results, 19 November 2015, p.7 ([http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20\[WEBSITE\]_0.pdf](http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20[WEBSITE]_0.pdf)).

reduced the number of mail centres prior to 2000. The main reason for consolidation before 2000 was to concentrate processing at a lower number of sites to establish more industrially-organised sorting centres and to make better use of machine capacities, i.e. to improve efficiency and quality of service. Besides, Deutsche Post and PostNL were also driven by the national privatisation process and plans for early market opening.

After 2008, at USPS, PostNord (Denmark and Sweden) and at La Poste, the consolidation of letter sorting centres was largely driven by volume decline:

- La Poste originally planned to reduce the total number to 49 in 2012 but continued consolidation by closing a further seven letter sorting centres between 2012 and 2014. Additionally, La Poste introduced a D+2 standard delivery service for consumers some years ago and promoted the shift from D+1 to D+2 letter services through price incentives. The proportion of D+1 letters declined to less than 15% in 2014.¹⁶⁷ It appears that this supported the consolidation process at La Poste.
- PostNord Sweden closed 6 sorting centres (nearly half of the original number) between 2009 and 2015 and built two new sorting centres.
- [redacted].¹⁶⁸
- Since 2010 USPS has cut back excess capacity resulting from decreased mail volume by reducing the number of mail-processing and distribution units. At the same time, the company re-scheduled its transportation routes. New delivery standards established in 2012 (longer delivery times resulting in reduced overnight delivery) allowed further consolidation of mail centres in 2012 and 2013.¹⁶⁹

Similar to La Poste, Royal Mail decided to consolidate its mail centres relatively late. This is in contrast to Deutsche Post, PostNL and PostNord Sweden who implemented their changes to letter sorting centres in the 1990's. Royal Mail decided not to apply a greenfield approach but relied on existing sites to the maximum extent possible. Whereas four sorting centres have been newly constructed, the majority of the selected sites have been refurbished.

Mail centre consolidation and modernisation usually go hand in hand, as is the case at Royal Mail. The consolidation allows the postal operator to make enhanced use of the modern, more productive sorting machines. Modern machines need less footprint to sort the same number of letter items compared to older sorting machines. Moreover, since 2008 volume decline is another important driver for mail centre rationalisation as

¹⁶⁷ See ARCEP, L'observatoire du marché postal en France, Année 2014, p.9.

¹⁶⁸ Site visit and interview PostNord Denmark, 12 August 2015.

¹⁶⁹ See GAO (2014), U.S. Postal Service, Status of Workforce Reductions and Related Planning Efforts, p.14-15.

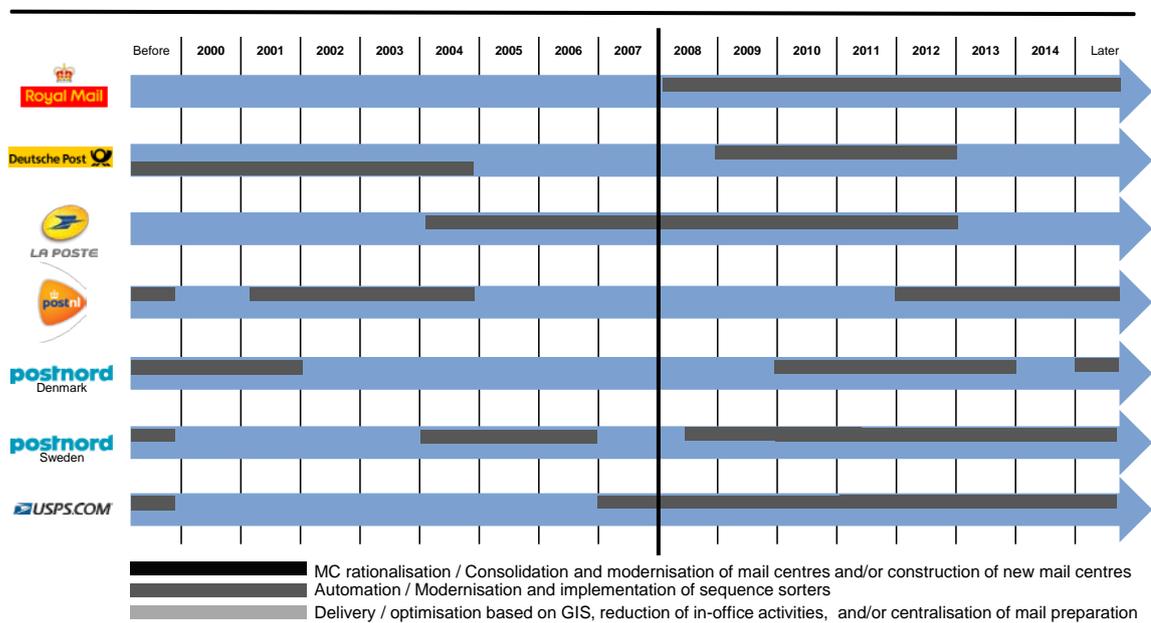
the examples of La Poste (after 2010), PostNord Denmark and Sweden (after 2009) and USPS show.

Generally, those postal operators that started earlier with mail centre consolidation, particularly PostNord Sweden and Denmark, faced two waves of consolidation (pre 2000 and after 2008). In contrast, Deutsche Post and PostNL have not (yet) reduced the number of letter sorting centres post-2008. La Poste and Royal Mail started later with the result that they are able to adapt their network driven by (1) more productive sorting machines and (2) letter volume decline. The example of La Poste shows that during the planning and implementation process periodic reviews are needed, with potential changes to processes being required in order to reflect the changing market environment, particularly letter volume decline.

3.3.3 Automation

Figure 3-6 presents the timing and the implementation period of major investments in automation for the postal operators. It includes the modernisation of existing sorting technology and the introduction of sequence sorters for letters.

Figure 3-6 Efficiency and cost saving programmes of Royal Mail and the international postal operators: Automation



Source: WIK research.

Mail centre consolidation and modernisation usually go hand in hand, as is the case at Royal Mail. The consolidation allows the operator to make improved use of modern, more productive sorting machines.

- Between 2009 and 2015, PostNord Sweden combined the mail centre rationalisation with the acquisition of new sorting machines for letter, large letters and more bulky letter items (packages).
- Deutsche Post acquired new sorting machines for small and large letters for all sorting centres which were installed between 2009 and 2012.
- PostNL and PostNord Denmark invested in new sorting machines for letters after 2010 and PostNL is replacing its sorters for large letters.
- La Poste (2004-2010) and Royal Mail (2008-2013) have replaced their sorting machines for letters and large letters in their mail centres as a core element of their modernisation programmes.

Today, all postal operators use machines to sort letters into delivery order.

- USPS was the first postal operator worldwide implement sequence sorting (starting in the mid 1990's).
- Post Danmark (now PostNord Denmark) closely followed in the second half of the 1990's.
- PostNL and Deutsche Post introduced these machines at the beginning of the last decade.
- Royal Mail and La Poste started relatively late: La Poste in 2007 and Royal Mail in 2008/09.

The earlier sequence sorters were implemented, the more successful postal operators have been at (1) maximising the proportion of walk sequenced letters (up to 90-95%) (something which Royal Mail has not yet achieved (82%)¹⁷⁰); and (2) translating time savings in manual sequencing into reduced indoor activities in delivery operations. This progress is reflected in the average proportion of working time allocated to indoor activities which varies between 20% at early starters such as Deutsche Post and USPS and around 40% at Royal Mail.¹⁷¹

¹⁷⁰ See Royal Mail plc, annual Report and Financial Statements 2014-15, p.10; (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

¹⁷¹ These proportions are related to the "traditional" delivery organisation, i.e. indoor and outdoor activities in delivery are performed by the same employee.

Generally, elements of efficiency programmes related to automation are very similar among postal operators. Differences in timing and scope of the programmes result from factors such as the investment cycle and the operational life of existing machines in combination with differences in the business environment.

We observed that those postal operators confronted with significant letter volume decline, notably PostNord Denmark and PostNL, are more cautious in their investment behaviour than postal operators which have experienced less volume decline such as Deutsche Post.

- Deutsche Post replaced most of the machines it had installed between 1994 and 1999 in a short period of time (3 years) by investing around EUR 400m between 2009 and 2012.¹⁷²
- In contrast, PostNL is replacing its machines (also installed before 2000) only gradually. This investment strategy limits total investment per year and helps to ensure investing in sustainable machines in an environment of declining letter volume. Together with the technology provider Solystic, PostNL developed a “mixed mail” sorter that is able to sort letters and large letters, which is in the view of PostNL more sustainable than separate machines for letter and large letter sorting for the foreseeable future (when letter volumes are expected to continue to decline substantially).¹⁷³
- PostNord Denmark decided to continue using more than 15 year old barcode sorters in letter processing because of the significant decline in letter volume. However, it is replacing these machines because their maintenance is becoming more and more problematic (e.g. spare parts are not available).¹⁷⁴

La Poste and Royal Mail, as late starters, have a special position because both operators combined the modernisation in automation with mail centre rationalisation in one wave. For this reason they invested significantly in new machines when reducing the number of operational sites. Both companies had the opportunity to take the declining letter market into account in their transformation plans. Moreover, they need fewer machines to replace the old ones because nowadays they are even more productive in terms of sorting speed.

The situation is quite different in parcel automation. Growing parcel volumes require investment to increase the capacity for machine processing of parcels. As presented in Section 3.2, all selected postal operators process parcels by machine and usually perform this in sorting facilities separate from letter sorting centres. Moreover, parcel

¹⁷² See WIK-Consult (2013), Review of Postal Operator Efficiency (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

¹⁷³ Ibid.

¹⁷⁴ Site visit and interview PostNord Denmark, 12 August 2015.

services of the international peers are more advanced compared to Royal Mail's standard parcel services in terms of the number of tracking events. Most postal operators have sought to increase the processing capacity for parcels.¹⁷⁵

- PostNL has successfully transformed its parcel operations from four parcel sorting centres and 37 dedicated parcel delivery bases into 18 combined centres, thus increasing the sorting capacity from 100 to 170m parcels per year.
- Since 2011 Deutsche Post has modernised and expanded its parcel network by investing EUR 750 million. The process has not yet been completed. This investment includes the upgrade of dedicated parcel delivery bases to allow sorting of parcels to rounds by machine.

In contrast, Royal Mail currently manually sorts parcels in its mail centres. This will change in the next two to three years as announced by Royal Mail. The company plans to install machine sorters for small parcels in around 20 of its busiest mail centres.¹⁷⁶ This investment will increase the productivity in parcel processing (and thus the capacity) and, simultaneously, reduce manual handling of parcels in these mail centres. In parallel, Royal Mail plans to improve parcel tracking. However, manual processing of parcels will continue to play a significant role at Royal Mail compared to its international peers at least in the remaining mail centres without parcel sorters. It remains to be seen whether the investment in parcel automation will significantly reduce the need for additional manual processing centres at peak times in the coming years. Since 2010, from November to January each year, Royal Mail has opened ten temporary parcel sort centres using around 3,000 seasonal workers to support Royal Mail's employees in the manual processing of small parcels over the Christmas period.¹⁷⁷

3.3.4 Logistics

The revision of transport arrangements is a logical consequence of mail centre and delivery office rationalisation. As a result, operators' specific programmes related to transport are generally not publicised. However, the following measures were implemented either to reduce costs and/or to increase flexibility:

- Reduction of expensive air transport for domestic mail by minimising the number of night flights necessary for mail delivered the next working day:

¹⁷⁵ See WIK-Consult (2013), Review of Postal Operator Efficiency (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

¹⁷⁶ Royal Mail says in its Full Year 2014-15 Results, Presentation 21 May 2015 that it will begin rolling out automated parcel sorting machines in c.20 of its busiest mail centres. (<http://www.royalmailgroup.com/sites/default/files/FY%202014-15%20Results%20Presentation.pdf>).

¹⁷⁷ See Post & Parcel, Royal Mail opening ten temporary parcel sort centres for Christmas surge, 30 October 2015 (<http://postandparcel.info/68990/news/royal-mail-opening-ten-temporary-parcel-sort-centres-for-christmas-surge/>).

- Deutsche Post significantly reduced its night air-mail network after 2000;¹⁷⁸
- La Poste reduced the number of planes used from 15 in 2010 to 8 in 2014.¹⁷⁹
- Outsourcing of transport services, particularly in national road transport, is a long-term practice at PostNL, Deutsche Post, and PostNord Sweden. Similarly to Royal Mail, PostNord Denmark, La Poste and USPS use contracted transport services only to offset capacity bottlenecks in peak times (see also Section 3.2).
- Outsourcing of collection from postboxes not undertaken by postmen/postwomen as Deutsche Post and PostNL do.
- Generally, all postal operators seek ways to reduce their carbon footprint and invest in measures to reduce CO₂ and, as an intended side effect, to save transport costs (i.e. fuel) in national and regional transport, as well as in delivery. These measures consist of investing in fuel-saving or electric vehicles and in programmes for changing driver behaviour.

Royal Mail has forecasted [X] in logistics following the consolidation of its mail centres and delivery offices. The company was mainly relying on consolidation of transport routes, reduced flights and fuel-saving and maintenance-reducing changes in driver behaviour. In contrast to some of its international peers, outsourcing of transport activities is not an option at Royal Mail because the current labour agreement¹⁸⁰ with the Communications Workers Union (CWU) precludes any additional outsourcing activities in core operational functions (see Section 3.4 for more detail on employment and labour conditions).

3.3.5 Delivery

The organisation of letter delivery accounts for a significant portion of total operational costs. Changes in the delivery organisation such as the reduction of delivery offices (with sorting function), implementation of optimisation tools for delivery rounds and measures to increase the flexibility of the delivery organisation in light of varying mail volumes can lead to significant cost savings. Figure 3-7 illustrates the timing and the

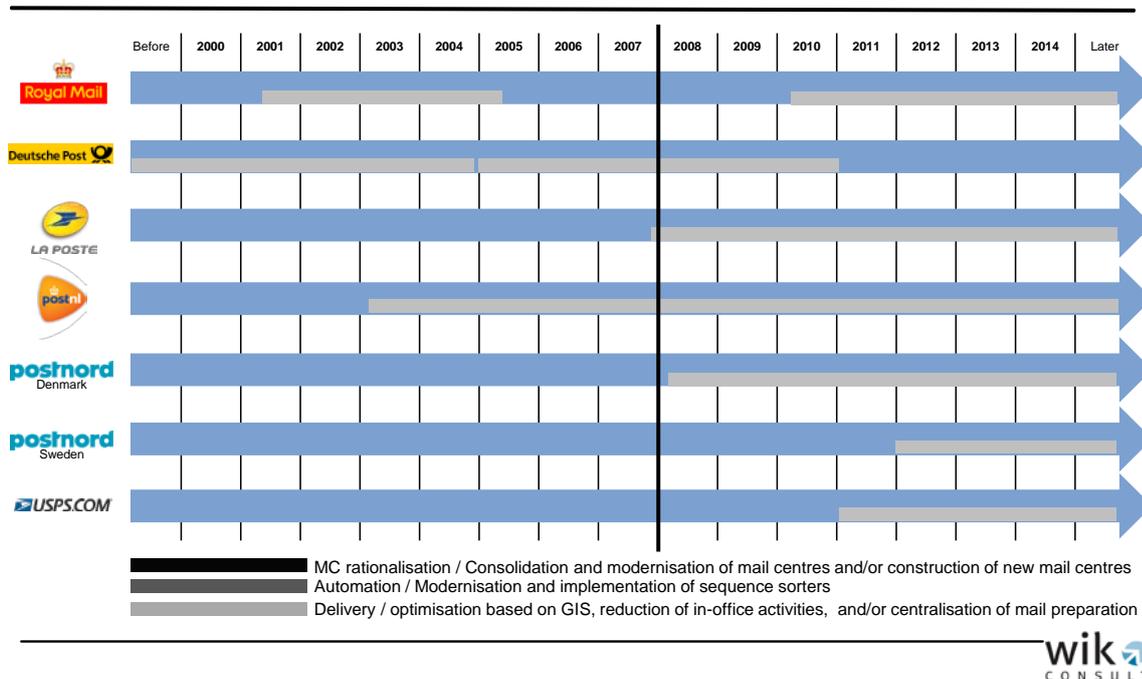
¹⁷⁸ See WIK-Consult (2013), Review of Postal Operator Efficiency (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

¹⁷⁹ See La Poste Group, Registration Documents [Annual Reports] 2010-2014.

¹⁸⁰ See CWU (2014), Agenda for Growth, Stability & Long Term Success, January 2014, (http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf), see also Legal Contract between Royal Mail and CWU, January 2014 (http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094287_04274_Legal_Contract_Between_R.pdf).

implementation periods for major changes in the delivery organisation for Royal Mail and its international peers.

Figure 3-7 Efficiency and cost saving programmes of Royal Mail and the international postal operators: Delivery



Source: WIK research.

Note: GIS – Geographic Information Systems.

Traditionally, delivery organisations for most postal operators were often fairly inflexible with regard to volume fluctuations. Each postman/postwoman had his/her round which did not change much over time. This inflexibility often resulted in substantial productivity losses, especially in the case of volume decline. Postal operators therefore tend to seek opportunities to increase the cost flexibility in delivery operations. The most important drivers for substantial revisions in delivery organisation are:

- Information technology: Emergence of optimisation tools and improvements in mail flow control;
- Processing technology: Introduction of sequence sorters, increasing automation to minimise manual handling in delivery offices;
- Volume decline: Volume decline reduces the time required for indoor activities which means that the time allocated to outdoor delivery can increase, so the length of rounds can increase and the total number of rounds can be reduced;

- Volume variation during the week / month / year: Combined with improvements in mail flow control the number and size of delivery rounds vary with volume delivered.

Implementing changes in delivery are often challenging because delivery is a complex activity involving a high number of employees. In delivery the “human factor” is much more important than in processing where the machines and the mail flow mainly determine the organisation and the pace of work. Moreover, the delivery organisation is something that is steadily changing; it is an ongoing optimisation process with determined revision cycles.

All postal operators needed some years to fully realise the benefits from more automation in delivery operations. Those postal operators who introduced sequence sorting machines much earlier were also able to re-design the delivery organisation accordingly. This is reflected in a steady decline of delivery centres and delivery rounds as summarised in Table 3-4.

Table 3-4 Development of delivery centres and delivery rounds

Postal operator	Delivery centres			Delivery rounds		
	2008	2014	% change	2008	2014	% change
Royal Mail	~1,400 (1)	~1,400	n/a	66,500 (FYE 2010 (2))	~60,000	[-10%]
Deutsche Post	~3,300 11,500 (1993)	~3,100	-6%	54,000 (>80,000 before 2000)	51,500 (2012)	-6.5%
La Poste	n/a.	~3,000	n/a	>62,000	56,500	-9%
PostNL	465 (2006)	~80 (~2,500 depots)	-83%	n/a.	~20,000 (part-time deliverers)	n/a
PostNord Denmark	~300	153 (2012)	-49%	6,600	3,500	-47%
PostNord Sweden	~520	~400 (incl. depots)	-23%	9,200	8,400	-9%
USPS	~37,200 (2004)	~24,200	-35%	248,900	224,400	-10%

Source: WIK-Consult (2013), Review of Postal Operator Efficiency; Interviews postal operators.

Notes: (1) Royal Mail figures on delivery offices refer to published material in the annual financial statements of FYE 2008 and FYE 2014.

(2) See Royal Mail submission of question 8 of RFI, 23 December 2013.

n/a means 'not available'.

Traditionally, post offices were used for delivery and retail functions. The separation of these functions at most European postal operators started in the 1990's and allowed postal operators to contract retail services out (e.g. Deutsche Post and PostNL make use of postal agencies). At the same time, the number of delivery offices was

substantially reduced. After 2008 the consolidation of delivery offices continued at most of the selected postal operators. Royal Mail does not report on changes in the total number of delivery offices, only in the number of modernised delivery offices.¹⁸¹ However, we understand that the transformation of former mail centres into MPUs also resulted in the closure of some smaller delivery offices (e.g. in London). We therefore estimate that the total number of delivery offices has slightly gone down since 2008. As outlined in Section 3.2 three European postal operators centralise mail preparation in a small number of delivery offices and then complement the delivery network with pick-up points (“depots”) for deliverers (PostNord Denmark and Sweden, PostNL).

Letter volume decline combined with increased automation in letter sorting reduces the need for mail preparation in delivery offices and thus the average time span for indoor activities relative to outdoor activities of a full-time postman/postwoman. As a result, more working hours are available for outdoor delivery and less for indoor activities. With regard to efficient resource planning, this can result in longer outdoor time spans for full-time employees or, alternatively, a new division of tasks between part-time employees and full-time employees.

Royal Mail reports that its postmen/postwomen still need c40% of their working time for indoor activities. This relatively high proportion indicates that improvements in automation have not yet been fully converted into time savings for indoor activities and, correspondingly, into a reduced number of (longer) delivery rounds. Not surprisingly, the allocation of indoor and outdoor time is a point of discussion with workplace representatives at local level. With the transformation programme Royal Mail started the process under the current Collective Labour Agreement (CLA). This is an ongoing process to identify “efficient and fair ways to align resources to workload in delivery”.¹⁸² Nonetheless, Royal Mail managed to reduce the number of delivery rounds by c10% between FYE 2010 and FYE 2015.

Royal Mail's international peers also made progress in reducing delivery rounds, e.g. USPS with 10%, La Poste with 8% and PostNord Sweden with 13% (facing similar rates of letter volume decline to Royal Mail of around 5% per annum on average). PostNord Denmark, who experienced a volume decline of 10% per annum on average – the most significant decrease among the international comparators – nearly halved its number of delivery rounds during the same period. As described above, PostNL only relies on

181 Royal Mail usually reports having c.1,400 delivery offices. See Royal Mail Holdings plc, Report and Accounts Year ended 30 March 2008, p.13 (http://www.royalmailgroup.com/sites/default/files/2007-08Group_Accounts_19-05-08Final.pdf) and Royal Mail plc, Annual Report and Financial Statements 2013-14, p.14 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202013-14_0.pdf).

182 CWU (2014), Agenda for growth, stability & long-term success, January 2014, p.20 (http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf).

part-time deliverers and therefore reports a relatively high number of delivery rounds where the total number of delivery rounds varies between peak and off-peak days.

Table 3-5 summarises major reorganisations in delivery operations of Royal Mail and its international comparators.

Table 3-5 Delivery: Major reorganisations in delivery operations

Royal Mail	2002-2005	Major reorganisation in delivery following the reduction from two daily deliveries to one Delivery span*: 50% ¹⁸³
	2010 -	<ul style="list-style-type: none"> • Modernisation of delivery offices and deployment of new delivery methods ("shared van", high capacity trolleys), deployment of handheld scanners (accomplished) • Consolidation of delivery offices and establishment of Mail Processing Units equipped with sequence sorters in combination with mail centre rationalisation (ongoing) • Collection on delivery (2013-2016) • [X<] • [X<] Delivery span: [60%]
Deutsche Post	Before 2000	<ul style="list-style-type: none"> • Optimisation and changing work organisation (team) to increase flexibility • Optimisation of delivery offices (number, location and size): -70% • Delivery rounds: -25%
	2001–2008	<ul style="list-style-type: none"> • Ongoing optimisation after roll-out of sequence sorters • Delivery rounds: -10%; delivery offices: -10% (by 2008) • Extension of delivery span to 70-80% of daily worktime
	2008–2010	<ul style="list-style-type: none"> • Introduction of mail preparation centres in urban areas (separation of manual mail preparation and delivery) Delivery span: ~70-80%
La Poste	2007-	<ul style="list-style-type: none"> • Delivery rounds: -8% (mainly driven by volume decline) • Consolidation of delivery offices: -17% • One postman - one round still valid, but more flexible work organisation Delivery span: n/a
PostNL	2003–2008	<ul style="list-style-type: none"> • Consolidation of delivery offices and introduction of depots for part-time deliverers (around 50% of the 2003 level) • Introduction of part-time mail deliverers: start of transformation from full-time postmen/postwomen to part-time deliverer in delivery
	2009 –	<ul style="list-style-type: none"> • Enforced transformation to part-time delivery • Completed: Separation of mail preparation and outdoor delivery • Ongoing centralisation of delivery offices (from 260 in 2012 to 75 in 2015) • Introduction of peak and off-peak delivery days in 2012 • Reduction from 6-day to 5-day delivery • Plan: Distribution of unaddressed items only on Saturdays Delivery span: >95% (part-time deliverers)

¹⁸³ See CWU Delivery Blueprint (2008), Foundations for a New Delivery Model, p.1.

PostNord Denmark	2008–2014	<ul style="list-style-type: none"> • X/Y distribution model (2008-2009): Peak and off-peak elements to ensure full-time employment in delivery • “Small Monday” (2009-2011): Shift of non-priority letters (D+3/4) to Tuesday-Saturday • Separation of mail preparation from street delivery (different employees are responsible for each task) • Mail preparation: Introduction of voice-directed letter sorting (at sorting frames) • Delivery offices down by one third • Delivery rounds down by c40% (also driven by volume decline)
	2015–	<ul style="list-style-type: none"> • “Small Saturday”: B/C letters are shifted to Tuesday/Wednesday and Friday to keep Mondays, Thursdays and Saturdays low Delivery span: 80%
PostNord Sweden	2012–	<ul style="list-style-type: none"> • Centralisation of manual mail preparation in selected DOs • Separation of manual mail preparation from delivery (rotation system between full-time postmen/postwomen), 100% street time (morning round and afternoon round) • Sorting frames are used 2-3 times per day (mainly for large letters) Delivery span: >95%
USPS	2011–	<ul style="list-style-type: none"> • Centralisation of delivery sequence sorters in mail processing centres (Finalised in 2013) • Delivery Unit Optimisation: Separation of delivery and retail activities; relocating letter carriers from some local postal offices to centralised delivery offices • Delivery conversions (since 2012): Shift from door delivery to less costly delivery modes (mainly centralised delivery); for business addresses on a voluntary basis • For residential: USPS changed regulation in April 2012 which allows USPS to determine the mode of delivery at new addresses • Load levelling (Standard Mail) to balance the distribution of mail through the week and reduce overtime Delivery span: ~80% (city carriers)

Note: * Delivery span means the average proportion of daily worktime a full-time postman/postwoman is busy with delivery of mail (outdoor delivery).

As outlined at the beginning of this section, the major visible outcome of delivery reorganisation is the development of the number of delivery offices and delivery rounds. More recently, the functions allocated to delivery offices changed. Postal operators differentiate between delivery offices with indoor functions (sequencing of mail) and delivery offices without such functions, so-called depots.

Before 2008, changes in the delivery network of postal operators were generally focused on increasing automation in letter sorting and enabling a more flexible work organisation. More automation increased the proportion of letters (up to 90-95%) that were walk sequenced by machine and large letters that were walk sorted. This reduced the time for indoor activities, left more time for delivery and allowed the extension of the delivery round to cover more potential stops (at a given letter volume). Deutsche Post, for example, was able to reduce the number of delivery rounds from more than 80,000 to less than 52,000 within a decade. Under the more traditional delivery model (i.e. the

postman/postwoman who prepares the letters also delivers them), increased automation allowed operators to reduce the proportion of total delivery time being dedicated to indoor work to around 20-30%.

Generally, all postal operators, including Royal Mail, apply optimisation tools for delivery round planning. However, progress made in converting benefits from increased automation into more efficient delivery operations varies. This is indicated by differences in the delivery span. Delivery span means the proportion of daily worktime during which a full-time postman/postwoman is busy with delivery of mail (outdoor delivery). Royal Mail has the shortest delivery span compared to the others who reach delivery span levels of 80% and above.

Since 2008, PostNL, PostNord Denmark and PostNord Sweden have implemented more innovative delivery models. The implementation of these models gained momentum in light of the substantial letter volume decline particularly faced by PostNL and PostNord Denmark. The operators decided to further centralise mail preparation in fewer delivery centres and to assign the indoor and outdoor activities to different employees. In addition to delivery centres, “depots” are used as starting points for postmen/postwomen to pick up the prepared bags or trays. The use of depots helps to reduce the distance between the pick-up point and the delivery rounds. The “indoor postman/postwoman” sequences the letters and prepares the bag or tray. The prepared bags and trays are then transported to the depot and the “outdoor postman/postwoman” picks up the bundles and deliver the mail.

- Full-time employees, such as at PostNord Denmark and Sweden, deliver letters in the morning and in the afternoon. During their morning round, indoor colleagues prepare the bundles for the afternoon round in the delivery centre. Thus, sorting frames can be used at least two times a day. The postman/postwoman picks up the prepared items at the depot later in the day to continue with the afternoon delivery round. PostNord Sweden offers a “rotation model” to their postmen/postwomen, for example one is responsible for outdoor delivery for the first two weeks and switches to indoor activities the next two weeks.
- PostNL decided to organise outdoor delivery mainly with (low-paid) part-time employees which increases the headcount of employees but allows a more flexible working organisation when combined with peak and off-peak delivery days as outlined below.

Two of the selected postal operators have re-designed the delivery network in a way that concentrates letter volume on specific delivery days.

- In 2008 PostNord Denmark introduced a new delivery model, the “X/Y distribution model”. Delivery is organised in a way to ensure stable daily delivery

volumes on Mondays to Saturdays (and thus full-time employment for delivery staff). Each round consists of two types of delivery points (X and Y). Letters for which overnight delivery is not required (D+4 letters and unaddressed items) are distributed to X delivery points on every second day (such as Tuesday, Thursday and Saturday) while the Y delivery points get these items on Monday, Wednesday and Friday.¹⁸⁴ The peak days are not bound to specific weekdays but vary between delivery rounds. The design is mainly driven by the objective to keep full-time jobs.

- In contrast, PostNL defined specific days of the week as peak days. This allows PostNL to guarantee delivery to their customers on a specific day (which can be important for example for publishers and for advertising campaigns). The total number of rounds varies day-by-day at PostNL: it is high on peak and low on off-peak delivery days.

3.3.6 Management reorganisation programmes

In addition to cost saving and efficiency programmes related to mail operations, some of the international postal operators also report on cost saving measures affecting overhead and administration, including management. However, none of the selected postal operators reported on dedicated plans for the reorganisation of the management as Royal Mail has done.

- Royal Mail set up a programme to reorganise group and operational management. This programme was announced in March 2014 and Royal Mail estimate that it will achieve cumulated cost savings of GBP 50m per year¹⁸⁵, recently updated to GBP 80m.¹⁸⁶
- As an element of its revised Master Plan III, PostNL announced other cost savings in Marketing & Sales and Overhead for the period from 2013 to 2017. The company forecasted a reduction in full-time equivalents of 500-700 by 2015 (1.7% - 2.4% of total full-time equivalents) resulting in estimated savings of about EUR 130m (around GBP 100m) combined with other measures (e.g. redesign IT and procurement structure).¹⁸⁷ In the most recent update on its

¹⁸⁴ WIK-Consult (2013), Review of Postal Operator Efficiency, Section 6.2.2

(<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

¹⁸⁵ See Royal Mail plc, Full Year 2013-14 Results, 22 May 2014, p.11

(http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202013-14_DDA_0.pdf). See also Royal Mail Group, Continued efficiency programme, press release 25 March 2014 (<http://www.royalmailgroup.com/continued-efficiency-programme>).

¹⁸⁶ See Royal Mail plc, Results for the Half Year ended 27 September 2015, 19 November 2015, p.9

(<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20for%20the%20half%20year%20ended%2027%20September%202015.pdf>).

¹⁸⁷ See PostNL, Q4 & FY 2012 Results, 25 February 2013, p.20

(<http://www.postnl.nl/en/about-postnl/investors/quarterly-results-presentations/>).

strategy PostNL announced it would continue reducing management and overhead staff by continuously scaling down overhead across PostNL.¹⁸⁸

- PostNord reported significant reductions of employees in managerial positions in both countries, Denmark and Sweden, between 2011 and 2013.¹⁸⁹
 - PostNord Denmark reduced the number by 90 from 710 to 620 employees (headcount) in this category (i.e. nearly 15%). During the same period administrative personnel were reduced by more than 1,000 or 40% during the same period.
 - At PostNord Sweden, the decline was lower. They reduced headcount by 77 or 8% for managerial staff and more than 500 or 15% for administrative staff (in headcount).
- In 2014 PostNord initiated a cost saving programme with expected annual savings of around SEK 500m (around GBP 38m) to reduce the number of employees by 800 mainly in Denmark (in headcount), in administration and other support functions.¹⁹⁰

In total, it appears that management reorganisation programmes are much less visible than efficiency programmes affecting operations. This might be partly due to the fact that these positions are not usually represented by unions and cause much less internal or public discussions. However, the implementation of complex transformation programmes often require substantial managerial skills and therefore it is possible that operators choose not to dismiss managers during the operations' transformation. For this reason, we consider it unsurprising that cost saving programmes related to administration and particularly management usually start later than operational efficiency measures.

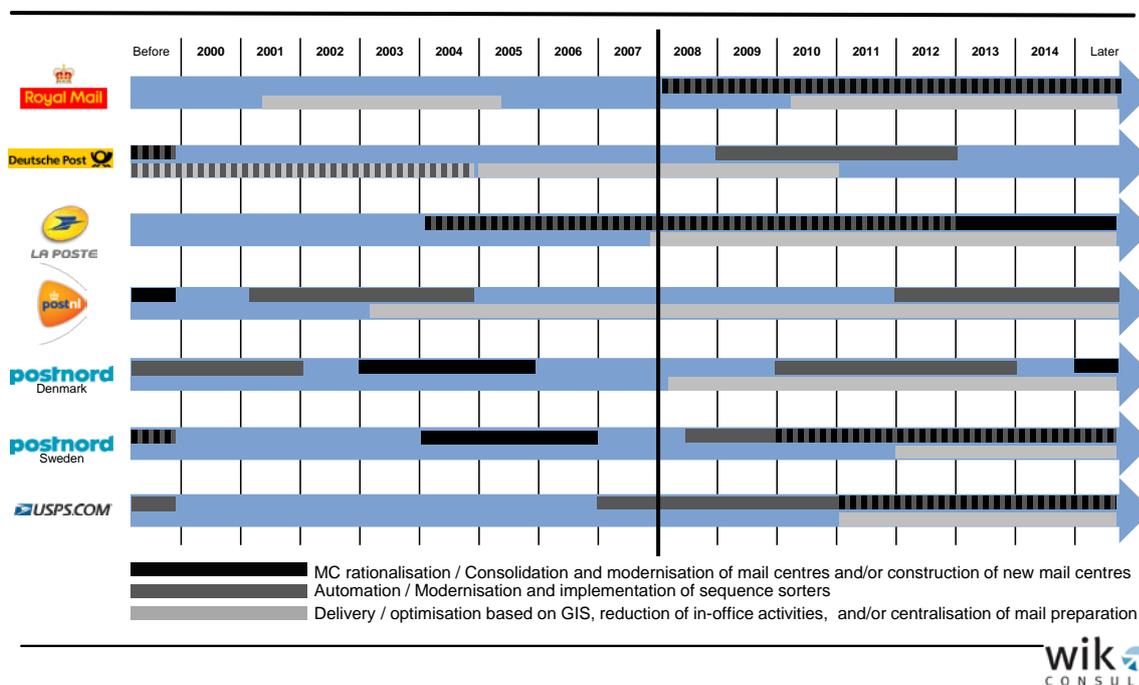
¹⁸⁸ See PostNL, PostNL 2020, 3 November 2015, p.21
(<http://www.postnl.nl/en/about-postnl/investors/quarterly-results-presentations/>).

¹⁸⁹ See PostNord, Annual Report 2013, p.65
(<http://www.postnord.com/globalassets/global/english/document/reports/annual-reports/2013/postnord-annual-report-2013.pdf>).

¹⁹⁰ See PostNord, Annual Report 2014, p.26
(<http://www.postnord.com/contentassets/3f267b67abbc41cebf34696b02fc31ca/wkr0006.pdf>).

3.3.7 Conclusions

Figure 3-8 Efficiency and cost saving programmes of Royal Mail and the international postal operators: Summary



Source: WIK research.

Note: GIS – Geographic Information Systems.

In this section we considered efficiency programmes differentiated into five categories:

- (1) Mail centre rationalisation
- (2) Automation
- (3) Logistics
- (4) Delivery
- (5) Management reorganisation programmes

Figure 3-8 illustrates three of these categories (MC rationalisation, automation and delivery) and the timing of major past (or still ongoing) efficiency programmes of Royal Mail and the international postal operators along a timeline. The vertical black line between 2008/09 indicates the start of accelerated volume decline in many letter markets (i.e. at the time of the financial crash).

Figure 3-8 shows that the different categories of initiatives are not implemented one after another but usually in overlapping periods. This is particularly the case for

automation measures (introduction of sequence sorting machines) and the revision of the delivery organisation. Typically, the reduction / modernisation of mail centres is the first step followed by increased automation and the re-design of delivery activities.¹⁹¹

The illustration highlights that some postal operators started much earlier with the rationalisation and modernisation process than others. Early starters are Deutsche Post, PostNL and PostNord (Denmark and Sweden). The reorganisation of postal operations from scratch cannot be completed in a short time period. Deutsche Post took around eight years for its major reorganisation in the 1990s. The implementation and integration of sequence sorters required an additional four years. PostNL needed a shorter period of time, however, its operations are significantly smaller than those of Deutsche Post. In both cases, the optimisation of delivery operations followed the reorganisation of processing and the transport network.

The late starters had to meet the challenge to rationalise, modernise and streamline their operations in a less advantageous environment with significantly declining letter volumes (particularly after 2008) compared to a situation of continuously growing letter markets experienced by Deutsche Post and PostNL before 2000. Royal Mail started its all-embracing transformation programme even later than La Poste. For this reason Royal Mail had to implement various measures at the same time.

The early starters were better prepared for the significant drop in demand which occurred in 2008 and the continued decline in letter volume since 2008 because mail centre rationalisation and reorganisation were completed and the accompanying IT platforms and related tools were still in place. Moreover, the basic reorganisation of delivery was already implemented, only fine-tuning was needed and revision processes were already established. Generally, employees of early starters have already experienced changes in operations so that additional changes can be implemented in a relatively shorter period of time. The changes in working conditions at the early stages of transformation might have even been seen as beneficial by a large proportion of employees with vested rights and this might have paved the way for less conflict-laden improvements in future.

In addition to changes in market demand, factors such as significant end-to-end competition in delivery markets and pressure from private investors further promoted progress in adapting the postal pipeline to changing customer needs.

Our analysis shows that the different categories of initiatives are not implemented one after another but usually in overlapping periods. This is particularly the case for automation and the revision of the delivery organisation. However, as concluded in

¹⁹¹ See WIK-Consult (2013), Review of Postal Operator Efficiency (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

WIK-Consult's former report for Ofcom¹⁹², the consolidation and modernisation of mail centres combined with a revision of transport arrangements is usually the first step followed by the consolidation and modernisation of the delivery organisation. We observe this chronological order also at Royal Mail and would conclude that one of Royal Mail's major tasks of its 2015 Business Plan is to optimise its delivery operations.

3.4 Employment and labour conditions

In this chapter we compare Royal Mail to the other postal operators and highlight variances in their approaches to:

- Labour agreements;
- Cooperation and co-determination;
- Wage policy;
- Flexibility in working time;
- Other working conditions;
- Outsourcing and franchising of core postal functions; and
- Mobility / Redundancies.

The measures we highlight in this chapter do not primarily refer to cost cutting measures alone but will also imply measures to improve job satisfaction and thus efficiency. At some postal operators, employees are more involved in transition processes than in others, in regard to the configuration of tools, operational procedures or working routines. Naturally, changes of working conditions may impact staff in terms of motivation. Our study shows that postal operators bear this fact in mind and do not only aim at reducing costs but also at improving productivity by increasing motivation and enhancing the working atmosphere. For instance, PostNord traditionally involves employees in work organisation changes and encourages them to make suggestions for technological improvements.¹⁹³

First of all, we provide a summarised overview of our findings (Table 3-6). Afterwards we present an in-depth discussion of the main aspects (1) Labour agreements; (2) Cooperation and co-determination; (3) Wage policy; (4) Flexibility in working time; (5) Other working conditions; (6) Outsourcing and franchising of core postal functions; and (7) Mobility / Redundancies.

¹⁹² Ibid.

¹⁹³ [3<]

Table 3-6 Labour relations and working conditions at postal operators (protected by agreements)

	Royal Mail	Deutsche Post	La Poste	PostNL	PostNord DK	PostNord SE	USPS
Labour agreements							
CLA (company)	✓	✓	✓	✓	✓	✓	✓
CLA coverage (company)	all	all	all	employee groups	all	all	employee groups
Last strike actions (company)	2009	2015	2015	2015	2001	-	n/a
Extent of last strike action (company) / regional or national focus	Started regionally in summer 2009, 5 strike days in Oct. 2009 on national level	Strike action four weeks in Summer 2015 national (at strategic points)	156,850 unpaid days (2014) many regional and national strikes each year	Less than one week spring 2015 regional (only self-employed drivers)	n/a	No strike action	n/a Public sector employees not allowed to strike
Cooperation and co-determination							
Unionisation (country)**	26%	18%	8%	20%	82%	77%	11%
CLA coverage (country)	29%	62%	98%	81%	80%	88%	n/a
Strike days per 1,000 employees (2005-13) (country)	23	16	139	8	135*	5	9
Union(s)	CWU, Unite	Verdi dpvkom	FO, CFDT, CFTC, CGC/UNSA	Abvakabo FNV, BVPP, VHP 2	3F Post (SEKO)	SEKO	NALC NRLCA NPMHU
Board level representation	-	✓	✓	✓	✓	✓	-
Co-determination at local level	✓	✓	✓	✓	✓	✓	✓
Cooperative approach	◐	◑	◐	◑	●	●	◐
Involvement in pilot projects	◐	◑	◐	◑	●	●	◐
Wage policy							
Pay increase in recent CLA	✓	✓	✓	✓	✓	✓	✓
Index oriented pay award	RPI (UK)	-	-	-	-	-	CPI (US)
Two-tier wage schedule	-	✓	-	✓	-	-	✓
Overtime payments limited by flex-time schedules	-	✓	-	✓	✓	✓	-
Flexibility in working time							
Weekly hrs.	39	38.5	35	37	37	40	40
Full-time (company)	74%	62%	90%	39%	77%	86%	75%
Full-time approach - part-time limited	✓	-	✓	-	✓	✓	✓

	Royal Mail	Deutsche Post	La Poste	PostNL	PostNord DK	PostNord SE	USPS
Other working conditions							
“One postman/postwoman – one round” principle removed	-	✓	-	✓	✓	✓	-
“Full day’s work for full day’s pay.”	✓	✓	-	✓	✓	✓	-
Re-design of rounds on local level only	-	-	-	✓	✓	✓	-
Outsourcing and franchising of core postal functions							
Limited for letter/combined delivery	✓	✓	✓	✓	✓	✓	✓
Limited for parcel delivery	✓	-	-	-	✓	-	✓
Mobility / Redundancies							
Natural attrition	✓	✓	✓	✓	✓	✓	✓
Compulsory redundancies	-	-	-	✓	✓	✓	-
Voluntary redundancy payments	✓	-	✓	✓	✓	-	✓
Early retirement	✓	✓	✓	-	✓	✓	-
Mobility programmes	-	-	✓	✓	✓	✓	✓

Source: WIK assessment based on WIK-Consult (2013), Review of Postal Operator Efficiency, updated by desk research, site visits and interviews.

Notes: CLA: Collective Labour Agreement

CLA coverage (company): At PostNL and USPS agreements are negotiated for certain employment groups, i.e. at PostNL for regular postmen/postwomen and for deliverers, at USPS for mail handlers, city carriers, rural carriers

Estimated number of strike days: Estimation by WIK-Consult based on press coverage of strikes. France: La Poste Annual Report 2014 (= unpaid days lost due to strikes).

Strike days (country): Average working days in country lost due to strikes (2005-13, for France 2005-12). Source: WSI-Arbeitskampfbilanz 2014, 4 Mar. 2015. * Figures in Denmark high because of strikes and lockouts in public education sector. ** (country) refers to whole country where the postal operator has its headquarter.

✓ = existent ; - = negligible or not existent ; n/a = information not available ; Harvey balls indicate to which extend measures have been put forward.

○ - not applied ● - largely applied, ◐ - mostly applied, ◑ - partly applied.

Labour agreements: All postal operators have reached agreements between the company and the union(s). The current CLA¹⁹⁴ between Royal Mail and the CWU was negotiated during 2013 against a backdrop in which the union had indicated it was prepared to take industrial action during the Christmas period.

Deutsche Post had to endure severe strikes during its CLA negotiation period in summer 2015. For the first time employees resorted to industrial action for more than four weeks to prevent a two-tier wage schedule in parcel delivery. In the end, extensive

¹⁹⁴ CLA means Collective Labour Agreement, an agreement closed between a postal operator and a union (CLA on company level).

achievements were made for the existing workforce, however Deutsche Post managed to retain its planned increase in subcontracting for parcel delivery (franchising system).

Strikes take place at La Poste more frequently than its peers (see Figure 3-6 above) and appear to be a common way of expressing disagreement. [3<]. According to La Poste's annual report the number of working days lost due to strikes was 156,850 in 2014 (around 0.3% of total working days¹⁹⁵) and 124,734 in 2015.¹⁹⁶

At PostNL owner-drivers in parcel delivery went on strike in 2015 for almost one week and achieved the offer of permanent contracts or increases in remuneration. In Denmark or Sweden strikes are not common practice. USPS may face industrial action during the current negotiation period with rural carriers, however, we understand that only people who are not employed in the public service are permitted to go on strike. Nevertheless, CLAs tend to contain agreements to refrain from industrial action during the period of the CLA.

At all the comparator companies', unions have agreed not to engage in industrial action during the retention period of the current CLA. An exemption is France where strikes are a constitutional right.¹⁹⁷ However, there are signs that at USPS unballoted industrial action might occur. During the current USPS negotiations with the American Postal Workers Union (APWU) and the National Rural Letter Carriers' Association (NRLCA) employees have, amongst other things started a postcard campaign and often collect signatures to keep pressure on the companies' management. Officially, from the view of the Congress, US postal workers fall under public service rules banning them from taking strike action, however, they have a very strong voice in the negotiation process.

Royal Mail and CWU have made remarkable efforts to "deliver cultural change" as defined in the 'Agenda for Growth, Stability & Long Term Success'.¹⁹⁸ Compared to CLA negotiations six years ago, progress has been made (see summary in box below "Recent development of Royal Mail and CWU relations"). However, the development of the discussions in 2009 show how changes in working conditions through the introduction of automation can mobilise the workforce to great effect. The strikes in

¹⁹⁵ WIK estimation based on total number of 212,077 FTE at La Poste (parent company) assuming 250 working days per year.

¹⁹⁶ See Le Groupe La Poste, Document De Référence 2015, p.258 [in French], http://legroupe.laposte.fr/content/download/27205/206805/version/1/file/Le_Groupe_La_Poste_Document_de_reference_2015.pdf.

¹⁹⁷ The current legislation relies on the French Constitution of 1946. Its Preamble promotes the right to strike (and the current Constitution of 1958 refers to this Preamble): "The right to strike shall be exercised within the framework of the laws governing it.", see http://www.conseil-constitutionnel.fr/conseil-constitutionnel/root/bank_mm/anglais/cst3.pdf. For a detailed description see e.g. Stewart, A.; Bell, M. (eds.), *The Right to Strike: A Comparative Perspective. A study of national law in six EU states*. The Institute of Employment Rights. Liverpool, p.27ff.

¹⁹⁸ CWU (2014), *Agenda for Growth, Stability & Long Term Success*, January 2014, (http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf), see also *Legal Contract between Royal Mail and CWU*, January 2014 (http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094287_04274_Legal_Contract_Between_R.pdf).

2009 were held at a national level and involved more than 121,000 employees in sorting and delivery.¹⁹⁹ Recent developments (privatisation, Ofcom's investigations) have led to explicit statements by the CWU on how it will oppose lower standards (such as pay and conditions).

Recent development of Royal Mail and CWU relations

- **Pre-2009:** Before 2009, there were strikes on a national level in June, July and October 2007, followed by further unballoted industrial action. The disagreement was mainly about the modernisation/automation plans which were considered necessary to remain financially sustainable by Royal Mail. The CWU assumed that the plans would result in the loss of around 10,000 jobs. The discussions were mainly about work flexibility, i.e. Royal Mail's plans that employees ought to fulfil different tasks (e.g. deliver on different rounds, overlap of functions in sorting and delivery) on a daily basis and that implied existing "rules" (i.e. go home if delivery is finished) should be abandoned. In the end, Royal Mail and CWU agreed on the 2007 Pay and Modernisation Agreement. This included: work time flexibility on a daily/weekly basis; flexible attendance patterns; establish patterns to enable local flexibility (effective workload alignments); full cooperation and support for new technology; and working in nearby offices. It also included a pay increase of 5.4% (October 2007) plus a lump sum and an increase of 1.5% in wages at all local branches where the agreed flexibility was implemented.

- **2009-2010:** The last strikes at Royal Mail to date took place in October 2009. The CWU held a ballot for industrial action in September. National strikes were held 22-23 October and 29-31 October. Their main point of disagreement was the modernisation plans that would affect the job security of Royal Mail workers in sorting and delivery, and the failure to reach an agreement about this. The CWU claimed that Royal Mail failed to involve the union in a dialogue about the modernisation as agreed in the 2007 CLA .

Local unballoted industrial action took place in London, Bristol and areas of Scotland (walkouts) before the national strike. The press reported that there were more than 50 million undelivered items because of the strikes.

An agreement to settle the dispute was finally agreed to on 8 March 2010 (Business Transformation - 2010 And Beyond). It included approx. 3% annual pay increases, the promise to keep 75% of the workforce as full-time, and to reduce working hours from 40 to 39 hours a week without pay cuts. The CWU agreed on Royal Mail's automation plans (i.e. to introduce automated walk sequencing machines). Both parties committed to the aim of improvement in employment relations.

- **2012:** The negotiations around the previous agreement 'Business Transformation and World Class Mail' in 2012 were not accompanied by balloted industrial action. The agreement is based on the Business Transformation Agreement 2010 that commits Royal Mail and CWU to work together regarding the World Class Mail initiative²⁰⁰ and includes a review of its development and its relationship with existing national agreements, industrial relations, safety procedures, and employee engagement.

The purpose of the agreement is to provide a framework for World Class Mail actions and to

¹⁹⁹ See for example "CWU stages Parliament Square protest in support of "The People's Post" campaign", Post & Parcel, 9 July 2015 and "Strike warning over Royal Mail full sell-off plan", Post & Parcel, 8 June 2015, or press coverage during the 2009 strikes, lasting for more than three weeks where more than 121,000 employees have been involved: "Postal strike action continuing", BBC News 16 Sept. 2009, "Fresh mail strikes will go ahead", BBC news 28 Oct. 2009, "Postal strike: support for union ebbing away. Support for the postal workers over the bitter strike action has fallen substantially over the last two weeks, according to a poll undertaken", The Daily Telegraph, 3 Nov. 2009.

²⁰⁰ World Class Mail (WCM) "is a comprehensive programme for continuous improvement. It is structured into 10 parts – called pillars – and involves employees using well-established techniques for improving safety, customer service, productivity and quality." (see <https://www.myroyalmail.com/working-royal-mail/world-class-mail>).

continue with “the positive engagement of employees and with Royal Mail and CWU working together” (Business Transformation and World Class Mail 2012, p.1).

- **January 2014:** The current agreement, based on the ‘Agenda for Growth, Stability & Long-term Success’ and concluded in Jan 2014, includes an approach to prevent escalation of conflicts between Royal Mail and CWU. The union is given the opportunity to provide more input, influence and involvement in decision making (Section 2, Delivery cultural change). Mediation processes are implemented to resolve disputes, mostly on a local level. The CWU promised not to engage in industrial action until the agreement expires in 2019.

There were threats to strike in October 2013, but strikes were prevented by the conclusion of the new agreement before Christmas 2013. Because of the ongoing negotiations, the CWU agreed not to strike during the Christmas season. A lump sum in 2014 and pay increases over three years are settled (3.0% in April 2013, 3.0% in FY 2014/15 and 2.8% (subject to review) in FY 2015/16).

- **June 2015:** The CWU opposed the final sale of Royal Mail shares by the UK government and announced that any attempt to “undermine the legally binding agreement that protects Royal Mail workers’ terms and conditions will be defended through strike action” (CWU press release 4 Jun 2015).

- **July 2015:** The CWU launched the “People’s Post campaign” which in the CWU’s view aims to defend daily deliveries and protect all postal workers’ job security, payment, and working conditions.

Source: Royal Mail press releases, CWU press releases, press articles.

Cooperation and co-determination: Royal Mail introduced new agreement procedures that puts the local level in charge and defines escalation mechanisms. As described in the box below (“Agenda for Growth, Stability and Long Term Success” – agreement procedures), conflicts will be firstly dealt with on the first level of management and only if a mutual agreement cannot be reached, will the conflict be dealt with at the next level.

This voluntary mediation process (see description in box below) has been established to prevent industrial action. Employee engagement is enhanced by these initiatives as conflicts will be discussed and solutions will be developed with the parties concerned at the site involved. This process was started with the new CLA in 2014. From our research we can conclude that this is a step forward, yet, the processes appear to be highly formalised and thus prone to slowing down changes.

Co-determination at local level is implemented at all comparators, but the level of cooperation is quite different. National operators, especially PostNord in Denmark and Sweden, but also Deutsche Post and to a lesser extent PostNL, have been following a close engagement policy for a number of years. For example, participation in pilot projects to test new working conditions (PostNord, Deutsche Post) seems to have good results. [X].

At La Poste, [X]. At USPS involvement is much more formalised and can therefore be more complicated and challenging.

The level of unionisation is not an informative indicator for a cooperative environment. [38]. A cooperative environment can be underpinned by an overall cooperative culture (as in the Netherlands, Denmark, Sweden, and to a certain extent Germany) but legal factors also play a role.

In some countries unionisation might be high (such as in Denmark and Sweden) but at the same time unions are more partners than opponents in negotiations. This seems to be a plausible explanation for almost no strike action in the postal sector in these countries. High social security standards and a labour market with low unemployment rates and good preconditions for fluctuation (“flexicurity” in Denmark) might also lead to fewer conflicts.

In other countries union membership rates are rather low (Germany, the Netherlands, and especially France) but CLA coverage is high throughout the country. In Germany and the Netherlands this might lead to a less controversial attitude towards negotiations as the chance to find a new job opportunity with comparable standards seems to be higher.

The amount of strike days in a country might indicate the level of cooperation and co-determination insofar as postal operators in countries with overall high strike days per 1,000 employees (such as France, and to a certain extent UK in comparison with the other countries included in this study, see Table 3-6) face more frequent and significant conflicts. In addition, it seems to be relevant if one very strong union is present at the company (CWU, Verdi) or several with different political orientation which might neutralise some conflicts in the end (as is the case in France).

At all companies except Royal Mail and USPS unions are represented at board level and thus involved in top-level control and management. This can contribute to more information transparency as well.

“Agenda for Growth, Stability and Long Term Success” – agreement procedures

The Legal contract between Royal Mail and CWU from January 2014²⁰¹ includes “Dispute resolution procedures”²⁰² to facilitate agreements on a local level as well as a national level, and a newly introduced voluntary mediation based on the “Agenda for Growth, Stability and Long Term Success”.

The dispute resolution procedures are based on subsidiary rules, starting with the “Achieving Local Agreement Procedure”. While this procedure is being followed, there will be no unilateral action from the management or CWU, namely there will be no kind of strike action and the union will try to prevent or stop any unballoted industrial action. If unballoted action occurs, the CWU's representatives and the Head of Industrial Relations will appoint two Special Mediators (or one joint mediator) to resolve the problem.

²⁰¹ Download via http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094287_04274_Legal_Contract_Betw_een_R.pdf.

²⁰² Legal contract between Royal Mail and CWU, January 2014, p.17-23.

The "Achieving Local Agreement Procedure" includes the following consecutive steps:

1. Agreement by joint statement at local level (first level)²⁰³. The Second Line Manager and the Area Representative will be informed.
2. In the case of a continuing disagreement, the Second Line Manager and the Area Representative will receive statements from the First Line Manager and the Unit Representative. Ideally, they will receive a joint statement about the conflict. If not, the Second Line Manager and the Area Representative shall try to reach a joint statement within a week.
3. Engagement in a discussion attended by other managers and representatives to come to a solution on second level. If an agreement is not reached within one week, it will be referred to the next stage.
4. The Second Line Manager and the Area Representative agree to a joint statement outlining the disagreement within a week and forward it to the third level. If they cannot agree to a joint statement within a week, they will forward separate statements.
5. The Third Line Manager and the CWU's Divisional Representative attended by other managers and representatives will engage in a discussion to reach an agreement. Within two weeks the discussions must have one of the following outcomes (1) a written agreement, (2) an agreed formula for the First Line Manager and the Unit Representative to negotiate, (3) recognition that an agreement cannot be reached at this level. Then, the failure to agree will be reported to the national level and the case can be solved or referred to External Mediation after seven days of discussion.
6. "Achieving National Agreement": After one month, disagreements will be referred to an (ideally jointly appointed) External Mediator. The mediation process will last four weeks minimum. If an agreement cannot be reached, the Mediator will issue a statement with the final positions, his conclusions and recommendations. Recommendations of the External Mediator are non-binding, however, the expectation is that the parties will make use of them.

At any time during the "Achieving Local Agreement Procedure" Royal Mail or CWU may agree to engage Voluntary Mediators. If an agreement cannot be reached within a week the procedures automatically move to the next step. By following the step-by-step procedure and by engaging a mediator at an early stage of the disagreement both sides want to prevent escalation that could result in industrial action.

In April-May 2014 Royal Mail, Parcelforce and CWU jointly recruited 5 CWU members and 5 managers to 10 industrial relations mediator roles.²⁰⁴ Successful applicants were to receive mediation training.

Using mediation as a conflict resolution process is already practised on a national level at Royal Mail. Mediation is a widely used tool in trade disputes at other comparators as well, e.g. at Deutsche Post. Royal Mail's "Achieving Local Agreement Procedure"²⁰⁵ uses mediation in a new context and seems to be a suitable way to cope with a unionised environment. The new procedure can be considered as an efficient option for

²⁰³ First-line managers are supervisors on a local level (e.g. at a delivery office). Second-line managers are superior to first-line manager (e.g. area managers).

²⁰⁴ CWU press release, 29 Apr 2015 and Royal Mail Group Job web portal.

²⁰⁵ CWU (2014), Agenda for Growth, Stability & Long Term Success, January 2014, (http://www.cwu.org/assets/files/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf), p.14.

providing solutions on a local level. It might be helpful to prevent deadlocked situations during the implementation of technological innovations or the introduction of new working conditions. However, it is still in its early stages. Whether it proves to be effective remains to be seen.

Wage policy: All comparators agreed to pay increases during their last respective negotiations rounds. However, Deutsche Post, PostNL, and PostNord settled agreements well below 2% per annum which means that the increase was kept below or kept pace with inflation but did not mean an increase in real wages. PostNL pays the national minimum wage to all of its part-time deliverers. Only Royal Mail and USPS have agreed to adjust wages based on indexes, i.e. USPS based on CPI and Royal Mail on RPI.²⁰⁶

Deutsche Post, PostNL and USPS introduced new two-tier wage schedules, despite union opposition. Deutsche Post managed to establish new wage schedules for new staff (since 2001) and also incorporated new companies based on (lower) sector CLA wage schedules, rather than company CLAs. PostNL changed from being a full-time to a part-time employer by introducing new positions and accompanying wage schedules for postmen/postwomen with vested rights and new deliverers in 2003. USPS has differentiated wage schedules for career staff²⁰⁷ and formed the position of “non-career” staff with lower wages and fewer fringe benefits in 2011. Royal Mail, La Poste, and PostNord have not implemented a two-tier wage schedule so far. However, the Royal Mail Pension Plan closed to new entrants with effect from 1 April 2008 resulting in a two-tier scheme for pensions.²⁰⁸

Deutsche Post, PostNL and PostNord also reduced overtime payments by replacing additional working hours by flex-time schedules. At Deutsche Post flex-time schedules prevail in sorting and deliverers are only compensated with time off for working overtime. Part-time workers in sorting and delivery at PostNL are simply asked to work more hours until a full week's work (37 hours) is completed. At PostNord, flex-time schedules have been extended to a yearly basis (Denmark) or to a team who can independently allocate the gained “plus hours” (Sweden). [3<].

In the April 2007/2009 Pay and Modernisation Agreement Royal Mail and CWU determined some work time flexibility on a daily/weekly basis. The terms had been agreed nationally and had to be deployed in each unit. They include structural changes

206 Royal Mail agreed to adjust wages based on RPI in the Agenda for Growth, Stability & Long Term Success, January 2014, p.17, see also chapter 4.2.1.1 Inflationary assumptions of this report. For USPS see for example the arrangements with the National Association of Letter Carriers (2011-2016), with the National Rural Letter Carriers' Association 2010-2015, and the National Postal Mail Handlers Union 2011-2016).

207 Career employees at USPS have unlimited contracts and enjoy full benefits (not necessarily full-time), non-career employees do not receive health or retirement benefits.

208 See Royal Mail Group, Royal Mail Pension Plan, The Company's Decision, February 2008 (<http://www.royalmailgroup.com/sites/default/files/Company's%20Decision%20FINAL%20150208.pdf>).

to reflect the traffic profile (schedules can vary during the week, e.g. longer days on Fridays). If necessary, duty times can vary up to 30 minutes per day to cope with unexpected traffic volume or other resourcing issues but total weekly contractual hours would not change. We understand that overtime rules would not apply in this case.

Flexibility in working time: Royal Mail, La Poste, PostNord Denmark and Sweden as well as USPS have to cope with limits to part-time contracts. Royal Mail, PostNord Denmark and USPS have comparable limits (around two-thirds of the workforce must be full-time) whereas La Poste has to maintain a minimum of 90% full-time contracts and committed to enhance this proportion. In Sweden, employees have a right to full-time employment by national labour law. Thus, at PostNord Sweden nearly 90% of employees work full-time and this proportion is unlikely to go down. USPS has the option to use part-time flexible employees with no definite weekly working hours. These employees might work full-time weeks occasionally. PostNL is a company with a dedicated part-time approach. In sorting or delivery, there are only a few full-time contracts left. For example, 3,000 postmen/postwomen carry out the sorting and delivery to business customers. Part-time deliverers will spend their full day's work outdoors. Deutsche Post and their unions do not regulate part-time proportion in their CLA. Part-time is voluntary and the proportion of 38% has been constant for several years.

Other working conditions: Apart from Royal Mail, La Poste and USPS, all companies have moved away from the "one postman/woman, one round principle". This is done to a lesser extent at Deutsche Post, PostNL and PostNord Sweden. At PostNord Denmark, rounds can even be re-designed and re-allocated on a daily basis. The re-design of rounds is only done at a local level at PostNL and PostNord Denmark and Sweden. USPS uses a highly formalised way to define workloads, working hours and routes. Royal Mail has recently introduced more involvement in the re-design process. [X]. At most comparators postmen/postwomen are required to complete their specified hours either by returning to the depots to carry out some additional tasks, or by completing additional rounds.

Outsourcing and franchising of core postal functions: Outsourcing of core postal functions such as sorting and letter delivery is limited by CLA at all postal operators but only Royal Mail, PostNord Denmark and USPS cannot subcontract any of their parcel delivery routes.²⁰⁹ Royal Mail has agreed in the current CLA negotiations to refrain from subcontracting. At Deutsche Post, the decision to subcontract, i.e. to use the services of a separate company for parcel delivery, is left to the companies' management. PostNL has subcontracted 80% of parcel delivery rounds. PostNord Sweden and La Poste also subcontract parcel delivery to a certain extent.²¹⁰

²⁰⁹ See Section 3.2 for more information.

²¹⁰ No detailed information available.

Mobility / Redundancies: Compulsory redundancies are not currently the primary method of choice at any of the comparator companies. PostNL plans moderate layoffs.²¹¹ So far, not all plans have come into practice. PostNord Denmark and Sweden had to reduce employee numbers when they started their transition process more than ten years ago. In Sweden some redundancies are currently compulsory but in Denmark the workforce is reduced by natural attrition and early retirement. USPS uses extra payments for leaving and has not excluded the possibility of reducing the number of mail handlers in sorting, however, there have been no compulsory redundancies so far. Deutsche Post and La Poste implemented early retirement schemes (still in force at La Poste). Deutsche Post is the only operator whose workforce has increased over the last 2-3 years.

Mobility programmes in regard to training and replacement are implemented, particularly at PostNL, to facilitate job migration into other companies (e.g. public transport). La Poste, PostNord and USPS use this tool for internal purposes (i.e. to train the existing workforce for new positions within the larger company structure e.g. in another business division). La Poste is the only operator who has a dedicated programme to enhance geographic mobility. Royal Mail is mainly relying on natural attrition but has implemented voluntary redundancy (VR) payments and an early retirement programme. The VR programmes are not subject to current CLAs.

3.5 Summary

In this section we summarise our main conclusions on the comparison between Royal Mail and the international postal operators with regard to current postal operations, efficiency programmes and employment and labour conditions.

The postal operators' environment in terms of demand developments and competition does affect their incentives. Royal Mail does not face significant end-to-end competition in letter delivery and it is unlikely that this will change in the near future. The decline in volume drives efficiency efforts so long as the operator is unable to recover its increasing costs through increasing its prices. This should be the case if there is significant competition, price regulation, and/or a substantial threat of increasing the shift to electronic communication channels by increasing its prices. In this regard, Royal Mail is not subject to any end-to-end competition of significant scale for letters, (although competition is stronger in relation to other postal products such as parcels and 'access mail'), and is subject to a light-touch approach in price regulation but is challenged by letter volume decline. Royal Mail's situation is different in the parcel sector, where it faces competition in both price and quality of service for the end-to-end delivery of parcels.

²¹¹ See. PostNL, Q4 & FY 2012 Results, Update 2015, 25 February 2013 , p.20 (<http://www.postnl.nl/en/about-postnl/investors/quarterly-results-presentations/>).

However, all postal operators, including Royal Mail, principally face the same challenge of an ongoing decline in letter volume. Their letter operations have largely the same structure and use similar technologies (even though at different stages of development). Their services are comparable: they all collect, transport and deliver letters and parcels. For these reasons a benchmark exercise on mail operations and related efficiency programmes provides useful insights on the relative position of Royal Mail's current and projected efficiency in mail operations.

The major differences between Royal Mail's current mail operations compared to those of the international postal operators are set out below.

Royal Mail's operations are organised differently in some respects compared to its international peers.

- Royal Mail still has room for improvements in automation.
 - Large letters are mostly sorted to delivery offices and not to rounds. This results in more manual work in delivery offices (need for a primary sort step).
 - Royal Mail has not yet attained the achievable level of walk sequenced letters by machine. This also results in more manual work in delivery offices.
- Machines for walk sequencing letters are usually installed in the mail centre which is not the case at Royal Mail. More than two-thirds of the machines are located in delivery offices without a substantial reduction in the number of delivery offices (as happened for example at PostNL that also situated sequence sorters in delivery offices).
- Royal Mail and USPS process letter and parcels in the same processing centre. More importantly, at Royal Mail, packages and parcels are sorted manually in its mail centres.
- Royal Mail does not franchise road transport on a regular basis which is common practice at the other postal operators (except for USPS and PostNord Denmark).

Royal Mail's delivery is organised differently in some respects compared to international peers.

- Collection on delivery is a general practice at the other European postal operators. While Royal Mail has put this in place in rural areas, we note that it is implementing this practice for low volume urban postboxes as well.

- Royal Mail has made relatively small progress in minimising indoor activities in delivery offices resulting in a delivery span of c60%.
- Royal Mail relies on delivery by foot or by “Shared van” (combination of van and foot delivery), while delivery by bicycle dominates at the European postal operators.
- Royal Mail's postmen/postwomen deliver letters and (small) parcels jointly which is similar to PostNord Denmark and USPS. The other postal operators jointly deliver letters and parcels (without weight and size restriction) usually on rural rounds if delivery is organised by van.

The following practices in postal delivery are not implemented at Royal Mail but are at some international postal operators.

- The assignment of in-office and street activities in delivery to different employees (separation of indoor and outdoor activities);
- The centralisation of mail preparation to a small fraction of delivery offices and the increased use of “depots” where postmen/postwomen pick up the pre-prepared bags or trays.
- Peak and off-peak delivery days by consolidation of non-priority mail and unaddressed items on fewer delivery days per week.

Royal Mail started an all-embracing transformation programme in 2008 which was relatively late compared to some of its international peers (notably compared to the fully privatised operators Deutsche Post and PostNL, but also to USPS (on automation) and to PostNord). The late start coincided with the beginning of an accelerated decline in letter volume on the one hand, and the dynamic growth in parcel demand driven by e-commerce on the other hand. For this reason, Royal Mail had to implement many different measures at the same time. The other postal operators (except for La Poste) started much earlier and usually under more advantageous conditions (growing demand in letter services and less competition in the letter delivery market) so that they were able to adapt the postal pipeline at a more gradual pace to increase efficiency and cost flexibility. For this reason, they were better prepared to face the overall demand decrease in 2008.

Overall, Royal Mail's transformation programme and related cost saving and efficiency initiatives planned in its 2015 Business Plan are similar to those which its international peers implemented in the past, particularly with regard to the major initiatives related to mail centre rationalisation, automation, logistics and delivery. However, there are differences in detail:

- Royal Mail is unable to outsource road transport because the agreements it has in place with the unions prohibit such outsourcing.
- The company does not consider any change in the “traditional” way of organising indoor and outdoor activities in delivery (i.e. no separation by employees and no centralisation).
- Royal Mail decided not to separate letter and parcel operations, neither in processing nor in delivery,²¹² but instead decided to limit parcel flow handled in mail centres to smaller packages by diverting larger, uneconomical parcels from the Royal Mail Core Network into the Parcelforce Worldwide network.²¹³
- Despite the substantial volume Royal Mail decided to improve parcel automation, i.e. to implement small parcel sorters for packages, much later than its peers.

A comparison between Royal Mail's current employment and labour policy compared to those of the international postal operators is set out below:

- A unionised workforce is a characteristic for Royal Mail but also for La Poste and USPS. La Poste can be described as the operator with the most radical unions (several with different political orientations from far-left to moderate or conservative) and by far the most frequent strikes. However, the impact of strikes is often only at a local level and several unions at a company might neutralise each other in negotiations which opens up options for agreements. On the other hand, the last national strike at Royal Mail seems to have had much more impact than numerous local strikes and the many national strikes at La Poste in 2014. Before the 2010 CLA the CWU seems to have used strikes as a common measure during negotiations with Royal Mail.
- The level of cooperation and co-determination is culturally influenced and traditionally high in Scandinavian countries (PostNord). This is also true for PostNL and Deutsche Post. It remains an open question as to how the

²¹² See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.8.

²¹³ See page 142 of Royal Mail plc's Prospectus, http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf.

recent strikes at Deutsche Post will change the cooperative climate at the company in the future. Royal Mail has made substantial steps towards a “cultural change” with more involvement of employees and less escalation of conflicts (mediation).

- Deutsche Post, PostNL and USPS have successfully implemented a two-tier wage schedule. Royal Mail cannot make use of this option as a result of the last CLA.²¹⁴
- There is a substantial variation among postal operators with regard to part-time employment. La Poste increased the proportion of its full-time contracts to more than 90% whereas Deutsche Post does not regulate part-time at all. PostNL has established a dedicated part-time policy for the whole company. The part-time – full-time ratio is frozen at Royal Mail and USPS. At PostNord Denmark and Sweden, the unions aim to ensure full-time employment without any definition of a fixed proportion and has accepted redundancies in exchange.
- Restrictions regarding the reassignment of work on a daily basis are disappearing (Deutsche Post, PostNL, PostNord Denmark and Sweden). Traditional practices such as “one postman – one round” or early daily finishes are vanishing. Trends to involve the workforce in daily decisions to a greater extent at a local level are observable and Royal Mail is also following this trend.
- Subcontracting of the core postal functions processing and delivery is generally not implemented at the comparators, however it is well-established in parcel delivery at Deutsche Post, La Poste, PostNL and PostNord Sweden.
- Half of the international peers made use of compulsory redundancies to reduce the workforce (PostNL, PostNord Denmark and Sweden). Most rely on natural attrition supported by early retirement schemes (Deutsche Post, La Poste, PostNord Denmark) or by payments for leaving (USPS and Royal Mail). Mobility programmes are also in force at most of these companies. Royal Mail will most likely follow natural attrition as the dominant option based on the CLAs. That said, payments for voluntary redundancies were substantial in previous years and they remain the only feasible incentive to promote headcount reductions for Royal Mail in light of the existing agreements with the unions.

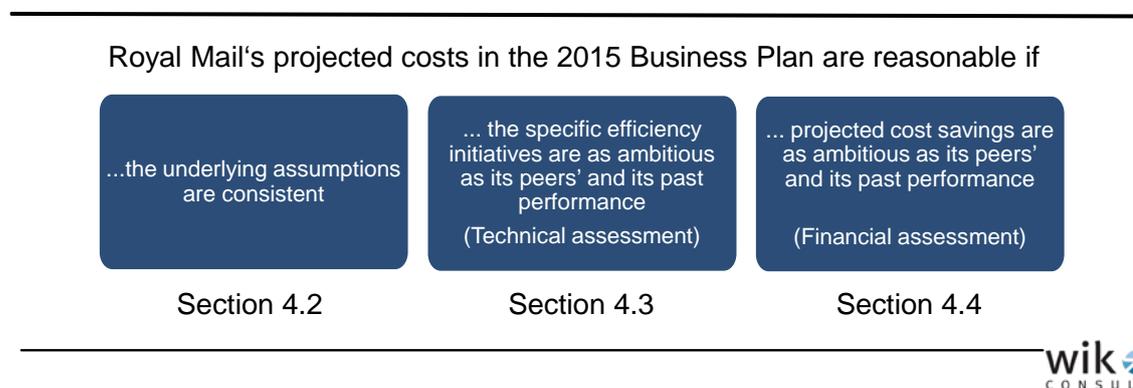
²¹⁴ However, we note that the Royal Mail Pension Plan closed to new entrants with effect from 1 April 2008 resulting in a two-tier scheme for pensions. See Royal Mail Group, Royal Mail Pension Plan, The Company's Decision, February 2008, (<http://www.royalmailgroup.com/sites/default/files/Company's%20Decision%20FINAL%20150208.pdf>).

4 Assessment of Royal Mail's planned cost reduction and efficiency projects

4.1 Criteria of the assessment

In this chapter, we assess Royal Mail's 2015 Business Plan with respect to its robustness, its internal consistency, and whether it is supported by evidence from Royal Mail's own performance in the past as well as the performance of international postal operators. The assessment puts emphasis on cost savings and efficiency initiatives that are relevant to Royal Mail's Reported Business.

Figure 4-1 WIK approach for assessing Royal Mail's projected costs



Source: WIK-Consult.

The assessment is based on three criteria:

- The consistency of the underlying assumptions and their application in Royal Mail's 2015 Business Plan is reviewed.
- Technical assessment
 - We discuss the planned efficiency initiatives and productivity targets in the broader context of Royal Mail's transformation programme, and assess whether they are more or less ambitious in light of past achievements, and
 - We assess whether Royal Mail's efficiency measures are more or less ambitious compared to efficiency initiatives implemented by the selected six international postal operators.
- Financial assessment
 - We assess the level of ambition of Royal Mail's targeted cost savings compared to its past cost savings achieved in the Reported Business.

- We discuss whether Royal Mail's cost saving targets are more or less ambitious in light of past achievements in cost savings made by the selected operators.

In Section 4.2 we discuss our major observations in relation to clarity of Royal Mail's documentation and consistency of assumptions included in Royal Mail's Business Plan. The forecast of cost effects depends on many assumptions of future cost drivers including input prices, demand and changes in the business organisation driven by efficiency and cost saving initiatives. In this context, we review the accuracy of Royal Mail's past forecasts of cost drivers and whether they are applied consistently throughout the Business Plan. Additionally, we take a close look at whether Royal Mail has managed in the past to meet its productivity targets.

Section 4.3 puts the emphasis on the technical assessment discussing the efficiency initiatives in light of Royal Mail's past performance and of international experiences. The efficiency initiatives are structured according to the core elements "Mail centre rationalisation", "Automation", "Logistics", "Delivery" and "Management Reorganisation Programme". Further, we discuss the question whether interrelationships between initiatives are sufficiently considered, for example double-counted effects or failure to take full account of linkages between initiatives.

The financial assessment is presented in Section 4.4 where we assess Royal Mail's cost saving targets in light of its past achievements and in light of past performance in cost savings of international postal operators.

In Section 4.5 we address potential measures to increase Royal Mail's efficiency. In doing so, we also consider the main factors affecting these plans which can be either within or outside Royal Mail's control.

A summary of the assessment of Royal Mail's Business Plan targets is provided in Section 5 of this report.

4.2 Consistency of underlying assumptions of Royal Mail's 2015 Business Plan

4.2.1 Inflationary assumptions

Royal Mail applies different drivers for changes in input prices (see Section 2.2.2.2). [REDACTED]. The pay awards for the first Business Plan period (FYE 2016) are based on already agreed increases with the unions and amount to 2.8% for frontline staff²¹⁵ ([REDACTED]) and [REDACTED].

[REDACTED]. The pay awards beyond FYE 2016 have not yet been negotiated between Royal Mail and CWU. [REDACTED].^{216,217}

In any case, the future pay awards are still subject to agreement between the unions (CWU and Unite) and Royal Mail, and therefore, are within Royal Mail's control to some extent. [REDACTED]. However, the increased pressure from private shareholders to improve profitability, a competitive environment in the UK parcel market, and ongoing letter volume decline may strengthen the bargaining position of Royal Mail compared to the pre-IPO situation. Moreover, Royal Mail's employees have the opportunity to participate in this improvement via their shares (12% of Royal Mail's shares are owned by its employees).

WIK-Consult has not assessed the inflation rate of each of Royal Mail's non-staff cost categories in detail. Generally, we consider the use of CPI growth as a benchmark inflator as reasonable in cases where no further information is available. [REDACTED].²¹⁸ [REDACTED].^{219,220,221}

[REDACTED]

²¹⁵ See Agenda for Growth, Stability, & Long Term Success, January 2014, p.17

http://www.cwu.org/assets/cwu/legacy-assets/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf.

²¹⁶ Price, Volume, Efficiency, Other.

²¹⁷ See CWU submission to Ofcom: Draft Annual Plan 2015/16, 26 February 2015, paragraph 69 and Ofcom, Annual Monitoring Update on the Postal Market, Financial Year 2013-14, paragraph 4.23.

²¹⁸ "Commercial Finance based on information from Office for National Statistics (ONS) and Forecasts are February quarterly projections".

²¹⁹ See for example forecasts of the Office of Budget Responsibility (OBR), March 2015 Economic and fiscal outlook: Charts & Tables, Table C3.20 (<http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2015/>). The average CPI inflation reported in its December 2014 forecast is 0.5% (Q2/2015 – Q1/2016), 1.8% (Q2/2016 – Q1/2017) and 2.0% (Q2/2017 – Q1/2018).

²²⁰ [REDACTED]

²²¹ The most recent OBR forecast dated from March 2016 reports 0.2% (outturn Q2/2015 – Q1/2016), 0.9% (Q2/2016 – Q1/2017) and 1.7% (Q2/2017 – Q1/2018); see OBR, March 2016 Economic and fiscal outlook: Charts & Tables, Table C3.20 (<http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2016/>).

- [REDACTED]²²²
- [REDACTED]²²³

[REDACTED]

4.2.2 Assumptions on demand drivers

The major demand driver for operational costs is mail volume.²²⁴ Volume forecasts depend on a number of assumptions which we do not review in detail in this report. However, one major assumption refers to the development of end-to-end competition in the UK letter market. In the 2015 Business Plan, Royal Mail assumes it will lose some letter volume to the former PostNL subsidiary Whistl. However, Whistl has withdrawn its end-to-end letter delivery operations so the expected decline in Royal Mail's letter volume will be lower than forecasted. This development is confirmed by Royal Mail's half-year results for FY 2015-16. The company reports a letter volume decline of 4.2%²²⁵ which is at the lower bound of its forecast range from 4-6%.²²⁶

The conversion of mail volume into workload determines potential hours and therefore cost savings due to volume decline. In our understanding of Royal Mail's documentation²²⁷ the transformation into workload depends on three sets of assumptions:

- The first set of assumptions is related to the volume split, e.g. the proportion of letters and large letters which has to be manually sorted in outward and inward processing.
- The second set is related to the split between fixed and variable workload proportions which Royal Mail determines separately for each core activity, e.g. the proportion of fixed workload is significantly higher in "delivery outdoor" than in "delivery indoor".²²⁸

²²² [REDACTED]

²²³ [REDACTED]

²²⁴ The material available to WIK has not allowed us to assess the demand driven cost changes of non-operational functions of the Reported Business.

²²⁵ WIK calculation based on the change in the total number of addressed letters. Royal Mail has rounded the change in letter volume to 4%. See Royal Mail plc, Results for the Half Year Ended 27 September 2015, 19 November 2015, p.8 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20of%20the%20half%20year%20ended%2027%20September%202015.pdf>).

²²⁶ Ibid, p.9.

²²⁷ See Royal Mail, 2015 Business Plan, Productivity Model.xlsx and Ops Traffic Model.xlsx. Additional explanations are provided in Royal Mail Group, Royal Mail Planning Process, 21 November 2012.

²²⁸ See Royal Mail Group, Royal Mail Planning Process, 21 November 2012, p.12.

- The third set of assumptions refers to the relative effort of handling different types of mail, e.g. the delivery of a parcel [§] is significantly [§] more time-consuming than the delivery of a letter.²²⁹

[§]

[§]

[§].²³⁰ Royal Mail estimates that letters will decline annually by [§] on average while the number of parcels will rise by [§].²³¹ The predicted change in the mail volume structure therefore [§].

[§]²³²

Table 4-1 Change in workload assumptions of Operations

[§]

Source: Royal Mail Group, 2015 Business Plan, Operations Planning Model; Royal Mail plc, Full Year 2014-15 Results, 21 May 2015, p.12.

Note: n/a: not available.

In our opinion, recent developments indicate that the workload will decline less than predicted by Royal Mail for two reasons. Firstly, letters decline is less than expected as explained at the beginning of this section. Secondly, parcel volumes have increased more than predicted. According to the 2015-16 Half Year Results of Royal Mail the number of parcels processed in Royal Mail's core network increased by more than 3%. Both effects result in stable workload as outlined in the Half Year Report.²³³

4.2.3 Efficiency assumptions

Increases in efficiency are reflected in improved productivity resulting in less gross hours needed for the same volume. Figure 4-2 shows the productivity forecasts and the actual achieved values provided by Royal Mail in the current and previous business

²²⁹ [§]

²³⁰ See Royal Mail Response to Ofcom / WIK Business Plan queries dated from 8 January 2016, Answer to Question 3.

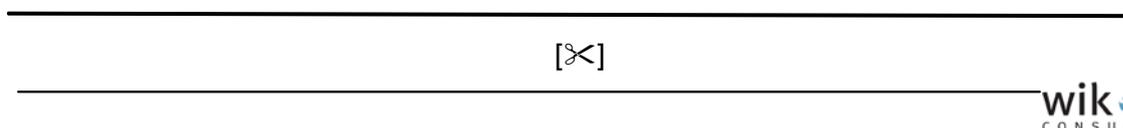
²³¹ See Royal Mail, 2015 Business Plan, Plan Workload Bridge (based on sales for delivery, adjusted by number of working days).

²³² Ibid. [§]

²³³ See Royal Mail plc, Results for the Half Year Ended 27 September 2015, 19 November 2015, p.9 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20for%20the%20half%20year%20ended%2027%20September%202015.pdf>).

plans. Past experience shows that Royal Mail has overestimated improvements in productivity as Royal Mail was unable to achieve its productivity targets²³⁴ ([<]).[<].

Figure 4-2 Productivity targets compared to performance



Source: Ofcom (2014), End-to-end competition in the postal sector, Final guidance on Ofcom's approach to assessing the impact on the universal postal service (Confidential version), paragraph 3.65 and Royal Mail, 2015 Business Plan, Ofcom Presentation – based on Board presentation, 27th March 2015, p.4.

The productivity metric provides a measure of the operational efficiency of Royal Mail's delivery and processing (mail centre) operations. This measure calculates the ratio between volumes processed and time taken. Volumes are weighted by the time expected to be taken to process them to give a weighted volume (or "workload") which includes the impact of a change in mix of products and volume decline.²³⁵ In FYE 2015 the actual value outperformed Royal Mail's forecast reported in its 2014 Business Plan by [<]. It seems that the productivity forecast FYE 2016 provided in the 2015 Business Plan of [<] will be [<]: Royal Mail reports an increase in productivity of 2.9% in its Half-Year results for the ongoing financial year 2015-16 which is [<] than the forecast.²³⁶

4.2.4 Conclusions

In this section we discussed the underlying assumptions of Royal Mail's cost projections with emphasis on the best documented Reported Business' Operations in its 2015 Business Plan. Overall, Royal Mail's 2015 Business Plan is based on a bundle of assumptions. We found that these assumptions are consistently applied throughout the plan. There are three groups of assumptions:

- Inflationary assumptions
- Assumptions on demand drivers
- Efficiency assumptions

²³⁴ See for example, paragraph 3.67 of Ofcom's Review of end-to-end competition in the postal sector. 2 December 2014, <http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>.

²³⁵ See for example, paragraph 3.63 of Ofcom's Review of end-to-end competition in the postal sector. 2 December 2014, <http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>.

²³⁶ Royal Mail plc, Results for the Half Year ended 27 September 2015, 19 November 2015, p.9 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20or%20the%20half%20year%20ended%2027%20September%202015.pdf>).

(1) Inflationary assumptions

[§]. Inflationary assumptions are applied in an internally consistent way throughout Royal Mail's 2015 Business Plan.

(2) Assumptions on demand drivers

The major demand driver for operational costs is mail volume which Royal Mail translates into "workload" to better capture differences in the handling of parcels, letters and large letters. [§]. Given the information available at the time Royal Mail developed the 2015 Business Plan, we consider the assumptions as appropriate.

(3) Efficiency

In previous business plans, Royal Mail usually set too ambitious productivity targets that were not met in practice.²³⁷ [§].

4.3 Technical assessment of Royal Mail's efficiency initiatives

4.3.1 Mail centre rationalisation

Royal Mail's Mail Centre Rationalisation programme has reduced the number of mail centres from 69 to 39 between 2008 and 2014, [§].²³⁸

As part of this rationalisation, Royal Mail successfully closed 34 mail centres and opened 4 fully modernised new mail centres between 2008 and 2014. Royal Mail intends to further reduce the total number of mail centres from 39 to 37.²³⁹ The closure of the additional two mail centres and the finalisation of ongoing rationalisations are expected to result in cumulated cost savings of [§] during the Business Plan period [§].²⁴⁰

Reducing its overall estate to 37 mail centres appears to be appropriate in terms of average population covered per mail centre. At La Poste, PostNord Sweden and USPS the average number of inhabitants per mail centre varies between 1.4m and 1.6m. In the case of Royal Mail, this number will be 1.7m at the end of the rationalisation

²³⁷ See for example, paragraph 3.67 of Ofcom's Review of end-to-end competition in the postal sector. 2 December 2014, <http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf>.

²³⁸ See Royal Mail, Overview of efficiency and change initiatives in Royal Mail, Presentation for Ofcom, October 2013, p.17.

²³⁹ See Royal Mail plc, Half Year 2015-16 Results, 19 November 2015, p.7 ([http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20\[WEBSITE\]_0.pdf](http://www.royalmailgroup.com/sites/default/files/H1%202015-16%20Results%20Presentation%20-%20FINAL%20[WEBSITE]_0.pdf)).

²⁴⁰ Please note that the cumulated cost savings only refer to efficiency related cost savings without consideration of increasing input prices ("inflation") and changes in mail volume, see Section Fehler! Verweisquelle konnte nicht gefunden werden..

process. In smaller and therefore less comparable countries such as Denmark and the Netherlands the average number of inhabitants per mail centre is higher (around 2.8m) because of shorter distances between mail centres.

Royal Mail decided to consolidate its mail centres relatively late. In contrast to Deutsche Post, PostNL and PostNord Sweden who implemented their letter sorting centres in the 1990s, Royal Mail decided not to apply a greenfield approach but to rely on existing sites to the maximum extent possible. Four Mail Centres were newly constructed but the majority of the selected sites have been refurbished and modernised. This procedure is more demanding than a greenfield approach because the transformation has to be accomplished during running operations.

Given the past performance in mail centre rationalisation this final step is as ambitious as its peers. The process of mail centre rationalisation will end around 2016, eight years after the start of the transformation programme.²⁴¹ The implementation period is similar to implementation periods of international peers of a similar size. Deutsche Post and La Poste needed comparable periods for the transformation of their networks. Overall, we conclude that this bundle of measures is as ambitious as Royal Mail's past performance within the context of Royal Mail's transformation programme and similar programmes of its international peers.

4.3.2 Automation

Royal Mail's planned initiatives include investments in IT and automation to reduce processing costs,²⁴² including the upgrade of large letter sorters and IT investments to improve readability of letter items and production control. Royal Mail expects cumulated cost savings of [x] of the Reported Business' costs (excluding transformation costs) in 2015. Cost savings due to parcel automation accounts for [x] of overall savings [x].

Royal Mail, similarly to La Poste, is a late starter in terms of mail centre rationalisation and automation. Royal Mail substantially modernised its sorting technology and implemented sequence sorters for letters in parallel with the mail centre rationalisation. The sorting technology is broadly similar between Royal Mail and its international peers. Despite progress made in modernisation of the sorting technology Royal Mail still faces a gap in terms of automation compared to its international peers as concluded in Section 3:

²⁴¹ Based on Royal Mail's current plans.

²⁴² See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 1.6.

- Large letters are mostly sorted to delivery offices and not to rounds which results in more manual work in delivery offices (i.e. the need for a manual primary sort step); and
- Royal Mail has not yet attained the achievable level of walk sequenced letters by machine i.e. 90% and more (see Section 3.2). This also results in more manual work in delivery offices.

For this reason there is still room for improvement in operational efficiency. We expect that the [X] will increase the proportion of walk sorted letters and large letters ([X]).[X].

In addition to the transformation programme, Royal Mail has started the parcel automation project. Royal Mail is planning to introduce sorters for small parcels in around 20 mail centres. Royal Mail estimates that the machines sort up to [X] items per hour (under ideal conditions) which is [X] than the small parcel sorters implemented in the Swedish mail centres.²⁴³ [X].^{244,245}

In our opinion, Royal Mail's parcel automation project is more driven by competition and customer needs than the transformation programme. In contrast to its international peers, Royal Mail started the implementation of parcel automation very late. [X].

We believe that there are indications that Royal Mail will accelerate the roll-out of the Parcel Automation programme. Key drivers are the growth potential in the UK parcel market, and more importantly, the pressure from other parcel operators and e-retailers (notably Amazon who also owns a stake in Yodel, a major competitor in Business to Customer (B2C) delivery in the UK parcels market). Additionally, Royal Mail's shareholders are highly interested in the parcel strategy of Royal Mail and are pushing for more progress.²⁴⁶

That said, we conclude that there is still room for more parcel automation and related cost savings due to more efficiency. The manual handling of more than one billion packages per year is not efficient given international practice, especially when there is an additional need for track and trace to retain competitiveness in the UK parcel market. Royal Mail decided to continue with the combined processing of letters and parcels in

²⁴³ The Fives Cinetics parcel sorters are able to sort up to 12,000 packages per hour. Moreover, sorting is not limited to barcoded items because the machines are also equipped with OCR system (see PostNord (Rikard Nilsson and Petri Princis), Sort it out, published in Postal Technology International (2014).

²⁴⁴ See Royal Mail Group, Royal Mail Operations and Ofcom meeting, 27 November 2015, p.6.

²⁴⁵ See Post & Parcel, Royal Mail opening ten temporary parcel sort centres for Christmas surge, 30 October 2015.

²⁴⁶ Many questions of investors are related to the parcel programme. See Royal Mail plc Full Year 2014-15 Results, Management presentation and Q&A transcript, 21 May 2015 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Full%20Year%202014-15%20Results%20Transcript.pdf>).

the same facilities. In combination with the significant consolidation of the total number of mail centres, [§<] which therefore constrains Royal Mail's ability to achieve significantly greater parcel automation.

4.3.3 Logistics

Royal Mail forecasts [§<] cost savings in logistics partly following the consolidation of mail centres. The company's initiatives include national road and air network reviews, along with focus on fuel, maintenance, and fleet costs.²⁴⁷ Additionally Royal Mail notes that among its forthcoming initiatives in this area is improving driver behaviour.²⁴⁸ Royal Mail mainly relies on [§<]. In total Royal Mail estimates it will achieve cumulated cost savings of [§<] of the Reported Business' total costs (outturn FYE 2015, excluding transformation costs). Nearly [§<] the saving is expected to come from the change in driver behaviour which requires a cultural change in employee behaviour which we observe has historically been difficult for operators to achieve. However, as the projected cost savings [§<] we conclude that the efficiency measures related to logistics are as ambitious as its past performance.

In contrast to some of its international peers (e.g. Deutsche Post and PostNL), outsourcing of road transport activities is not an option at Royal Mail because the current labour agreement with the Communications Workers Union (CWU) precludes any outsourcing activities in core operational functions which includes the road transport in regional and national logistics. Outsourcing would reduce expenses for workshop and maintenance and would shift the risk of temporary overcapacities to the contractor. Generally, outsourcing helps to increase the flexibility of transport costs.²⁴⁹

4.3.4 Delivery

Royal Mail's planned initiatives focus on reviewing and streamlining work organisation of indoor and outdoor activities in delivery with planned cumulated cost savings of more than [§<] during the Business Plan period. In total, delivery related cumulated cost savings amount to [§<] of the Reported Business' total costs (outturn FYE 2015, excluding transformation costs) and [§<] in Royal Mail's 2015 Business Plan. Given that delivery frontline staff costs account for [§<] of the Reported Business' total staff costs, the level of cost saving appears relatively low. In addition to delivery-related measures, Royal Mail has implemented the initiative "Collections on Delivery" resulting in additional cumulated cost savings of [§<].

²⁴⁷ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.27.

²⁴⁸ See Operations Plan: Logistics, 1 April 2016, <https://www.myroyalmail.com/news/2016/04/operations-planlogistics>.

²⁴⁹ [§<]

The reorganisation of its delivery organisation is a core element of Royal Mail's transformation programme. Since 2008, Royal Mail has significantly changed the delivery methods of its postmen/postwomen. Major elements were the implementation of the "Shared van" delivery method (to replace delivery by bicycle in urban areas) and the modernisation of foot delivery (introduction of High Capacity Trolleys and light trolleys instead of bags). Royal Mail and most of its international peers apply optimisation tools for delivery round planning. However, progress made in converting benefits from increased automation into more efficient delivery operations varies among Royal Mail and the international postal operators which is reflected in the delivery span of postmen/postwomen. In combination with the implementation of sequence sorters, Royal Mail managed to increase the average delivery span of its full-time postmen/postwomen from 50% to 60%. Simultaneously, the total number of delivery rounds declined by around 10% as a result of both progress in optimisation and volume decline. However, there is still room for improvement as concluded in Section 3.2. International peers report delivery spans of up to 80% in the more "traditional" delivery organisation, i.e. postmen/postwomen are responsible for both, indoor and outdoor activities in delivery. Royal Mail's major challenge in the first instance is therefore to convert the benefits from increased automation into more efficiency in delivery, i.e. into a longer delivery span for full-time postmen/postwomen which would result in a fewer rounds.

Changes in delivery organisation are most challenging for all postal operators because delivery is a complex activity involving a high number of employees. In delivery the "human factor" is much more important than in processing where the machines and the mail flow mainly determine the organisation and the pace of work. In contrast to processing, it is more difficult to implement standardised processes in delivery operations because of local circumstances and differences in the preferences and practices of local postmen/postwomen. Moreover, delivery organisation is something that is steadily changing; it is an ongoing optimisation process with more or less determined revision cycles. Experience at international peers has shown that delivery reorganisation can be a very time-consuming process which requires a substantial amount of communication with unions and employees. The situation is the same at Royal Mail. Moreover, Royal Mail is also a late starter in the field of delivery reorganisation particularly with regard to the implementation of walk sequence sorters. For this reason Royal Mail started the necessary negotiations with the unions and workplace representatives later than most of its international peers and its employees still seem more reluctant to changes.

That said, the relationship between postal operators and their employees is of utmost importance to the success of any transformation and modernisation programme particularly in delivery. In our view a unionised environment is not a unique feature of Royal Mail compared to, for example, La Poste, USPS, or even Deutsche Post. All

postal operators are challenged by high proportions of union membership²⁵⁰ and their dedicated workplace representatives, and as a result, have had to establish a cooperative relationship and a common understanding of the necessity of the transformation process with their employees.

However, in our opinion, Royal Mail took much longer to foster a cooperative relationship with its union compared to other postal operators. Examples of PostNord Denmark and Sweden, but also Deutsche Post, PostNL and even La Poste show how developing a more cooperative union relationship and involving the union in decision making can enable more sustainable change management. Especially in countries such as Denmark and Sweden where overall union membership is highest (around 80% of the workforce) cooperation and co-determination is highly valued and established allowing PostNord to implement sustainable change.

The current CLA at Royal Mail imposes several constraints on Royal Mail but also creates opportunities for improved change management in the transition process. The clear commitment to more cooperation and co-determination, documented for example in a joint agreement on delivery reorganisation and new mediation procedures, can be seen as an important step in this direction.

Based on the 2014 Labour Agreement, “Agenda for Growth, Stability & Long Term Success”, Royal Mail and CWU agreed on an approach for delivery revisions in September 2014.²⁵¹ We understand that this agreement allows Royal Mail to conduct delivery revisions in a tighter, more robust and more logical way than in previous revisions by going through a well-defined 6-phase approach. The revisions of delivery offices are conducted step-by-step. The first 200 delivery offices subject to this new approach were “places which fall into categories including previous revisions not working, in locations experiencing direct delivery competition, and also where there has been significant growth”²⁵². This indicates that direct delivery competition²⁵³ was an important driver for more efforts in delivery optimisation.

However Royal Mail faces significant restrictions for specific actions resulting from the legal contract Royal Mail agreed with CWU in early 2014. At Royal Mail, the CWU not only managed to protect vested rights of existing employees, but also managed to prevent the introduction of different labour conditions for new employees. The current CLA's distinguishing elements are: the one-tier wage schedule; the ban on subcontracting; and freezing the proportion of part-time jobs in relation to full-time jobs. The combined constraints are indeed unique to Royal Mail compared to the other postal

250 Verified by interviews. Official membership figures treated confidentially by unions.

251 Royal Mail Group / CWU, Delivery Revisions, September 2014.

252 CWUTV, Improved revision process, February / March 2015

(http://europe.nextbook.com/nxteu/cwu/postal_20150203/index.php?device=mobile&pg=11).

253 ‘Direct delivery competition’ is used by Royal Mail as synonym for ‘end-to-end competition’.

operators in this study who all succeeded in opening up at least one new source of cost savings.

Against this background Royal Mail's major strategy in delivery operations is to maximise the volume delivered by postmen/postwomen, through retention of the combined delivery of letters and parcels and to deliver more unaddressed items (door-to-door) and to collect letters from postboxes. This is combined with the target to keep a high level of full-time employment in postal operations. [X].

The more innovative delivery models as implemented by PostNL and PostNord Denmark are characterised by the centralisation of indoor activities in delivery (i.e. of manual walk sequencing) combined with the separation of indoor and outdoor activities by assigning them to different postmen/postwomen. This step does not appear to have been considered by Royal Mail so far. PostNL and PostNord started significant changes in delivery reorganisation much earlier, are under greater pressure to reduce costs due to substantial letter volume decline (and competition in case of PostNL) and therefore managed the change earlier and in close cooperation with the unions. They also managed to agree upon frequent and needs-oriented re-design of routes. Companies such as PostNL or PostNord are able to re-design routes whenever necessary on a local level and do not have to undergo overly strong formalised procedures. [X].

The extension of the "Collections on Delivery" approach to low volume postboxes appears reasonable.²⁵⁴ As outlined in Section 3.2 this is already a generally applied practice at the international peers. Moreover, the remaining collections tours in urban areas have been outsourced to transport companies by Deutsche Post and PostNL. However, it is likely that Royal Mail will not pursue this option because, as mentioned earlier, the outsourcing of core activities is excluded by a labour agreement.

Overall, we conclude that the initiatives to improve efficiency in collection and delivery are less ambitious than the progress made by international peers. We consider that Royal Mail could be more ambitious particularly in the transformation of its delivery organisation even without changing its traditional character.

4.3.5 Management reorganisation programme

In 2014, Royal Mail set up a programme to reorganise group and operational management. The company expected a net decline of 1,300 people in group and operational management staff.²⁵⁵ Royal Mail estimated cost savings of cumulated GBP 50m ([X]) in its first description of the program of which approximately GBP25m

²⁵⁴ See <http://www.royalmail.com/personal/help-and-support/postboxes-faqs>.

²⁵⁵ Royal Mail plc, Full Year 2013-14 Results, 22 May 2014, p.11 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202013-14_DDA_0.pdf).

would be realised in FYE 2015. Actually, Royal Mail outperformed the projection and reported GBP 42m in FYE 2015 and c.1,400 leavers due to the CEP. The company increased the expected cumulated cost savings from GBP 50m to GBP 80m by FYE 2016.²⁵⁶

The forecasted CEP savings allocated to the Reported Business' Operations amounts to [X] for FYE 2016. In its half-year results for FYE 2016 Royal Mail reported savings of GBP 32m related to this programme²⁵⁷ which implies that the company has already outperformed the projected savings by [X]. Moreover, the company estimates that annualised total savings of the management reorganisation programme will amount to around GBP 80m.²⁵⁸

Management reorganisation programmes are also applied by international peers but are less prominently presented in the context of overall reductions in overhead and administration costs. The benchmark does not provide sufficient information to assess Royal Mail's management reorganisation programme. However, past performance of Royal Mail shows that its previous estimated cost savings were too conservative and that Royal Mail was able to achieve greater than anticipated savings from its management reorganisation programme in a short period of time.

²⁵⁶ See Royal Mail plc, Full Year 2014-15 Results, 21 May 2015, p.12 (http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf).

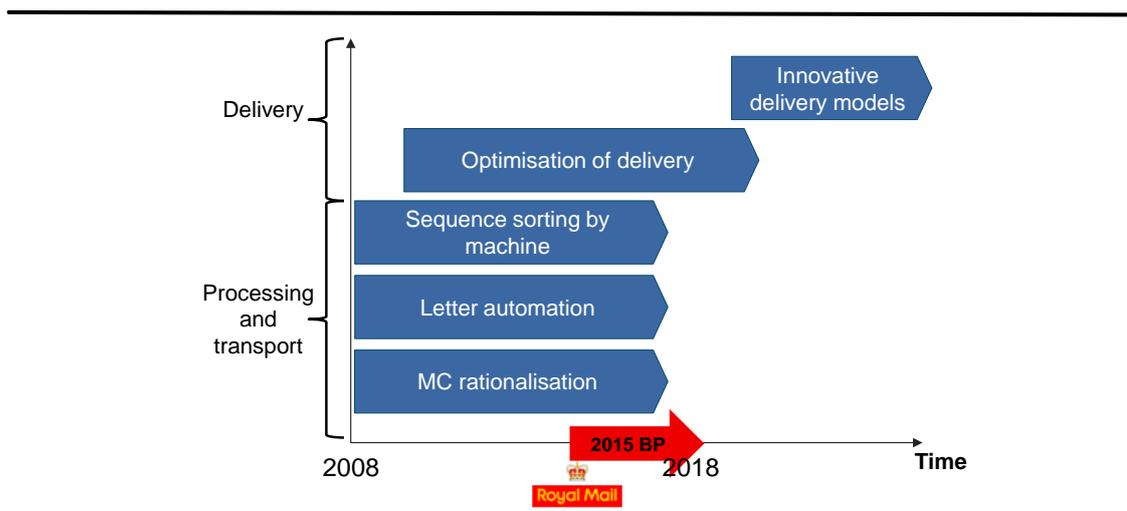
²⁵⁷ See Royal Mail plc, Results for the Half Year ended 27 September 2015, 19 November 2015, p.9 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20for%20the%20half%20year%20ended%2027%20September%202015.pdf>).

²⁵⁸ Ibid.

4.3.6 Conclusions

Royal Mail's projected efficiency measures mainly aim at accomplishing the transformation programme which consisted of the rationalisation and modernisation of its mail centres and the continued optimisation of its delivery operations (that started around 2010).

Figure 4-3 Royal Mail's estimated progress in operational efficiency



Source: WIK-Consult.

Royal Mail's transformation programme consists of a combination of measures including mail centre rationalisation and modernisation, more automation, optimisation of transport and revision of delivery operations. Figure 4-3 illustrates the progress we estimate Royal Mail will have made after the implementation of the 2015 Business Plan. It shows that the company will have finished the major elements of the transformation programme which would result in more (productive) efficiency and some cost savings. The figure also highlights that Royal Mail is implementing a number of major steps (MC rationalisation, letter automation, and sequence sorting by machine) at the same time, illustrating the complexity of Royal Mail's transformation programme. Other postal operators had tackled these challenges consecutively rather than simultaneously.

Overall, we consider Royal Mail's projected efficiency measures are appropriate in the broader context of its transformation programme and as ambitious as international practice for three of four major elements:

- Mail centre rationalisation:
 - [redacted]²⁵⁹
 - Given Royal Mail's past performance in mail centre rationalisation this final step appears appropriately ambitious. The size of the network and the implementation period is in line with international practice.
- Letter automation:
 - [redacted]
 - Overall, the planned measures appear appropriately ambitious and consistent with Royal Mail's transformation programme and international practice.
 - However, there is still room for improvement in walk sorting and sequencing by machine which is not explicitly mentioned in Royal Mail's planned initiatives.
- Logistics:
 - [redacted]
 - Projected cost savings are mainly attributed to [redacted] we conclude that the efficiency measures related to logistics are as ambitious as its past performance.
- Delivery:
 - [redacted]
 - This proportion is low given that [redacted] of the Reported Business' costs are accounted for by frontline delivery staff costs.
 - The initiatives to improve efficiency in delivery are technically feasible but appear less ambitious in light of Royal Mail's overall transformation programme and its progress made in the communication with unions.

259 Please note that the cumulated cost savings only refer to efficiency related cost savings without consideration of increasing input prices ("inflation") and changes in mail volume, [redacted].

- We consider that Royal Mail's plans are less ambitious in the transformation of its delivery organisation than the progress made by its international peers. It could achieve more, even without changing its traditional character.

In addition to the measures related to the transformation programme, Royal Mail is implementing additional initiatives:

- Collections on delivery:
 - [X]
 - The initiative is consistent with international practice and appears appropriately ambitious.
- Parcel automation:
 - [X]
 - [X], the parcel automation programme appears less ambitious than those of its peers.
- Management reorganisation programme:
 - [X]
 - Royal Mail has been very successful in implementing this programme in a short period of time by outperforming its own cost saving forecasts. This programme therefore appears as ambitious as its own past performance.

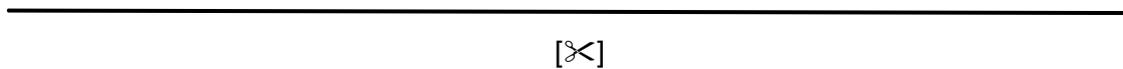
Our review of Royal Mail's financial evaluation of planned initiatives concludes that, overall, the value that Royal Mail considers it is capable of saving by its initiatives appears appropriate given the conditions Royal Mail faced when developing its 2015 Business Plan (in early 2015). While the financial evaluation of planned initiatives appears appropriate, we conclude that the choice of initiatives itself could be more ambitious.

4.4 Financial assessment of Royal Mail's projected costs

4.4.1 Royal Mail's past and projected performance in cost savings

In the following paragraphs, we analyse Royal Mail's performance with regard to headcount reduction and net cost savings for the period FYE 2008 to the end of the Business Plan period (FYE 2018). Figure 4-4 illustrates the development of Operations' headcount, staff and non-staff cost at the Reported Business.

Figure 4-4 Reported Business: Development of headcount, staff and non-staff cost



Source: Royal Mail, Regulatory Financial Statements and 2015 Business Plan.

Note: Excluding transformation costs.

[REDACTED]²⁶⁰

Figure 4-5 Reported Business: Development of headcount, staff and non-staff costs (CAGR)



Source: Royal Mail, Regulatory Financial Statements and 2015 Business Plan.

Note: OPEX: Sum of staff, non-staff and transformation costs
 CAGR: Compound annual growth rate.

[REDACTED]

[REDACTED] In the years FYE 2012 to FYE 2015, the performance has reduced significantly. While headcount reduction continued at c2% per annum, staff costs increased annually by more than 3% on average between FYE 2012 and FYE 2015. In other words, progress made in productivity was fully offset and even outweighed by increasing staff costs.

[REDACTED]

260 WIK uses headcount figures in Operations because they are available for the period starting with FYE 2008 until the end of the Business Plan period. Neither FTE figures nor employment figures allocated to the Reported Business are available for this period.

Figure 4-6 Reported Business: Development of headcount, operating expenditures, staff and non-staff costs (CAGR): Past and projected performance

[Redacted]



Source: Royal Mail, Regulatory Financial Statements and 2015 Business Plan.

Notes: OPEX: Sum of staff, non-staff and transformation costs
CAGR: Compound annual growth rate.

WIK uses headcount figures in Operations because they are available for the period starting with FYE 2008 until the end of the Business Plan period. Neither FTE figures nor employment figures allocated to the Reported Business are available for this period. For the Business Plan Period, Headcount in Operations includes Frontline headcount and Manager & Admin headcount (see Royal Mail, Operations 2015/16 Budget & Plan (OFCOM), 30th April 2015, p.20). [Redacted]

This development is also highlighted in Figure 4-6. In this illustration we distinguish two periods, from FYE 2008 to FYE 2015 and the projection period FYE 2015 (Outturn) to FYE 2018 to compare Royal Mail's past performance to the projected performance in cost savings. The temporary cost savings in staff and non-staff costs made during the first period are not visible [Redacted].²⁶¹

Given Royal Mail's past performance, the planned headcount reduction between FYE2015 and FYE2018 appears appropriately ambitious. [Redacted].

Overall, the estimated savings in staff costs are consistent with average past performance in staff cost savings at Royal Mail. It is a conservative estimation given the first period between 2008 to 2012 and in light of the most recent Half-Year Results of Royal Mail which reports a decline in staff costs of 1.3% (mainly driven by CEP). The estimated savings in non-staff costs appear appropriately ambitious given Royal Mail's past performance and reported savings of 2% in UKPIL non-staff costs for the first half of FYE 2016.²⁶²

4.4.2 Performance in cost savings compared to international peers

Finally, we compare the performance in cost savings at Royal Mail's Reported Business to the performance at the international peers. The selected operators are partly company groups with significant international business (e.g. Deutsche Post DHL). For the international benchmark we identified for each company (group) the segment or entity most comparable to Royal Mail's Reported Business. This comprises Royal Mail's core network (excluding Parcelforce) and is responsible for the provision of universal

²⁶¹ In Section 4.4.2 we use these indicators for comparing Royal Mail's performance in cost savings with the performance of international peers.

²⁶² See Royal Mail plc, Results for the Half Year Ended 27 September 2015, 19 November 2015, p.9 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20for%20the%20half%20year%20ended%2027%20September%202015.pdf>).

postal services. Table 4-2 lists the selected segments / entities for each international operator which form the basis for the international benchmark exercise in this section.

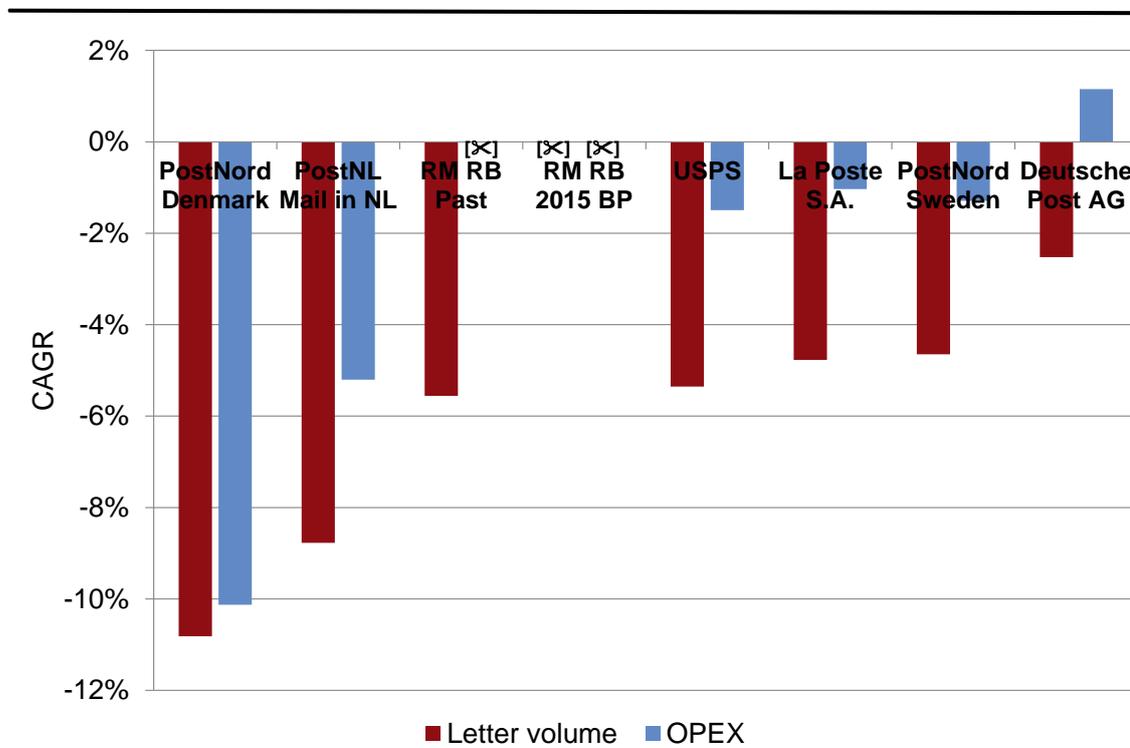
Table 4-2 Segments / entities of selected postal operators most comparable to Royal Mail's Reported Business

Group	Segment / entity	Reasons
Deutsche Post DHL	Deutsche Post AG (parent company)	Domestic and cross-border letter and parcel operations are assigned to Deutsche Post AG
Groupe La Poste	La Poste S.A. (parent company)	Domestic and cross-border letter and parcel operations are assigned to La Poste S.A. (responsible for provision of universal postal services)
PostNL	Mail in NL	Letter and parcel operations are assigned to different business divisions Mail in NL: Domestic and cross-border letter operations (responsible for provision of universal postal services)
PostNord	Mail Denmark	Focus on letter operations until 2012, then integration of domestic parcel activities (responsible for provision of universal postal services)
PostNord	Mail Sweden	Focus on letter operations in Sweden Parcel & logistics activities assigned to another business division responsible for operations in the Nordic countries (responsible for provision of universal postal services)
USPS	USPS	Focus on letter and parcel operations (responsible for provision of universal postal services)

For the comparison we refer to the period after 2008 which can be characterised as the period of accelerated letter volume decline.²⁶³ In that period all postal operators have taken measures to keep their costs in pace with volume decline, and measures that also increase the efficiency of their postal operations in relation to mail centre rationalisation (PostNord Denmark and Sweden, USPS, La Poste), automation (all operators), logistics, delivery (all operators), and management reorganisation (PostNL, PostNord).

²⁶³ See Section 3.1.

Figure 4-7 Operating expenditures: Royal Mail's projections for the Reported Business and past performance of international postal operators (2008-2014)



Source: Royal Mail, Regulatory Financial Statements;
 International postal operators: Annual Reports regulators' market study (PostNord Sweden)
 PostNord Sweden / Letter volume: PTS market surveys
 Royal Mail Reported Business: Royal Mail, 2015 Business Plan.

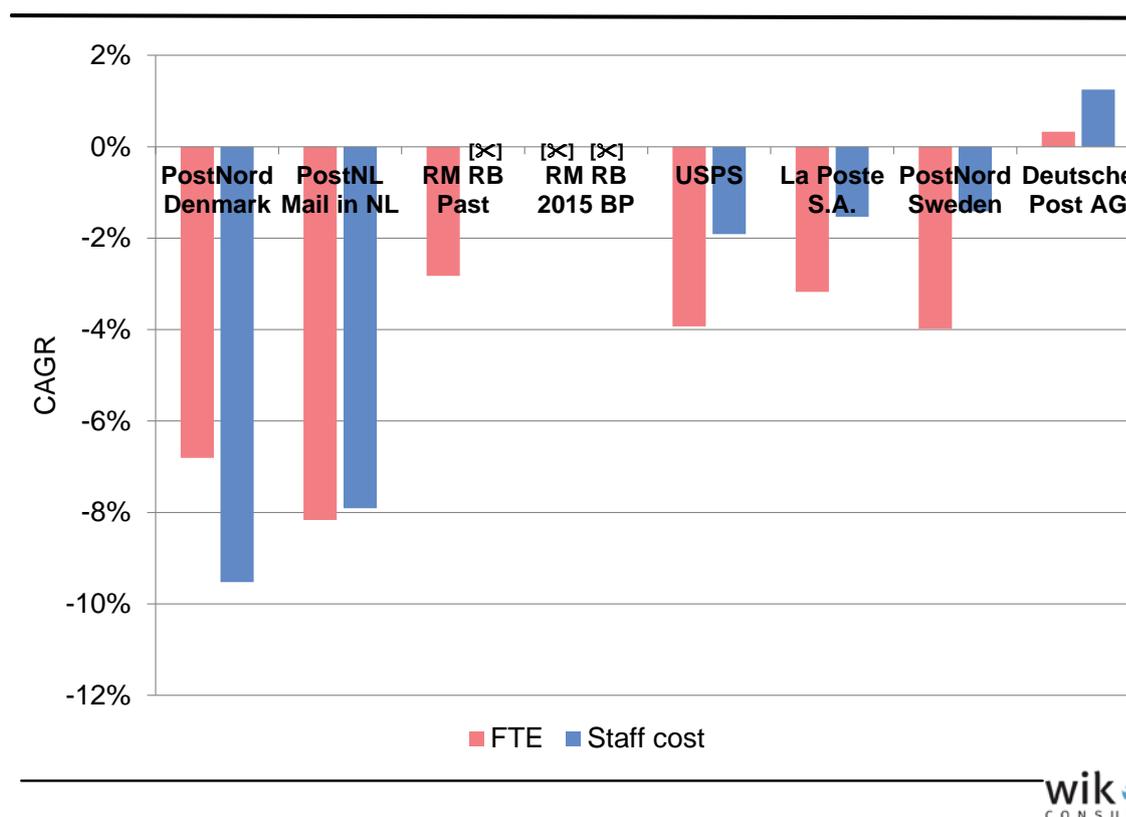
Notes: CAGR : Compound Annual Growth Rate;
 FTE: Full-time equivalents .
 OPEX: Operating expenditures (including transformation costs)
 Royal Mail Past FYE 2008- FYE 2015; Employment: Headcount Operations;
 Royal Mail 2015_BP: Business Plan period; Employment: Headcount Operations;
 Letter volume refers to total mail (including parcels): FYE 2009 – FYE 2014;
 Deutsche Post AG: Mail volume 2008-2013;
 PostNL: Financial data 2009-2014;
 PostNord Denmark and Sweden: Financial data 2009-2013.

Figure 4-7 presents the compound annual growth rates of employment, letter volume, operating expenditure, staff costs and non-staff costs between 2008 and 2014. Royal Mail's Reported Business is included twice; the first set of bars covers the historic period FYE 2008 – FYE 2015, [X].

PostNord Denmark and PostNL have been the most successful operators in reducing their operating expenditure. However, both companies have been greatly affected by letter volume decline and they have substantially changed their delivery organisation as a result. Moreover, parcel operations do not play a role in the PostNL segment

information. For these reasons these companies are less comparable and therefore less appropriate to be used as a benchmark for Royal Mail's potential cost savings. [X]. All operators have managed to reduce their OPEX except for Deutsche Post.²⁶⁴ Overall, Royal Mail's projected cost savings (after transformation costs) appear reasonable compared to average cost savings achieved by other operators [X].

Figure 4-8 Staff costs: Royal Mail's projections for the Reported Business and past performance of international postal operators (2008-2014)



Source: Royal Mail, Regulatory Financial Statements; International postal operators: Annual Reports regulators' market study (PostNord Sweden) PostNord Sweden / Letter volume: PTS market surveys Royal Mail Reported Business: Royal Mail, 2015 Business Plan.

Notes: See Figure 4-7. WIK uses headcount figures in Operations because they are available for the period starting with FYE 2008 until the end of the Business Plan period. Neither FTE figures nor employment figures allocated to the Reported Business are available for this period. For the Business Plan Period. Headcount in Operations include Frontline headcount and Manager & Admin headcount (see Royal Mail, Operations 2015/16 Budget & Plan (OFCOM), 30th April 2015, p.20). [X].

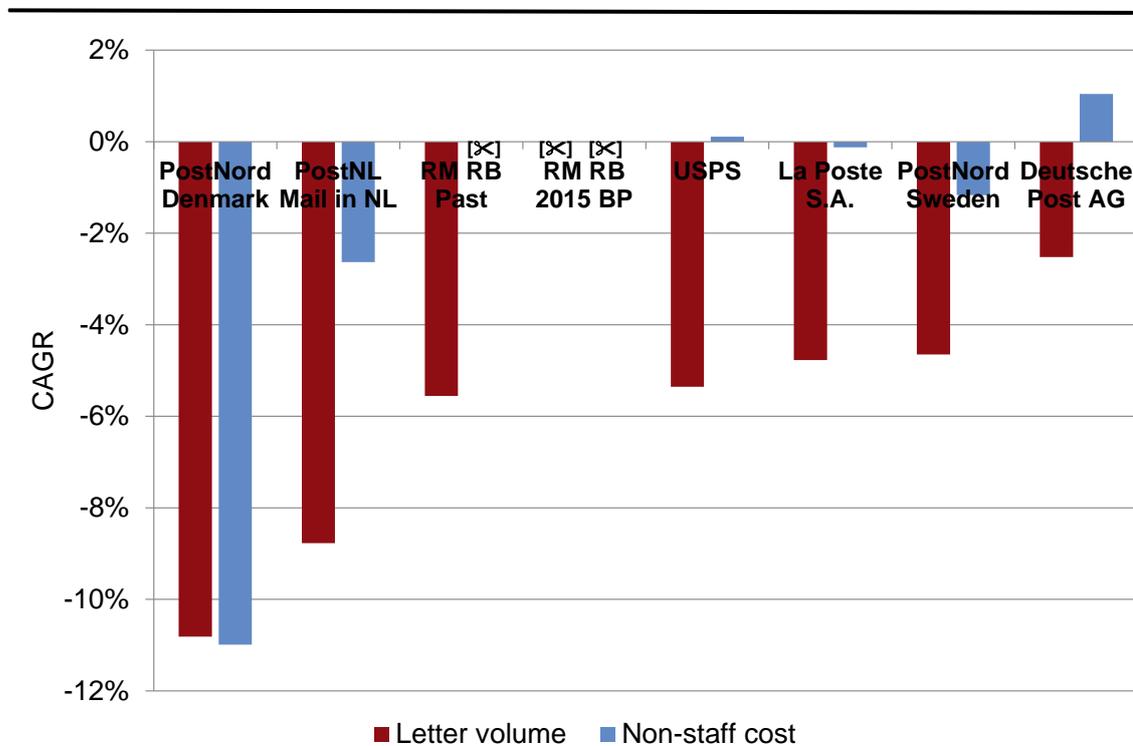
The Reported Business' performance in saving staff costs in both periods between 2008 and 2014 and the projection period appears to be [X] lower compared to the international peers (see Figure 4-8):

²⁶⁴ Deutsche Post AG does not only include German letter and parcel operations but also the central administration and head office of Deutsche Post DHL which may explain growing operating expenditures.

- Employment declined by only 3% which is the second-lowest value of all postal operators with significant decline in letter volume;
- [X]

Again, PostNL and PostNord Denmark are less appropriate benchmarks for Royal Mail in this context because of a more significant decline in employment (driven by volume decline and changes in delivery organisation). Royal Mail's projected staff cost savings still appear less ambitious than current international practice.

Figure 4-9 Non-staff costs: Royal Mail's projections for the Reported Business and past performance of international postal operators (2008-2014)



Source: Royal Mail, Regulatory Financial Statements;
 International postal operators: Annual Reports regulators' market study (PostNord Sweden)
 PostNord Sweden / Letter volume: PTS market surveys
 Royal Mail Reported Business: Royal Mail, 2015 Business Plan.

Notes: See Figure 4-7.

Figure 4-9 shows the development of letter volume and the average savings rate in non-staff costs at Royal Mail and its international peers. The projected savings rate appears more ambitious than international peers [X].

While Royal Mail has successfully managed the downsizing and modernisation of parts of its network since 2008 this has not been fully reflected in the development of operating expenditures. Compared to most of the international peers, [X].

4.4.3 Conclusions

The comparison of the performance in cost savings between Royal Mail and its international peers for the period 2008-2014 indicates that Royal Mail's cost savings in operating expenditure are lower than the savings achieved by those international peers facing a similar decline in mail volume. This “underperformance” is mainly driven by lower savings in staff costs in the previous years and [X] during the Business Plan period.

A closer look at the Reported Business' year-on-year data revealed that for the period FYE 2008 to FYE 2012 Royal Mail has managed to significantly reduce both headcount and staff costs, to a similar extent as its international peers. However, staff costs have increased significantly despite continuing headcount decline from FYE 2013 to FYE 2016 [X]. Progress made in productivity growth was therefore offset by increasing staff costs. In light of Royal Mail's past performance, particularly if compared with the period FYE 2008 to FYE 2012 the Business Plan cost saving targets appear less ambitious.

4.5 Potential measures to increase Royal Mail's efficiency

Based on the assessment in Section 4.3, we have identified areas for measures that could be appropriate to increase Royal Mail's efficiency. These measures do not necessarily take into account the restrictions defined in the 2014 labour agreement and are therefore more relevant for the long term perspective. For this reason, a necessary precondition for all of these measures is that Royal Mail must continue to improve its employment and industrial relations, i.e. to negotiate a better outcome for the business. This does not only mean that Royal Mail has to negotiate a better outcome for the business as regards flexibility in working time but also has to avoid deadlocks that might lead to industrial action. To negotiate sustainable measures that are in both parties' interest seems to be the main future challenge.

Below we discuss the areas for potential measures to increase efficiency we have identified despite potential preclusions determined by current agreements with the unions.

Flexibility

Based on the legal contract between Royal Mail and the CWU in early 2014, Royal Mail has committed to maintain a one-tier wage schedule from January 2014 until March 2019. While terms and conditions are the same between old and new hires, the pension scheme has been closed to new entrants since 2008 so that the company operates a

two-tier pension scheme. In contrast, international peers such as Deutsche Post, PostNL and USPS successfully managed to implement a two-tier wage schedule with significantly lower wages for new staff.

Outsourcing as another option to gain flexibility is not available either. In the contract that is based on the "Agenda for Growth, Stability & Long Term Success" outsourcing of business functions and franchising out of core operational functions is excluded. Outsourcing of core postal functions, i.e. processing and delivery, is limited by CLAs at all postal operators in our benchmark but only Royal Mail (Reported Business), PostNord Denmark and USPS cannot subcontract any of their parcel delivery routes.

Like its international peers Royal Mail has agreed to maintain a waiver of compulsory redundancies and keep vested rights for the workforce. In light of the international benchmark, however, this could be rated as an unsatisfactory result. Both Royal Mail and the unions agreed to more flexibility in working time but the scope of flexibility is still subject to further negotiations. Deutsche Post, PostNL and PostNord have reached more flexibility in terms of reduced overtime payments by replacing additional working hours by extended flextime schedules or extensive use of part-time work (PostNL). So far Royal Mail only managed to introduce some work time flexibility on a daily/weekly basis after the Pay and Modernisation Agreement with the CWU (April 2007/2009).

Like other international peers Royal Mail has to deal with limits to part-time contracts. The existing full-time/part-time ratio has to be maintained and permanent contracts have to be kept but compared to other postal operators, the current agreements leave Royal Mail with fewer alternative ways to enhance flexibility. For example, La Poste, PostNord, and USPS also face limits to part-time work but could negotiate other options instead (i.e. flextime schedules, flexible route re-designs at the local level, outsourcing options).

Maintaining full-time employment and retaining permanent contracts leaves Royal Mail with few alternative ways of offsetting the other restrictions in order to increase workforce flexibility. Its international peers in Denmark, Sweden, the Netherlands and Germany have been more successful in building a relationship with their employees and unions that allows more options in the field of wage policy and flexibility in working time. In the short run, flexibility in working time could be an option for Royal Mail to increase flexibility despite limits to part-time contracts. PostNord might serve as an example of how flexibility can be enhanced while keeping an overall full-time policy.

Combined, the restrictions from the agreements significantly limit Royal Mail's ability to increase flexibility in its postal operations and its potential for additional cost savings in a more and more challenging market environment. In contrast, the international peers, notably PostNord Denmark and Sweden, PostNL and Deutsche Post, have proactively managed the relationship with their employees and with the unions in the past which resulted in higher levels of efficiency and cost flexibility.

Automation

There is still scope for improvement in automation at Royal Mail particularly with regard to the proportion of walk sequenced letters by machine and with regard to parcel automation.

Royal Mail still has some potential to **increase the proportion of walk sorted and walk sequenced letters** in the next few years. International peers achieve levels above 90%. However, [3<]. Past experience at Royal Mail showed that the proportion of letters automatically walk sequenced has increased only gradually since 2013 and has now reached 82%.²⁶⁵ One critical point which may limit the maximum proportion is the location of the sequence sorters and the extent to which Royal Mail is able to cover a high proportion of delivery rounds by machine sorting. The sequence sorters are usually installed in mail centres at international peers, which is not the case at Royal Mail. More than two-thirds of its machines are located in delivery offices instead. This could limit the achievable proportion of automatically walk sequenced letters for the following reasons:

- Maintenance and handling of machines is easier in mail centres because of better availability of skilled personnel and spare parts.
- The machines can be used more efficiently because they can sort letters over 24 hours for different purposes and can therefore process more letters than they would in a delivery office where they are usually in operation during the late night and the early morning.

Decentralisation of sequence sorters may make sense if indoor activities for delivery are centralised in a relatively low number of delivery offices and therefore cover a substantial number of delivery rounds. In the case of Royal Mail this would require that sequence sorters implemented at MPUs are used to walk sequence letters not only for the rounds at that delivery office but also for rounds assigned to adjacent delivery offices.²⁶⁶

The **automation of parcels and packages** could be further promoted [3<]. [3<], Royal Mail could consider using separate locations for the processing of letters and parcels, particularly if parcel volumes continue to increase dynamically. We believe that Royal Mail does not intend to introduce walk sorting for parcels using these machines because this would require either a substantial number of gates (which would require a large amount of space which may not be achievable in Royal Mail's current property portfolio) or more than one sorting step (which ultimately may not be more efficient).

²⁶⁵ See Royal Mail plc, Annual Report and Financial Statements 2014-15, p.10, http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf.

²⁶⁶ [3<]

Consequently, the manual work at delivery offices would not be affected by the parcel automation programme; it would still be necessary to sort the parcels to walks first before handing over to the postman/postwoman. Therefore, Royal Mail could additionally seek opportunities to improve the methods for walk sorting packages and parcels in delivery offices with enough space (e.g. by adding adequate tools in MPUs).

Royal Mail could consider increasing the **automation of unaddressed items** and leaflets following the practice of PostNord. If the company aims to further extend the distribution of unaddressed items, they could consider mechanising the bundling process. PostNord Denmark and Sweden are both very advanced in the handling of unaddressed items. They have mechanised the bundling of unaddressed items into a wrapped collection of items. Furthermore, the machine prepares walk bundles taking into consideration those addresses who do not want to receive any unaddressed advertising. Finally, it facilitates the indoor work of postmen/postwomen who currently merge leaflets with addressed letters to one bundle in the sorting frame.

However, general practice at international peers is to keep the addressed and unaddressed bundles separated. Therefore, Royal Mail could consider as an intermediate option to change its current practice of merging addressed and unaddressed items and to instead leave unaddressed items in separate bundles. This would also avoid the extra processing step of merging bundles at the frame, but would require a different organisation of transporting the bundles (e.g. the various compartments on the High Capacity Trolleys). This would avoid an additional sorting step in the walk sequencing process. In delivery, however, picking up letters and unaddressed items from separate bundles requires a little more time per delivery point than picking up both from one bundle. Royal Mail would therefore have to make a judgement call as to which method is more efficient in its own network.

Logistics

Royal Mail could consider franchising out transport services more than it has done previously. We understand that franchising out is limited to air and rail transport.²⁶⁷ Franchising out road transport is only practiced during peak times, if necessary. Unlike most of its international peers, Royal Mail still relies on its own drivers and vehicles in the UK.²⁶⁸ Given the importance of downstream access combined with the consolidation of mail centres, regional logistics and line haul transport between mail centres has become less important. [X]. In that case it would be much easier to adapt the transport services to volume variations and avoid overcapacity in off peak times. However, as mentioned in the beginning of this section, Royal Mail faces substantial restrictions with regard to franchising out core postal activities which as we understand

²⁶⁷ See Royal Mail plc (2013), Prospectus, Section 4.2 (A) (http://www.royalmailgroup.com/sites/default/files/Full_Prospectus.pdf).

²⁶⁸ Ibid. Sections 1.31, 2.3, 4.2 (A).

includes road transport. During the contract period of the 2014 labour agreement, the CWU might consider this as being in breach of the agreement made in the CLA, and could result in industrial action by the CWU.

Innovative delivery models

A radical change in delivery organisation as established by PostNL and PostNord is [X]. Examples of the types of initiative that Royal Mail could pursue in order to increase flexibility in delivery operations and maximise the delivery span are as follows:

- the centralisation of mail preparation;
- the assignment of mail preparation and delivery to different employees; and
- the implementation of peak and off-peak delivery days.

Centralisation of mail preparation

The consolidation of mail preparation to a reduced number of delivery offices requires a high proportion of automatically and accurately walk sorted and walk sequenced letters to minimise manual sorting of letters. In our opinion, unaddressed and addressed items should not be manually merged or unaddressed items should already be merged and bundled to walks. Manual walk sequencing would then be minimised and could be conducted in two day shifts i.e. sorting frames could be used more than once per day (which additionally requires some relabelling or alternative solutions such as the voice-controlled mail preparation²⁶⁹ applied by PostNord Denmark). Prepared bags or trays can then be transported to pick-up points that would be necessary to limit the distance between the postman/postwoman's pick-up point and their round.

The delivery method matters as well. Royal Mail has introduced the "Shared van" method which allows a substantial distance to be covered in a relatively short time. Additionally, this method may reduce the need for replenishments, but at the same time, a slower employee may determine how quickly the Shared van team completes its delivery.

However, if the proportion of parcels increases, the capacity of a van shared by two postmen/postwomen will also be a limiting factor. In any case, van delivery allows for more consolidation of delivery offices.

A starting point for achieving a pick-up point style organisation could be to make greater use of those delivery offices already equipped with sequence sorters, i.e. the MPUs.

²⁶⁹ When using a voice-directed letter sorting system, the employee – equipped with a headset and a wireless terminal – says part of the street name on the item and a message is immediately displayed on the screen indicating the compartment in which to place the item in the sorting frame (see http://www.optiscangroup.com/doc/success_stories/Post-Danmark-success-story.pdf).

They could be used as core delivery centres while the adjacent delivery offices can serve as satellites and pick up points. The more delivery rounds assigned to an MPU, the more its sequence sorters' capacity can be used and the higher the proportion of walk sequenced letters.

We understand that delivery offices are also pick-up points for parcels that could not be delivered at the premises of the recipient. This function could be transferred for example to the Post Office network, which has a much higher density than Royal Mail's network of delivery offices. Royal Mail already has an exclusive agreement with POL to use post offices as a 'click and collect' network.²⁷⁰ This could serve as a model for an additional agreement to use Post Offices as a pick up point for non-delivered parcels. This would be more convenient for the customers (given that opening hours are also more in line with customers' needs) and could increase the attractiveness of Royal Mail's parcel services. We acknowledge that this suggestion has its limits as some Post Offices do not provide enough space for storage.

Separation of mail preparation and delivery

This step is interrelated to the centralisation of mail preparation and would allow Royal Mail to further extend the delivery span. However, this step would substantially change the way postmen/postwomen perform their duty today. This is therefore a measure that could be implemented only in the long run. The roll out could start in urban areas (in combination with depots) to reduce the distance between delivery offices and delivery rounds.

Peak and off-peak delivery days

The implementation of peak and off-peak delivery days could result in substantial cost savings. PostNord Denmark reported annual savings of between 3-5% in total operating costs following the implementation of the X/Y delivery model.²⁷¹ However, the implementation of peak and off-peak delivery days would be a substantial change to Royal Mail's postal pipeline and the underlying IT infrastructure. Moreover, mail volume structure is of key importance. Both companies set price incentives to additionally promote the shift from next-day delivery to slower products. The higher the proportion of "slow" letter products, the more efficient is the implementation of a peak and off-peak model.

Royal Mail offers a D+1 (First Class) and a D+3 (Second Class) letter service. Off-peak delivery would only be possible for D+3 letters because D+1 letters have to be delivered from Monday to Saturday. However, 57% of total letter volume is assigned to Royal Mail

²⁷⁰ See <http://www.royalmail.com/personal/receiving-mail/choose-local-collect>.

²⁷¹ See WIK-Consult (2013), Review of Postal Operator Efficiency (<http://stakeholders.ofcom.org.uk/binaries/post/postal-efficiency/wik.pdf>).

access²⁷² which is usually delivered the next working day after posting at Royal Mail's inward mail centre.²⁷³ We estimate that c60-70% of Royal Mail's total letter volume (Access letters and First Class letters)²⁷⁴ is subject to next day delivery specifications and requires delivery from Monday to Saturday, i.e. on 6 days a week. Therefore in order to achieve savings of the scale of PostNL and PostNord Denmark, Royal Mail would need to incentivise a further shift to D+3.

Facilitate delivery

Royal Mail delivers letters and large letters as well as parcels up to 2kg. The company differentiates between letterboxable parcels and parcels that do not fit into the letter box. PostNL has a similar solution: the company offers "letterbox parcels" that are delivered in combination with letters. But there is a big difference between the Netherlands and the UK; firstly, with regard to the standardisation of letter box sizes and particularly aperture sizes; and secondly, how much effort postmen/postwomen undertake in case of items which do not fit. In the Netherlands many letter boxes in case of door delivery are standardised so that the "letter box parcel" usually fits in the letter box. In the UK, letter boxes have very different sizes (e.g. 'Victorian style') which on occasion means that even large letters or magazines do not fit through. Standardisation of letter box sizes would help to facilitate delivery and to reduce delivery costs, although we note that this is outside of Royal Mail's control.

Another aspect is the location of delivery points. Delivery to the door appears to be the common practice in the UK, even in many apartment blocks, while in other countries cluster letter boxes are usually located on the ground floor near the entrance of the property (inside or outside the building). In France, there are regulations for buildings constructed after 1979 with regard to cluster letter boxes.²⁷⁵ These letter boxes are large enough to accommodate packages as well as letters. In rural areas, the difference in delivery cost between whether the postmen/postwomen have to deliver at the door of the house or at the property line is huge. In Denmark, for example, the state has issued

²⁷² See Ofcom, The Communications Market 2015, Figure 6.12

(http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr15/CMR_UK_2015.pdf).

²⁷³ See Royal Mail Wholesale, Standard Access: "Mailing items are handed over at Inward Mail Centres between 7:30am - 12:00pm, Monday to Saturday. Our service aim is to deliver 95% of your mail the next working day, as long as your mail meets presentation requirements such as mailing items meeting a minimum of 90% postcode and address accuracy."

(<https://www.royalmailwholesale.com/standard-access/>).

²⁷⁴ Estimation is based on Ofcom (2015), Annual monitoring update on the postal market, Financial year 2014-15, p.53-54 (numbers refer to total mail i.e. including packages, see http://stakeholders.ofcom.org.uk/binaries/post/monitoring-reports/Annual_monitoring_update_2014-15.pdf).

²⁷⁵ NF D 27-404 for letter boxes located inside and NF D 27-405 for letter boxes located outside the building, see http://www.sirandre.fr/pdf/normes_postales.pdf.

regulations that require letter boxes to be located at the property line.²⁷⁶ Again, we note that this change is outside of Royal Mail's control.

Both elements, standardisation of letter boxes and apertures, as well as the location of letter boxes on ground floors or at the property line, would help to reduce Royal Mail's delivery costs. However, this is not within Royal Mail's control.

276 See Executive Order on the Provision of Postal Services and Postal Service Providers, Executive Order No. 727 of 24 June 2011 (<http://www.postdanmark.dk/da/Documents/Om%20os/Engelsk/executive-order.pdf>).

5 Final assessment

In this chapter we compile the findings developed in Section 4 to draw an overall picture of the reasonability of Royal Mail's cost projections and its planned efficiency and cost saving projects.

Figure 5-1 WIK approach for assessing Royal Mail's projected costs



We have discussed Royal Mail's efficiency initiatives, cost projections and underlying assumptions of its 2015 Business Plan and have assessed whether they are more or less ambitious than Royal Mail's past performance in cost savings and relative to the performance of other postal operators from a technical and a financial perspective. To complete and summarise our assessment, we address the following guiding questions:

- Are the underlying assumptions consistently applied throughout the Business Plan?
- Are the planned initiatives more or less ambitious than Royal Mail's past initiatives and in light of international practice?
- Are the projected cost savings of the planned initiatives in Royal Mail's 2015 Business Plan accurately estimated and appropriately ambitious?
- Are Royal Mail's 2015 Business Plan targets more or less ambitious than its past business plan targets?
- Are Royal Mail's 2015 Business Plan targets more or less ambitious in light of its past achievements?
- Are Royal Mail's 2015 Business Plan targets more or less ambitious in light of other postal operators' past performance?

Overall, Royal Mail's transformation programme and the related cost saving and efficiency initiatives in its 2015 Business Plan are broadly in line with similar programmes implemented by its international peers in the past. They all include common features such as mail centre rationalisation, automation, optimised logistics and delivery. Royal Mail's transformation programme started in 2008 and one core element, the mail centre rationalisation, will be finalised within the next three years.²⁷⁷ The duration of the implementation period is consistent with international practice. The transformation of the delivery organisation, another core element of the transformation programme, started later (around 2010) and is still ongoing.

Are the underlying assumptions consistently applied throughout the Business Plan?

Royal Mail's 2015 Business Plan is based on a combination of assumptions which are consistently applied throughout the plan.

Are the planned initiatives more or less ambitious than Royal Mail's past initiatives and international practice?

Our analysis concludes that Royal Mail has been successful in reducing costs in some areas, including the quickly achieved savings of the management reorganisation programme and savings in non-staff costs.

However, Royal Mail's plans to improve efficiency in delivery operations, which account for [%] of operating cost, are less ambitious than international practice:

- Targeted cost savings in delivery are relatively low given that delivery costs account for [%].
- The company relies on traditional ways of organising delivery and does not (yet) appear to be pursuing more innovative delivery models. For example, walk sequencing is centralised less than at international peers, there is less separation of indoor and outdoor activities related to delivery, and the current state of mail flow control does not allow for the introduction of heavy and light delivery days (i.e. peak and off-peak working days). By introducing heavy delivery days, international peers have achieved lower average costs for second class (or other low priority) letters.

We consider Royal Mail's parcel automation programme is less ambitious than its peers [%].

The delivery reorganisation programme reflects the challenging relationship between Royal Mail and the unions. Royal Mail faces significant restrictions for specific actions

²⁷⁷ Based on Royal Mail's current plans.

resulting from the legal contract Royal Mail agreed with CWU in early 2014 based on the “Agenda for Growth, Stability & Long Term Success”.²⁷⁸ These restrictions limit Royal Mail’s ability to realise more cost savings:

- From January 2014 until March 2019, Royal Mail has committed to maintain a one-tier wage schedule (i.e. new employees have to be contracted under similar conditions as existing employees) whereas Deutsche Post, PostNL and USPS implemented two-tier wage schedules²⁷⁹ (allowing them to agree different conditions with new hires).²⁸⁰
- By precluding outsourcing of business functions and franchising of core operational functions, Royal Mail has further reduced its leeway for cost savings, most importantly in transport and parcel delivery.
- Royal Mail has agreed to a waiver of compulsory redundancies among other things, in return for agreements in areas of operational reform.
- In light of the international benchmark, the outcome of the last negotiations could be rated as an unsatisfactory result as most of the international peers managed to achieve a two-tier wage policy and more flexibility in working time, while the scope of flexibility at Royal Mail is still subject to further negotiation.
- Maintaining the existing full-time/part-time ratio and retaining permanent contracts leaves Royal Mail with few alternative ways of offsetting other restrictions in order to increase workforce flexibility.

Combined, these restrictions significantly limit Royal Mail’s ability to increase flexibility in its postal operations and its potential for additional cost savings in a market environment that is becoming more and more challenging. In contrast, we conclude that international peers in Denmark, Sweden, the Netherlands and Germany appear to have been more successful at managing the relationships with their employees and unions and, at the same time, agreeing higher levels of efficiency and cost flexibility, allowing them to meet market challenges more effectively.

The projected savings in staff costs are based on the assumption [§]. Any future pay awards are still subject to agreement between the unions (CWU and Unite) and Royal Mail, and, therefore, they are arguably within Royal Mail’s control (shared with its employees). [§]. [§] The increased pressure from private shareholders to improve

²⁷⁸ See Legal Contract between Royal Mail and CWU, January 2014

(http://www.cwu.org/assets/cwu/legacy-assets/documents/jan_14/cwu_1389094257_04273_Agenda_For_Growth_Stabil.pdf).

²⁷⁹ Deutsche Post introduced two-tier schedules in 2000, PostNL in 2003 and USPS in 2011.

²⁸⁰ While pay terms and conditions are the same between old and new employees the pension scheme has been closed to new members since 2008 (so that Royal Mail is effectively operating on two tiers for pensions).

profitability, the competitive environment in the UK parcel market, and ongoing letter volume decline will strengthen the bargaining position of Royal Mail compared to the pre-IPO situation. Moreover, Royal Mail's employees have the opportunity to participate in this improvement via their shares (12% of Royal Mail's shares are owned by its employees).

While we consider that the current agreements with the unions puts Royal Mail in a more difficult position compared to its international peers, we conclude that Royal Mail's plans are still less ambitious than they could be, even under the agreements which (we considered to be fixed for the Business Plan period). For example, we believe that Royal Mail could be more ambitious in implementing more flexible work arrangements. Managing labour relations responsibly to achieve more flexibility for staff costs is pivotal to achieving further cost savings.

Overall, we conclude that Royal Mail's planned initiatives are technically feasible but, overall, less ambitious than its peers.

Are the projected cost savings of the planned initiatives in Royal Mail's 2015 Business Plan accurately estimated and more or less ambitious than its international peers and its past initiatives?

Our review of Royal Mail's financial evaluation of planned initiatives concludes that, overall, the value that Royal Mail considers it is capable of saving by its initiatives appears appropriate given the conditions Royal Mail faced when developing its 2015 Business Plan (in early 2015). While the financial evaluation of planned initiatives appears appropriate, we conclude that the choice of initiatives itself could be more ambitious as outlined earlier.

Are Royal Mail's 2015 Business Plan targets more or less ambitious than its past business plan targets?

[redacted]. [redacted] given that Royal Mail has achieved productivity growth between 1.7% and 2.5% per annum since FYE 2013.²⁸¹ This [redacted] comes at a surprising time as Royal Mail has been privatised, and one would expect Royal Mail to enjoy more commercial flexibility now, as well as facing stronger incentives to become more efficient.

Are Royal Mail's 2015 Business Plan targets more or less ambitious than its past achievements?

In FYE [redacted] 2014, Royal Mail did not fully achieve its productivity targets. The achieved productivity gains were [redacted] below 2% in FYE 2014 and increased to 2.5% in FYE 2015.

²⁸¹ See Royal Mail's response to Ofcom's Review of Royal Mail Regulation, dated 18 September 2015, http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf, paragraph 4.42.

For the first half of FYE 2016, Royal Mail reported an increase in productivity gains to 2.9%.²⁸² Based on these positive developments, its productivity targets in the 2015 Business Plan appear [X].

[X]. These cost savings were [X] than those planned by Royal Mail for the Business Plan period.

[X].

Are Royal Mail's 2015 Business Plan targets more or less ambitious than other postal operators' past performance?

[X]. Our comparison of the performance in cost savings between Royal Mail and its international peers (for the period 2008-2014) indicates that Royal Mail's targeted cost savings in the Reported Business' operating expenditures are lower than savings achieved by those international peers that face a similar decline in mail volume. In particular, Royal Mail is targeting less ambitious savings with regard to staff costs compared to other postal operators.

In our view, the major reason for different performances in cost saving efforts between Royal Mail and its international peers is that, at Royal Mail, efficiency driven savings are offset (to a large extent) by higher pay awards. In this context, more cooperative industrial relations are crucial for a successful transformation process.

Table 5-1 summarises the results of our assessment.

Table 5-1 Results of WIK's assessment

	Less ambitious	Appropriately ambitious	More ambitious
Overall assessment	X		
Technical evaluation of planned initiatives compared to peers and past initiatives	X		
Financial evaluation of planned initiatives		X	
Business plan targets relative to past targets	X		
Business plan targets relative to past achievements	X		
Business plan targets relative to other postal operators	X		
Business plan underlying assumptions	Internally consistent		

²⁸² See Royal Mail plc, Results for the Half Year Ended 27 September 2015, 19 November 2015, p.9 (<http://www.royalmailgroup.com/sites/default/files/Royal%20Mail%20plc%20Financial%20Report%20of%20the%20half%20year%20ended%2027%20September%202015.pdf>).

Based on international practice, we finally identify a number of potential measures Royal Mail could consider for further promoting its operational efficiency.

In the short run, the company could:

- Further increase the proportion of walk sequenced letters by promoting the centralisation of sequence sorters;
- Further promote parcel automation in mail centres and introduce more appropriate equipment to facilitate parcel sorting in delivery offices;
- Increase automation of unaddressed items;
- Continue reducing the time spent on indoor activities and allocate resources accordingly;
- Reconsider bundling addressed and unaddressed items;
- Introduce more measures to ensure resources are better matched to workload, e.g. using flex-time schedules.

In the long run (i.e. after FYE 2019), Royal Mail could additionally consider:

- Franchising road transport;
- Centralising mail preparation in delivery;
- Assigning indoor and outdoor delivery activities to different employees.

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Tax No. 222/5751/0926

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