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# Annual Monitoring Update on Postal Services

Financial Year 2019-2020

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[Annual Monitoring Update on Postal Services](#) – Welsh overview

**REPORT:**

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# 1. Overview

**This report sets out data and trends in the postal sector for the 2019-20 financial year. It also examines more recent developments in the sector due to the Covid-19 pandemic.**

Ofcom's regulatory framework is designed to fulfil our statutory duty of securing the provision of a universal postal service, having regard to financial sustainability and efficiency. An effective and ongoing monitoring regime is one of the key safeguards of the framework.

As well as the wider postal market, we look at Royal Mail's 'Reported Business', which is the part of Royal Mail responsible for the universal service. This requires Royal Mail to collect and deliver letters six days a week and parcels five days a week, at an affordable and uniform price to all UK addresses.

2019-20 was a challenging year for Royal Mail. Its financial performance was weaker than in previous years; and issues facing the business due to the changing market and consumer trends were apparent even before Covid-19 started to have an impact.

Royal Mail needs to modernise its network, to keep pace with parcel customers' changing requirements, as well as manage costs associated with higher parcels volumes. Unless it is able to become more efficient, and adapt to a changing market, there is a risk it will not be able to secure a commercial rate of return for the universal service business. This could put the sustainability of the universal postal service at risk in the longer term.

## What we have found

Our main findings on **Royal Mail's finances, efficiency and quality of service** during 2019-20 are:

- **Letter and parcel volumes were lower than expected.** Reported Business letter volumes declined by 7.6% (excluding elections), while revenues fell by 2.9%. Parcel volumes grew by 2.0% and revenues increased by 5.4%. Domestic parcels growth of 3.8% was driven by an 18% increase in demand for tracked parcels from online retailers. However, parcel volume growth was impacted by industrial relations in late 2019, according to Royal Mail, and international parcel volumes declined in early 2020, as the pandemic reduced imports from China.
- **Reported Business revenue grew, but profits fell.** Revenues across the universal service network grew in nominal terms for the first time since 2013-14, partly due to rises in letter prices and wholesale network access prices. However, the profitability of the Reported Business declined, and losses were only avoided because of the one-off benefit of increased mail from two UK elections in 2019. The EBIT margin, an indicator of the longer-term sustainability of the universal service, fell to 0.4% from 1.6% in 2018-19 and 4.4% in 2017-18.
- **Efficiency performance continues to be a concern.** Although Royal Mail says it met its overall cost avoidance target for the UK business in 2019-20, real costs for the Reported Business increased by 1.4%. Our analysis indicates no underlying efficiency improvements (excluding transformation costs); Royal Mail did not meet its 2%+ target of productivity improvement, achieving 1.0%. Further, frontline hour reductions were low and Royal Mail stated that these did not fully absorb the additional pay costs which flowed through from the October 2018 reduction in the contracted working week.
- **Royal Mail's quality of service improved in 2019-20**, after we fined the company £1.5m for failing to meet our First Class delivery targets in 2018-19. Having taken account of the impact of Covid-19 in the final weeks of the year, we consider that the company met its regulatory obligations.

The **broader market and consumer trends** in relation to post in 2019-20 were as follows:

- **The overall parcels market continued to grow.** Total volumes increased by 8.0% year-on-year, reaching a total of 2.8 billion items. Total revenues increased by 1.7% in real terms, reaching £10.4 bn.
- **Total letter volumes and revenues continued to decline.** Addressed inland letter volumes declined by 3.9% to just under 10 billion items. Letters collected by access providers reduced by less (3.5%) than Royal Mail end-to-end volumes (4.8%), while revenues fell by 1.9% in real terms to £4 bn.
- **Most consumers continue to be satisfied with postal services.** Over eight in ten residential customers are satisfied with Royal Mail (82%) and postal services overall (85%). Similarly, over eight in ten SMEs who use Royal Mail (85%) and other providers (82%) say they are satisfied.

## Covid-19 and the postal sector

Covid-19 began to impact upon international parcels volumes in the early months of 2020. However, the more significant implications for the postal sector and consumers became apparent in Q1 of

2020-21. The temporary closures of retail outlets led to a sharp rise in online shopping, driving increased demand for parcel delivery services. This has been sustained into the second half of 2020, and some parcel operators are expanding their delivery networks and creating new jobs in response.

The pandemic has also highlighted the importance of the postal sector in providing key services to consumers, such as government, NHS and bank communications, and the delivery and collection of Covid testing kits. However, lockdown restrictions on businesses, and the economic downturn caused a sharp reduction in letter volumes (particularly advertising mail) creating a challenging environment for bulk mail operators.

As a provider of both letters and parcels, Royal Mail has experienced significant but mixed impacts from Covid-19. While addressed letter volumes fell by 28% in the first six months of the financial year, Royal Mail's UK parcel volumes rose by 31%. Parcel revenues grew by a third and surpassed letter revenues for the first time.

Covid-19 has also increased Royal Mail's cost base. This includes direct costs associated with the pandemic such as protective equipment and overtime/agency staff to cover high absences. But it also reflects the extra costs associated with handling more parcels, partly because some of the processes are still manual. As a result, although Royal Mail's overall revenues grew by 4.9%, the Reported Business recorded a first half adjusted operating loss of £180m (though the majority of this loss reflects voluntary redundancy costs for its recent management restructure).

We continue to monitor the impact of Covid-19 on Royal Mail and the sector more generally.

## **Royal Mail transformation and universal service sustainability**

In May 2019, Royal Mail announced its five-year strategy to modernise its network and transition towards becoming a parcels-led business. Alongside network changes, the use of new technology was intended to enable productivity improvements. By February 2020, Royal Mail acknowledged delays to the delivery of its transformation plan, partly because of the industrial relations environment. Before Covid-19 hit, Royal Mail indicated that its UK business might be loss-making in 2020-21.

In June 2020, Royal Mail confirmed its commitment to its strategy to transform the network. But it stressed that Covid-19 had accelerated the need to modernise its business and to adapt to the changing product mix. It announced a management restructure and reductions in capital expenditure to support its financial position. It also entered into talks with the trade unions in July with the objective of agreeing operational changes. As of November 2020, these talks are ongoing and the timing for delivery of parts of the strategy remains unclear.

In our 2018-19 annual monitoring update, we identified some risks to Royal Mail's strategy and hence to the longer-term sustainability of the universal service. We have reviewed the financial health metrics of Royal Mail Group and do not consider there is an immediate threat to the short-term sustainability of the universal service. We note the Group's overall profitability has been supported by the strong performance of GLS, its international parcels business.

Some progress has been made on delivery of the transformation plan, such as the increased roll-out of automated parcel sorting machines. However, in other areas – such as the use of data tools to

optimise delivery resourcing as well as the development of new parcel hubs – Royal Mail is behind schedule. As a result, some of the productivity improvements and cost savings set out in its strategic plan will be delayed.

There is significant uncertainty ahead including, but not limited to, the continuing direct and broader economic impacts of Covid-19 on the postal sector. The recent steep reduction in letter volumes will further increase the financial pressures on Royal Mail. However, there is an opportunity for the lost value in letters to be offset by significant growth in parcels if the increased demand for delivery of goods bought online is sustained.

Unless Royal Mail is able to become more efficient, and to adapt to a changing market, there is a risk it will not be able to secure a commercial rate of return for the universal service business. We will continue to monitor the sustainability of the universal service and engage with Royal Mail on its progress in delivering its transformation plans.

## 2. Introduction

- 2.1 Ofcom has a duty under the Postal Services Act 2011 to carry out its postal functions in a way that it considers will secure the provision of a universal postal service, having regard to its financial sustainability and efficiency. The minimum universal service requirements are set by Parliament and require Royal Mail to provide certain postal services at affordable, uniform prices throughout the UK.
- 2.2 In our March 2017 statement on the Review of the Regulation of Royal Mail, where we confirmed we would broadly maintain the current regulatory framework until 2022, we said that our ongoing monitoring of the postal market remains a key safeguard of our regulatory framework, alongside the Second Class safeguard caps on certain universal service products and mandated access regulation.<sup>1</sup> As part of the monitoring regime, we committed to publishing an annual monitoring update which sets out key data and trends in the postal sector, focusing on the provision by Royal Mail of the universal service.
- 2.3 In order to ensure that the regulatory framework continues to work effectively we monitor a range of factors including competition and developments in the parcels and letters markets, consumers' and businesses' experiences in the postal sector, Royal Mail's performance on efficiency and the financial performance of the universal service network, and Royal Mail's prices and quality of service.
- 2.4 2020 has been an extraordinary year, with significant restrictions placed on UK citizens and businesses as a result of the Covid-19 pandemic. Much of the data which underpins this report relates to the period before these restrictions were introduced and therefore before the main impacts of Covid-19 on the UK had been experienced. Section 8 provides a high-level overview of how Covid-19 has impacted Royal Mail and the wider postal sector in recent months. There is currently uncertainty about how significant changes in market trends may develop and how they might affect the universal service or the wider postal market. We will continue to monitor these on an ongoing basis. However, we consider it is important to publish our data and considerations from 2019-20 for continuity as it will support our future work on the postal sector, alongside any associated industry and consumer engagement.

### Ofcom's Plan of Work for the postal sector

- 2.5 The wider post monitoring programme equips Ofcom with the relevant postal sector information needed to inform our activities as set out in our Plan of Work for 2020-21<sup>2</sup>, which includes:
- a) **Review of user needs:** We have undertaken a comprehensive review of the needs of postal users and assessed whether the current minimum requirements still reflect what people and businesses need from postal services. In line with our Plan of Work, we

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<sup>1</sup> Ofcom, 2017. [Review of the Regulation of Royal Mail](#).

<sup>2</sup> Ofcom, 2020. Ofcom's [Plan of Work 2020-2021](#).

commissioned research in 2019 and 2020, and we have published our main findings alongside this annual monitoring update.<sup>3</sup> It would be for the UK Government to determine whether any changes are needed to the minimum requirements and to bring any proposals before Parliament.

- b) **Review of the future regulatory framework for post:** We are also undertaking a review of the future regulatory framework for post, which we expect to conclude in 2022. This will consider issues affecting the broader postal sector as people's reliance on parcels continues to grow. During 2019-20, we commenced a number of projects which form the building blocks for the 2022 review. These included the review of user needs referred to above, an assessment of the parcels market, bottom-up cost modelling and a review of Royal Mail's efficiency. During 2020-21 we are continuing to bring this work together under this umbrella review and intend to publish a call for inputs on the future regulatory framework for post in Q4 2020/21.

- 2.6 Royal Mail (along with other postal operators) provides a range of confidential data to us. Although the confidential nature of this data means that we do not publish it, the data informs our ongoing monitoring programme, and is used to identify any potential or emerging problems in relation to the provision of the universal service and wider competition in the postal markets.

## Royal Mail remains the focus of our monitoring regime

- 2.7 The focus of our monitoring is Royal Mail, although we undertake our monitoring within the context of the broader postal services market. This is because Royal Mail is the designated universal postal service provider, operating a network capable of delivering letters and parcels to around 30 million business and household addresses nationwide.
- 2.8 Not all of Royal Mail's business is subject to Ofcom regulation. The parts on which we focus are known as the 'Reported Business', which sits within a group of business units which Royal Mail has referred to as 'UK Parcels, International and Letters' (UKPIL).
- 2.9 The Reported Business includes all universal services, as well as other services which are delivered over the universal service network, namely retail bulk mail and access products and bulk parcels.<sup>4</sup>

## Presentation of data in this annual monitoring update

- 2.10 Financial data presented in the annual monitoring update on the postal market is in real terms, unless otherwise stated, except for the revenue, price and cost data presented in Sections 5 and 6. This is consistent with how it is presented in Royal Mail's Regulatory Financial Statements.

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<sup>3</sup> Ofcom, 2020. *Review of postal services users' needs*.

[https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/208220/2020-review-of-postal-user-needs-report.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/208220/2020-review-of-postal-user-needs-report.pdf).

<sup>4</sup> Royal Mail, Universal Service Obligation, <https://www.royalmailgroup.com/en/about-us/regulation/how-were-regulated/universal-service-obligation>.

- 2.11 Where we report real terms changes, we have elected to use the Consumer Price Index (CPI) as the basis for our calculations, as has been our custom since the 2014-15 annual monitoring update on the postal market. This year we have used a yearly average CPI index (from April 2019 - March 2020).
- 2.12 Royal Mail reports its financial statements using whole weeks. This means that for the 2018-19 financial year Royal Mail reported a 53-week year. In Sections 5 and 6, where possible, 2018-19 results have therefore been adjusted to 52 weeks to enable a like-for-like year-on-year comparison. Where we discuss changes, we are referring to the comparisons to the prior financial year i.e. 2019-20 to 2018-19 on a 52-week basis (unless otherwise stated).
- 2.13 The metrics in this update are, unless otherwise stated<sup>5</sup>, consistent with those in our previous three annual monitoring updates on the postal market, published in November 2017, November 2018 and December 2019 respectively (enabling year-on-year comparisons). While the majority of the analysis in this report focuses on 2019-20, pricing information focuses on the most recent pricing data available (i.e. 2020), which is in line with previous monitoring updates. We also set out in Section 8 some of the financial impacts of Covid-19 in 2020-21 reported by Royal Mail. This annual monitoring update comprises both this report and accompanying Post Monitoring Interactive Data available on the Ofcom website.<sup>6</sup> Data presented in the annual monitoring update is available in csv files on the Ofcom website.
- 2.14 As part of this year's Post Monitoring Interactive Data, we provide pricing information across multiple years. We have included consumer research data taken from our residential and business tracker surveys across financial years 2012-2013 to 2019-2020. While this information is available across previous annual monitoring updates, we are providing access to consumer insights in an interactive format for the first time. We introduce this material in Section 4 of this report.

## The structure of this report

- 2.15 This report focuses on the 2019-20 financial year. However, we also include a discussion of more recent developments in the postal sector relating to the Covid-19 pandemic. The structure is as follows:
- Section 3 – Market developments;
  - Section 4 – Consumer and SME research;
  - Section 5 – Financial performance;
  - Section 6 – Efficiency performance;
  - Section 7 – Regulatory compliance;
  - Section 8 – Covid-19 and the postal sector.

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<sup>5</sup> For instance, our change to use a yearly average instead of March CPI index.

<sup>6</sup> Annual monitoring reports and interactive data available here: [https://www.ofcom.org.uk/postal-services/information-forthe-postal-industry/monitoring\\_reports](https://www.ofcom.org.uk/postal-services/information-forthe-postal-industry/monitoring_reports).

## 3. Market developments

- 3.1 This section covers developments in the postal services market and presents 2019-20 market-wide volumes and revenues data. We first outline trends in the parcels market and then consider the letters market. Further information about these markets can be found in the Post Monitoring Interactive Data, such as volumes and revenues data across multiple financial years at pages 4 and 5 of the interactive data.
- 3.2 We also collected additional information from, and had a series of meetings with, parcel operators during 2019-20 to deepen our understanding of the parcels market. In this section we summarise some of our main findings from this work. This includes a summary of information we collected on the extent to which there are geographic variations in the delivery services provided by parcel operators to online retailers.
- 3.3 While we note the impact of Covid-19 on international parcel volumes in 2019-20 in this section, we separately provide an overview of the impacts of Covid-19 on the postal sector in the first half of 2020-21 in Section 8.

### Parcels market in the UK

- 3.4 The parcels market can be split into three segments<sup>7</sup>:
- a) **Consumer to business/consumer (C2X)** – these are largely single-piece items from consumer to consumer, or consumer to business. For example, a person sending a birthday present to a relative or an online marketplace seller sending the item to the buyer.
  - b) **Business to consumer (B2C)** – these are deliveries from business to consumer, for example an online retailer sending items bought by online customers. These are generally deliveries that are part of bulk contracts between a business and a parcel operator.
  - c) **Business to business (B2B)** – these are generally bulk deliveries from a business to other businesses, for example a car dealer with multiple sites receiving parts from a manufacturer.
- 3.5 In contrast to the letters market, there is end-to-end competition in the UK parcels market, with multiple parcel operators competing for customers.<sup>8</sup> In addition, some operators with

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<sup>7</sup> For the purposes of the data presented in this section, we have defined a parcel as an addressed postal item that is delivered end-to-end and: (a) is not a letter or a large letter (as defined in footnote 38); (b) weighs no more than 31.5kg; and (c) can be lifted by a single average individual without mechanical aids. Parcel services form part of a broad set of delivery services used by residential and business consumers in the UK, such as two-person and pallets delivery (for large and heavy items) and more generally the logistics services that are used for business supply chains. In contrast to parcel services, these other services do not involve postal items.

<sup>8</sup> These include operators with UK-wide networks including The Alternative Parcels Company, Amazon Logistics, DHL International and DHL Parcel UK, DPD Group, DX, FedEx, TNT, Hermes, Royal Mail Group (including Parcelforce Worldwide), Tuffnells, UPS and Yodel. As in previous years, the data collected from these operators forms the basis of our published market figures.

a relatively limited geographic network, or without a last mile network of their own, also offer services via access agreements (in which they collect, sort and inject parcels into the network of another operator, normally but not exclusively, Royal Mail). Other operators specialise in last mile delivery in particular geographies, for example in urban centres or remote areas, on behalf of other operators.

- 3.6 The parcels market is fast-growing (volumes up 8% between 2018-19 and 2019-20). The main focus of competition is in the growing B2C segment. In recent years, the market has shifted away from B2B to B2C, linked closely to the growth in online shopping. Even before Covid-19 further increased demand, the ONS reported that internet sales made up 19.2% of total UK retail sales in 2019, up from 18.0% in 2018 and 16.3% in 2017.<sup>9</sup>

## C2X services

- 3.7 Compared to B2C, the C2X market segment is relatively small and growth is limited. However, it is also boosted by e-commerce through returns of unwanted goods bought online, and by sales of items sold via online marketplaces.
- 3.8 C2X remains a significant part of Royal Mail's parcel business, and Royal Mail is by far the largest provider of C2X services. Hermes and Yodel are the second and third largest providers of C2X services. Alongside this report, we have published new research into postal user needs and we provide more context on the C2X part of the parcels market in our research findings document.<sup>10</sup>
- 3.9 The focus of our regulation of the parcels market is on Royal Mail's universal service obligation (USO) to provide certain C2X or 'single piece' parcel services. Under the USO regulatory obligations, Royal Mail is required to:
- a) deliver USO parcels (weighing up to 20kg) five days a week to all households across the UK;
  - b) price USO services at affordable prices and at the same level regardless of where they are sent from or received; and
  - c) adhere to the safeguard cap which applies to second class parcels up to 2kg.
- 3.10 There have been some recent developments affecting the C2X part of the market. Following PayPoint's acquisition of Yodel's 50% stake in Collect+ (see paragraph 3.22 below), the in-store parcel network that allowed customers to pick up and drop off parcels for Yodel has begun to process parcels (including C2X services) for other parcel operators including Amazon, DHL, FedEx and DPD.<sup>11</sup>

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<sup>9</sup> Office for National Statistics, 23 October 2020. [Internet sales as a percentage of total retail sales \(ratio\) \(%\)](#).

<sup>10</sup> Ofcom, 2020. *Review of postal services users' needs*.

[https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/208220/2020-review-of-postal-user-needs-report.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/208220/2020-review-of-postal-user-needs-report.pdf)

<sup>11</sup> Collect+, 1 October 2020. [Changes to Collect+](#).

- 3.11 We continue to observe the use of parcel management services<sup>12</sup> (such as online resellers and price comparison services), which offer consumers access to multiple parcel operators and a range of service options. These services can involve print-at-home labelling (in order to access in-store parcel networks), parcel locker networks and home collections.
- 3.12 InPost continues to expand its network of secure parcel lockers, which are used by consumers to pick up and return parcels. In May 2020, InPost partnered with Lidl to establish parcel lockers at 24 stores in Birmingham, London and Manchester<sup>13</sup>, and at 14 South Western Railway Stations.<sup>14</sup>
- 3.13 As technology has developed in the parcel delivery sector, consumers are sometimes able to select home collection services options, as an alternative to using in-store parcel networks or other access points. DPD, Hermes and Yodel offer collection services as part of their courier operations. In October 2020 Royal Mail launched a new ‘Parcel Collect’ service, offering parcel collection directly from people’s homes. The service is set to operate six days a week (Sundays excluded) at a charge of 72p per parcel collection, plus usual delivery costs.<sup>15,16</sup>

## B2C services

- 3.14 The B2C market segment is growing and there are more operators competing actively in this part of the parcels market than in the C2X segment.
- 3.15 B2C customers are typically large retailers with an online presence, for example fashion retailers, like Boohoo or Asos, or Amazon’s retail businesses. Parcel operators often collect bulk parcels directly from retailers’ fulfilment centres or warehouses, although some retailers choose to deliver parcels directly into the parcel operators’ networks.
- 3.16 Parcel operators are increasingly adapting their business model to focus more on B2C and there are various business models in operation. Online retailers require flexibility and speed from parcel operators, and operators have reacted by investing in automated parcel hubs, boosting their sortation capacity and offering later acceptance times for next day delivery. In addition, all the main parcel operators offer Saturday delivery, with some also offering Sunday delivery.
- 3.17 In May 2019, Royal Mail set out its five-year transformation strategy.<sup>17</sup> The stated focus of the strategy is to move from being a UK-focused letters business that also delivers parcels, to an international parcels business that delivers letters in the UK, driven by developments in the B2C market. The strategy includes the deployment of additional small parcel machines in mail centres, plans to open new parcel hubs where parcels will be sorted by

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<sup>12</sup> These include online reseller services provided by eBay, Whistl’s ParcelsHub, Parcel2Go and Parcel Monkey. Such providers promote multiple delivery operators and their services, including flexible drop off locations or home collections.

<sup>13</sup> InPost, 15 May 2020. [InPost Partners with Lidl.](#)

<sup>14</sup> InPost, 27 May 2020. [InPost Partners with South Western Railways.](#)

<sup>15</sup> Royal Mail, 21 October 2020. [RM to collect as well as deliver the mail on the doorstep.](#)

<sup>16</sup> Royal Mail will collect pre-packaged parcels from the customer’s door or nominated safe place for 72p per parcel, in addition to postage costs. For pre-paid return items, the cost is 60p.

<sup>17</sup> Royal Mail, 22 May 2019, [Capital Markets Day presentation – Journey 2024, Full Year Results 2018-2019.](#)

automation and will be fully tracked, as well as introducing a second van delivery for parcels (see Section 6 for discussion of progress on delivery of this strategy).

- 3.18 Most parcel operators in the UK use vans to deliver parcels directly to customer premises, but the approach varies across different operators. Although most operators employ subcontractors to deliver at least some of their parcels, the way they do this varies. For example, while some operators such as DPD, FedEx and DHL generally use their branding on vehicles used for their deliveries, Amazon Logistics' contractors use a mixture of Amazon branded vans, unbranded vans, and cars (for the Amazon Flex programme<sup>18</sup>). Hermes mainly uses self-employed drivers working from their own cars to make deliveries. In contrast, Royal Mail is the only operator to use shared vans and high-capacity trolleys to deliver parcels, reflecting its current method of largely using its letter network to deliver parcels.
- 3.19 Amazon is an increasingly important player in B2C market dynamics and continues to expand its parcel delivery capability. As a large online retailer, Amazon uses multiple carriers to deliver its own retail products, as well as the goods of third-party sellers on the Amazon Marketplace who use its Fulfilment by Amazon (FBA) service. The FBA service provides warehouse storage, customer services and product delivery. Amazon also has its own delivery network – Amazon Logistics. Amazon uses Amazon Logistics to carry parcels sold on the Amazon website, either by Amazon Retail or third-party FBA sellers. In addition, Amazon has recently launched Amazon Shipping in the UK, whereby Amazon has begun to collect parcels from some retailers' own premises for delivery.

## Mergers and acquisitions

- 3.20 There have been a number of mergers and acquisitions (M&A) related to businesses involved in the parcels sector in the past year.
- 3.21 In December 2019, private equity group Mayfair Equity Partners took a majority stake in Parcel2Go, a website which offers access to parcel delivery services, as part of a management buyout. Parcel2Go said Mayfair's additional capital and operational support will fund business growth.<sup>19</sup>
- 3.22 In April 2020, and as mentioned above, Yodel sold its 50% stake in Collect+ to PayPoint<sup>20</sup>, the instore payment service. Yodel and PayPoint had set up Collect+ as a joint venture in 2009. Collect+ operates a network of third-party parcel shop locations, mostly newsagents and convenience stores, where customers can drop off and pick up parcels. While Yodel will continue to operate as a parcel carrier for Collect+, the parcel shop network now allows consumers to send and receive parcels from a range of operators.

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<sup>18</sup> Amazon Flex is a scheme where Amazon recruits delivery partners who use their own vehicles to deliver items ordered through Amazon's website or Amazon Prime Now service.

<sup>19</sup> Mayfair Equity, 4 December 2019. [Mayfair Equity Partners backs buyout of Parcel2Go.](#)

<sup>20</sup> PayPoint, 6 April 2020. [PayPoint secures full ownership of collect+ parcel service.](#)

- 3.23 In April 2020, Connect Group agreed to sell the logistics and parcels business Tuffnells Parcels Express for £15m to Palm Bidco, a special purpose vehicle.<sup>21</sup>
- 3.24 In August 2020, the Otto Group announced its intention to sell a 75% stake in Hermes UK to Advent International, a global private equity firm. Hermes stated that the partnership would facilitate further investment in technology and infrastructure, but that Hermes UK would retain its own management team.<sup>22</sup>

## Environmental sustainability

- 3.25 Environmental sustainability continues to be an important issue for the parcels sector, although Covid-19 has affected some initiatives.
- 3.26 The Ultra-Low Emission Zone (ULEZ) was introduced in central London in April 2019, expanding on the Low Emissions Zone (LEZ) initially introduced in February 2008. Transport for London (TfL) was set to introduce a charge from 26 October 2020 on heavier vehicles travelling within the LEZ that did not meet new, stricter emission standards. Due to the pandemic, TfL has suspended the charge until March 2021 to give the industry and freight operators more time to become compliant. Following temporary suspensions of the LEZ and ULEZ congestion charges in March 2020 to help key workers safely travel to work and to allow essential deliveries to take place,<sup>23</sup> these charges were reinstated in May 2020.<sup>24</sup> TfL has also delayed the enlargement of the ULEZ until October 2021.
- 3.27 In October 2020, Bristol City Council launched a consultation on potential clear air zones in the city, under which light goods vehicles may be required to pay to enter the city centre.<sup>25</sup> In the same month, Leeds City Council said that following a review which found a shift towards the use of cleaner vehicles, it would no longer be proceeding with its planned Clean Air Zone.<sup>26</sup>
- 3.28 In June 2020, the UK Government's Department for Transport (DfT) issued a position statement on last mile logistics. The statement said that DfT's Scientific Advisory Council recommended that the DfT continue to consult the freight industry, public and research community to support its aim of facilitating e-commerce growth and delivery businesses, whilst minimising any negative impacts on the UK transport system and environment.<sup>27</sup>
- 3.29 Operators continue to invest in reducing the emissions produced by their fleets by replacing petrol or diesel vehicles with electric vehicles. For example, DPD has announced plans to trial the Volta Zero – the first purpose built full-electric 16-tonne delivery truck – in

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<sup>21</sup> Insider Media Limited, 15 April 2020. [Connect Group to sell Tuffnells in £15m deal.](#)

<sup>22</sup> Otto Group, 10 August 2020. [Otto Group and Advent International announce partnership for Hermes.](#)

<sup>23</sup> Transport for London, 9 April 2020. [Transport for London to temporarily postpone enforcement of new stricter rules for freight vehicles on the capital's roads.](#)

<sup>24</sup> Mayor of London, 15 May 2020.

<sup>25</sup> <https://www.cleanairforbristol.org>

<sup>26</sup> <https://news.leeds.gov.uk/news/leeds-clean-air-zone-has-achieved-its-aims-early-and-is-no-longer-required-joint-review-finds>

<sup>27</sup> Department for Transport, 19 June 2020. [Position statement on last mile logistics.](#)

the ULEZ in Q1 2021<sup>28</sup>, as well as increasing its electric van fleet to 600 vehicles in a deal with vehicle manufacturer MAN Truck & Bus UK for 100 electric vans.<sup>29</sup> Meanwhile, Royal Mail, which already has nearly 300 electric vans in its fleet, announced in July 2020 that it had partnered with the London Electric Vehicle Company to trial its new electric vans.<sup>30</sup>

## Geographic variations in B2C parcel delivery services

- 3.30 Stakeholders have sometimes highlighted geographical variations in pricing (often referred to as ‘surcharging’) for the delivery of retail goods bought online as a concern. To help inform the debate, we have periodically collected information on the delivery services provided by parcel operators to retail businesses.<sup>31</sup>
- 3.31 We last published findings on geographic variations in B2C parcel delivery in our 2016-17 annual monitoring update.<sup>32</sup> As outlined in our 2019-20 Annual Plan, we decided to gather updated information from parcel operators to refresh our analysis. We also considered whether there is evidence of competition concerns in relation to the use of ‘third-party’ parcel delivery services (where the main operator contracts with another operator for ‘last mile’ delivery) in the Scottish Highlands and Islands (where usage of third-party operators is most prevalent). The findings of this research, which was carried out in late 2019 (before the Covid-19 pandemic further boosted demand for B2C delivery services), are summarised below.

### Summary of findings

- 3.32 We gathered information from operators in the parcels market relating to key aspects of B2C parcel delivery including the application of differential pricing and/or delivery restrictions, costs of delivery, and the choice of last mile third-party networks.
- 3.33 We found that operators take different approaches to the pricing of parcel delivery based on geographic location. Two large B2C operators – Royal Mail and Hermes – set uniform prices for delivering parcels across the UK, such that they do not set different standard prices based on location. However, the geographic profile of deliveries can still play some role in determining the level of the uniform price that these (and other) operators negotiate with retailers, for example if volumes are skewed towards a particular part of the UK.
- 3.34 The other operators from which we gathered information do differentiate their delivery charging on the basis of geographic location to some extent, though the extent to which they do this varies. For example, one operator applies a standard additional charge for

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<sup>28</sup> DPD, 2020. [Volta Trucks and DPD bring full-electric large commercial vehicle parcel deliveries to London’s Ultra Low Emission Zone.](#)

<sup>29</sup> DPD, 2020. [DPD boosts electric fleet to 600 with UK’s first MAN Truck & Bus 3.5t right-hand drive electric vans.](#)

<sup>30</sup> BBC, 7 July 2020. [Royal Mail trials refitted black cab electric vans.](#)

<sup>31</sup> The USO regulations require Royal Mail to provide single piece parcel services at a universal price, which is used by some small businesses. However, most online retailers usually agree bulk contracts with parcel operators (including Royal Mail) for the delivery of parcels, which is outside of the scope of the USO. For discussion about geographical variations in the C2X parcels services offered by C2X parcel operators please see the Section 3 of our *Review of postal users’ needs* document.

<sup>32</sup> See Ofcom, November 2017. [Annual monitoring update on the postal market: financial year 2016-17](#), paragraph 6.43-58.

delivering to a number of locations deemed as remote. Other operators vary the additional geographical charge across a range of locations, meaning the delivery price may be different, for example, in Northern Ireland than it is for a Scottish Island.

- 3.35 The geographic scope of additional charges applied by operators also varies, from small areas covering only parts of a postcode area, to larger geographic zones. We noted that the operators that are less active in the B2C segment of the parcels market are more likely to charge higher prices for delivery to some locations.
- 3.36 We also found that the actual prices charged for B2C parcel delivery are often bespoke. While operators may start with a standard rate card, they will often negotiate these charges on a bespoke basis with individual retailers.
- 3.37 The information gathered shows that the Scottish Highlands and Islands, as well as Northern Ireland, are the areas most likely to be subject to higher prices for B2C delivery from some operators.<sup>33</sup> Other areas – such as the Isle of Wight, south-west England and western Wales – are also subject to some additional location charges. We found, however, that even for the locations most likely to be subject to higher delivery prices, online retailers usually still have a choice of at least two operators (and usually a number of others) which do not vary their delivery prices in this way.
- 3.38 We also collected information on the extent to which operators restrict the delivery services they offer to some geographic locations. We found that delivery restrictions are also more likely to occur in rural parts of Scotland and Northern Ireland. Such restrictions can vary between a single additional day to four additional days for delivery. They are often attributed to difficulties in reaching the premises (for example, operators needing to use a ferry to reach a resident living on an island). However, even in these locations, we found that there are at least four operators that do not apply restrictions and offer a normal delivery service.
- 3.39 We also collected some data on the costs of parcel delivery incurred by operators. This suggests that delivery costs can vary significantly by geography. Operators provided several reasons why they may incur additional costs in delivering parcels to ‘hard to reach’ locations:
- a) Lower volumes and drop density, which can result in higher unit costs due to high fixed costs;
  - b) Longer transport legs, as parcels need to be moved over longer distances to reach remote areas;
  - c) Use of more expensive transport methods, for example ferry or air transport, to move parcels to remote areas; and

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<sup>33</sup> The ten operators included in this part of our analysis are DHL, DPD, DX, FedEx, Hermes, Parcelforce, Royal Mail, Tuffnells, UPS and Yodel. As noted above, Royal Mail and Hermes set uniform prices for delivering parcels across the UK. While we collected information regarding the delivery operations of Amazon Logistics, we have not included them in this part of the analysis because of the distinct nature of their B2C business model (see paragraph 3.19).

d) Use of third-party delivery networks, creating higher costs due to sub-contracting the last mile delivery and depot management to third parties (although we understand this is also an approach used by some operators to partially mitigate the higher costs of delivery to areas with lower volumes and drop density).

3.40 We also looked at the choice of third parties available for 'last mile' delivery. Overall, we found that operators generally have a choice of at least two third parties that they can use to deliver, including in the Scottish Highlands & Islands. This is in addition to Royal Mail which has an end-to-end postal network across the whole of the UK.

### **The role of retailers and Ofcom's role**

3.41 It is retail businesses (i.e. the party contracting with consumers for the goods to be delivered) that ultimately set the charge for delivery to consumers. Some retailers set a uniform delivery charge for customers – for example, those who opt for parcel operators that charge a uniform price (or negotiate a contract that adopts such a pricing policy), or those who may incur differential geographical delivery charges from parcel operators but choose not to pass these on to their customers. Some retailers may even offer 'free delivery' everywhere in the UK. Nevertheless, some retailers do differentiate their delivery charges on the basis of the geographic location of the recipient, which may reflect (to some degree) the differential charging of parcel operators.

3.42 As part of our work in this area, we have not collected information from retailers about the delivery charges they pass on to consumers. Our regulatory functions focus on the providers of postal services, rather than the users of those services (such as retailers). Further, the extent to which we can intervene in relation to specific aspects of parcel delivery outside of the universal service framework is limited. Postal operators (other than Royal Mail, as the universal service provider) are not required to offer services to everywhere in the UK or to set uniform pricing for B2C parcel delivery. In addition, Ofcom does not have the power to regulate delivery charges set by retailers.

3.43 However, we are publishing our findings on the approach taken by parcel operators in order to assist policy-makers and other stakeholders in having more information about how this part of the online delivery market is operating. We will continue to provide advice, evidence and data to help inform the wider debate about geographical variations in parcel delivery services.<sup>34</sup>

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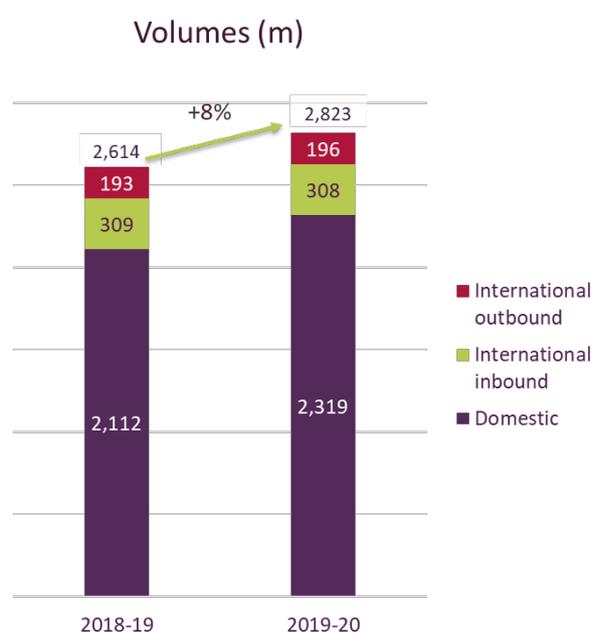
<sup>34</sup> For example, we will contribute to Consumer Protection Partnership and Consumer Network for Scotland discussions on this topic.

## Parcels market volumes and revenues

### Market volumes

- 3.44 Total parcel volumes<sup>35</sup> increased by 8.0% year-on-year in 2019-20, reaching 2.82 billion items.
- 3.45 Measured domestic parcel volumes increased by 9.8% to 2.32 billion items and made up 82.2% of total volumes in 2019-20 (compared to 80.8% in 2018-19). Next day (D+1) delivery items made up the majority of measured domestic parcel volumes during 2019-20, at 63.6%. The proportion of overall volumes for next day items increased by two percentage points.
- 3.46 International inbound parcel volumes reached 0.31 billion items in 2019-20, being flat year-on-year. International inbound made up 10.9% of total measured parcels volumes. International outbound parcel volumes increased by 1.1% year-on-year.

**Figure 3.1: Total measured parcel volumes**



Source: Operator returns / Ofcom estimates. Access volumes included in domestic.<sup>36</sup>

<sup>35</sup> Our estimate of market-wide parcel volumes is based on a definition that differs from Royal Mail's definition of parcels (which includes RM 24/48 large letters, some fulfilment letters and large letters), and is therefore not directly comparable to Royal Mail's parcel volumes reported in Section 5 on financial performance.

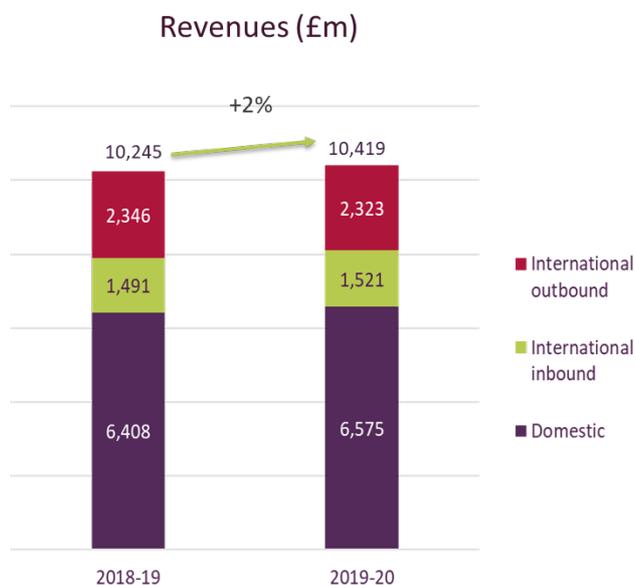
<sup>36</sup> 2018-19 data includes restatements for operator corrections. In 2019-20 several operators reported systems changes potentially changing the basis of 2019-20 data; in these cases 2018-19 data has not been restated. Data from Royal Mail Group included in the total market figure was provided on a 53-week basis for 2018-19 and 52-week basis for 2019-20. From 2019-20 Royal Mail has moved to a new methodology for the allocation of revenues and volumes for stamped letters and parcels. Royal Mail has stated that the impact of this change in methodology on its publicly reported 2018-19 revenues has been to move £154m of Royal Mail's published revenues from parcels to letters on a 52-week basis, equating to a decrease of 36 million parcels. The 2018-19 industry totals presented here have not been adjusted for the change in Royal

- 3.47 The early impact of Covid-19 is likely to explain why international inbound volumes were flat in 2019-20 (having increased by 15% year-on-year in 2018-19). Royal Mail has noted that its international parcels operation was impacted in Q4 2019-20, as the pandemic reduced the demand for imports from, and exports to, China and other countries which experienced the impacts of Covid-19 earlier than the UK. Other parcel operators, especially those with significant business in countries with early outbreaks, were also affected by the closure of businesses, and restrictions in cross border transport.

## Market revenues

- 3.48 Total revenues increased by 1.7% in real terms, reaching £10.42bn. Taking all measured parcels into account, the average unit revenue per parcel decreased by 5.8% year-on-year, from £3.92 in 2018-19 to £3.69 in 2019-20.
- 3.49 Measured domestic parcel revenues reached £6.57bn, an increase of 2.6% in real terms. While domestic parcel volumes were 82.2% of total volumes in 2019-20, they only make up 63.1% of total revenues (a percentage point increase from 2018-19). The average unit revenue for a domestic parcel was £2.83, 6.6% lower than in 2018-19 at £3.03.
- 3.50 Next day (D+1) delivery items made up the majority of measured domestic parcel revenues during 2019-20 at 66.1%. Next day delivery items were a more substantial part of parcel operators' revenues than other parcel products, reflecting the higher prices which are typically charged for next day services. The proportion of revenue accounted for by next day items stayed the same between 2018-19 and 2019-20. The average unit revenue for parcels delivered later than next day increased marginally from £2.52 in 2018-19 to £2.53 in 2019-20.
- 3.51 Inbound parcel revenues grew faster than volumes. Revenues grew 2.0% year-on-year in real terms and the average unit revenue for inbound parcels increased 2.3% year-on-year from £4.83 to £4.94.
- 3.52 The rate of growth in outbound parcel revenues was lower than the growth in volumes, with revenues dropping by 1.0% in 2019-20 in real terms (reaching £2.32bn). Outbound parcels represented 22.3% of total parcel revenues in 2019-20, compared to 6.9% of total parcel volumes. Average unit revenues for outbound parcels in 2019-20 fell from £12.13 to £11.88, a 2.0% year-on-year decrease in real terms.

Figure 3.2: Total measured parcel revenues



Source: Operator returns / Ofcom estimates. Revenues for delivery of access parcels included in domestic.<sup>37</sup>

## Letters market in the UK

3.53 This sub-section summarises recent developments and trends in the letters market.

3.54 The letters (and large letters)<sup>38</sup> mail sector today consists of two main segments:

- a) **Royal Mail end-to-end mail** – letters collected and delivered by Royal Mail, which can be further divided into bulk and ‘non-bulk’ mail. Bulk mail involves Royal Mail collecting large volumes of mail directly from larger businesses (or other organisations) and adding it to its network for sortation, distribution and delivery. Non-bulk mail is mainly made up of single piece letter services that Royal Mail is required to offer under the USO; and
- b) **Access mail** – bulk mail collected by competing access operators from larger businesses and organisations, which is then inserted into Royal Mail’s network for delivery.

3.55 While a few years ago there was some end-to-end competition, Royal Mail is now the only significant nationwide end-to-end provider of letters services in the UK. End-to-end

<sup>37</sup> 2018-19 data includes restatements for operator corrections. In 2019-20 several operators reported systems changes potentially changing the basis of 2019-20 data; in these cases 2018-19 data has not been restated. Data from Royal Mail Group included in the total market figure was provided on a 53-week basis for 2018-19 and 52-week basis for 2019-20. From 2019-20 Royal Mail has moved to a new methodology for the allocation of revenues and volumes for stamped letters and parcels. Royal Mail has stated that the impact of this change in methodology on its publicly reported 2018-19 revenues has been to move £154m of Royal Mail’s published revenues from parcels to letters on a 52-week basis, equating to a decrease of 36 million parcels. The 2018-19 industry totals presented here have not been adjusted for the change in Royal Mail’s methodology from 2019-20 onwards. For further information on the change to Royal Mail’s external reporting please see: <https://www.royalmailgroup.com/media/10704/royal-mail-changes-in-external-reporting.pdf>. Figures are in real terms, adjusted for CPI by Ofcom at 2019-20 prices and are shown to the nearest million in the chart.

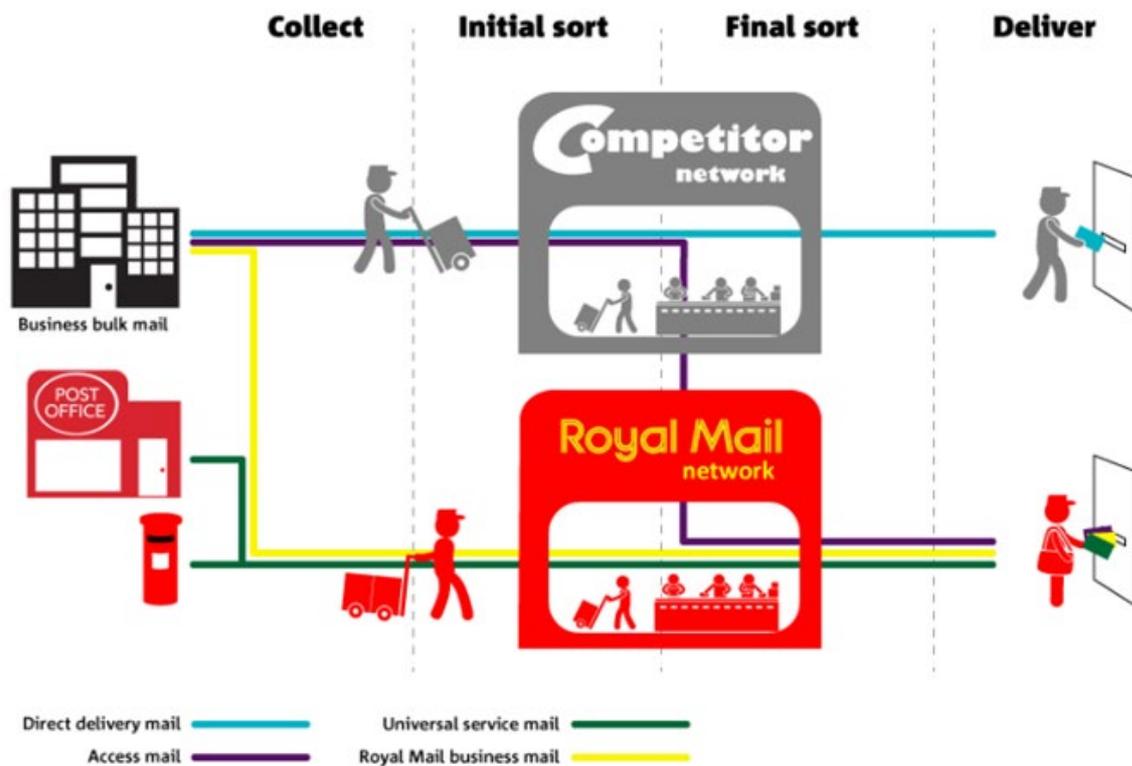
<sup>38</sup> Letters can be up to 24cm long, 16.5cm wide and up to and including 0.5cm thick, with a maximum weight of 100g. Large letters can be up to 35.3cm long, 25cm wide and up to and including 2.5cm thick, with a maximum weight of 750g.

competition would only occur if another provider operated a delivery network that did not rely on Royal Mail for collection, sortation or delivery of letters to end customers.

3.56 There is access-based competition in the market for bulk letters. This is where a postal operator other than Royal Mail collects mail from the customer, sorts it and then transports it to Royal Mail’s Inward Mail Centres, where it is handed over to Royal Mail for delivery (see Figure 3.3).

3.57 Royal Mail is subject to a regulatory condition requiring it to offer access at its Inward Mail Centres to other postal operators and customers for certain letters and large letters, which facilitates a routing time (at the retail level) of two working days or later. Access competition enables other operators to offer postal services to their customers (usually large businesses or public bodies) without setting up a delivery network.<sup>39</sup>

Figure 3.3: Forms of competition in UK postal market



Source: Ofcom

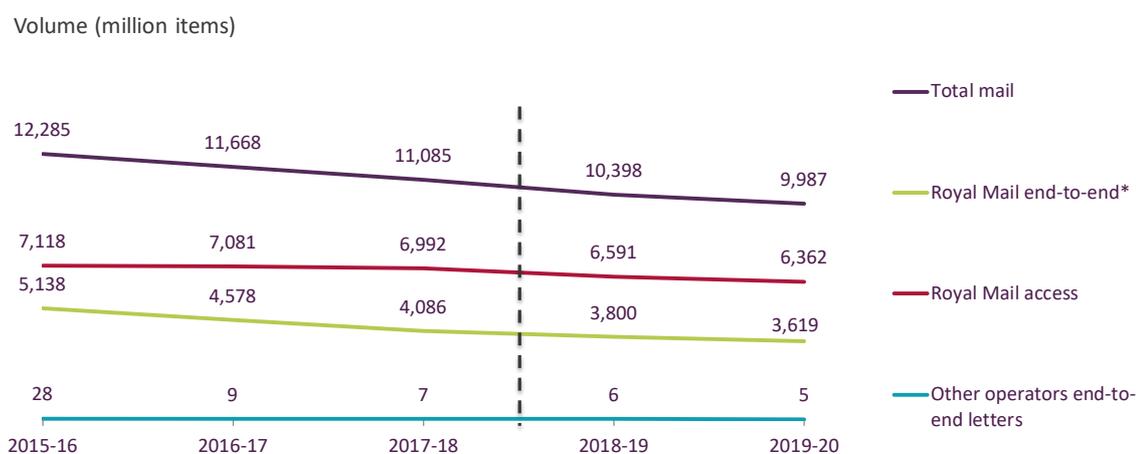
<sup>39</sup> Royal Mail also offer a similar access service for parcels on a commercial basis.

## Letters market volumes and revenues

### Market volumes

- 3.58 Addressed letter volumes<sup>40</sup> (letters and large letters, including election mail) declined by 3.9% to just below 10 billion items in 2019-20. This reflected continued structural decline in transactional mail (such as bills and statements) and advertising mail.
- 3.59 Bulk mail continues to make up the majority of letters sent, and declining demand from businesses is still driving total volume declines.
- 3.60 The volume of letters sent using the universal service is also declining. We estimate that in 2019-20, the volume of letters sent under the USO declined by 10.7%.<sup>41</sup>
- 3.61 Letters carried downstream by Royal Mail on behalf of access providers<sup>42</sup> in the year to March 2020 accounted for 64% of addressed letters (down from 65% in 2018-19). Overall, access volumes declined by 3.5%, while Royal Mail end-to-end addressed letters volumes fell by 4.8%.
- 3.62 Meanwhile, the number of letters delivered by end-to-end operators other than Royal Mail in 2019-20 further declined to only 5 million items (under 0.1% of total letters volumes).

**Figure 3.4: Addressed letter volumes (millions)**



Source: Ofcom. Operator returns, Ofcom estimates. NB: 2018-19 Royal Mail data restated to reflect updated methodology. Access volumes include access parcels. It is not possible to make direct comparisons between

<sup>40</sup> Addressed letter volumes and revenues in this section includes all end-to-end and access volumes (including election mail). This differs from the definition of addressed letters used in the analysis of the performance of Royal Mail's Reported Business in Section 5, which includes international mail but excludes election mail.

<sup>41</sup> We use single piece letter volumes as a proxy for USO volumes. Our estimates suggest that single piece letter volumes are virtually all USO letter volumes (approximately 99%).

<sup>42</sup> Where a postal operator other than Royal Mail collects mail from a customer and hands it over to Royal Mail to complete the delivery.

pre-and post-2018-19 on the data in the chart. The effect of the change in methodology has been to increase reported Royal Mail end-to-end letters volumes.<sup>43</sup>

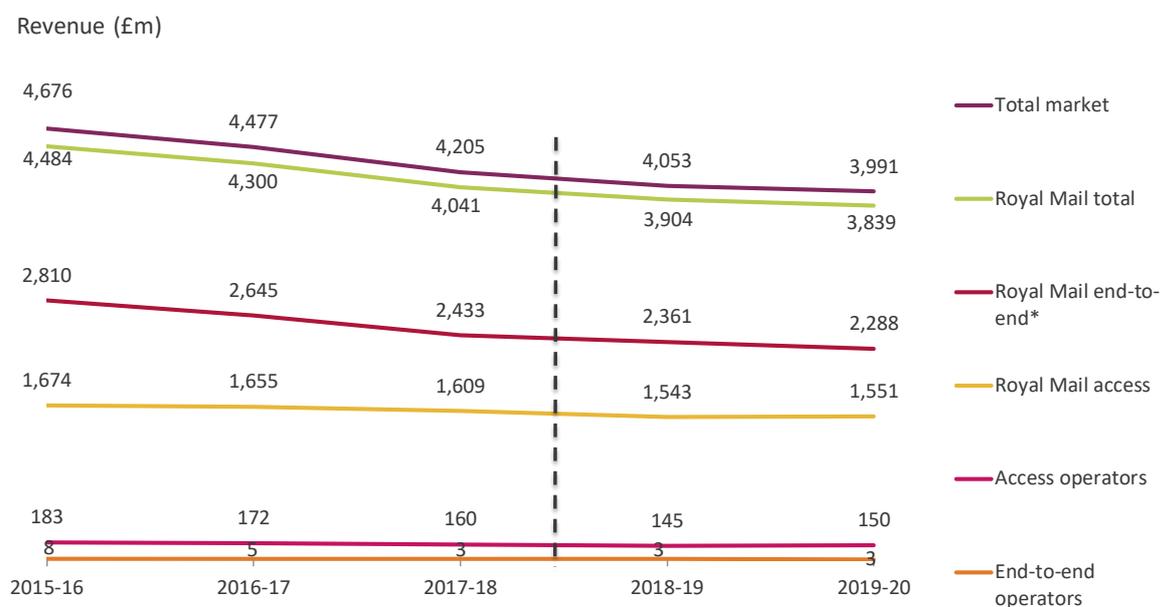
\*Royal Mail end-to-end is an Ofcom calculation and refers to Royal Mail total letters, excepting access. Figures exclude international. Access volumes include small volume of access parcels.

## Market revenues

3.63 Overall letters revenues fell by 1.5% in real terms to £4.0bn in 2019-20. This was driven by a 3.1% real terms decline in Royal Mail’s end-to-end letters revenues. Royal Mail access revenues were flat in real terms at £1.55bn.

3.64 We monitor the revenues retained by access operators for the delivery of mail, once payments to other operators (mainly Royal Mail) have been made. In 2019-20, reported revenues retained by access operators increased by 2.9% in real terms to £150m. This was driven by changes in product mixes and, in some cases, price rises.

**Figure 3.5: Letter revenues (£m)**



Source: Ofcom. Operator returns, Ofcom estimates. NB: 2018-19 Royal Mail data restated to reflect updated methodology. Access revenues include access parcels. It is not possible to make direct comparisons between pre-and post-2018-19 data in the chart. The effect of the change in methodology has been to increase reported Royal Mail end-to-end letters volumes.<sup>44</sup>

\*Royal Mail end-to-end is an Ofcom calculation and refers to Royal Mail total letters, excepting access. Figures exclude international.

<sup>43</sup> For further details please see: <https://www.royalmailgroup.com/media/10704/royal-mail-changes-in-external-reporting.pdf>.

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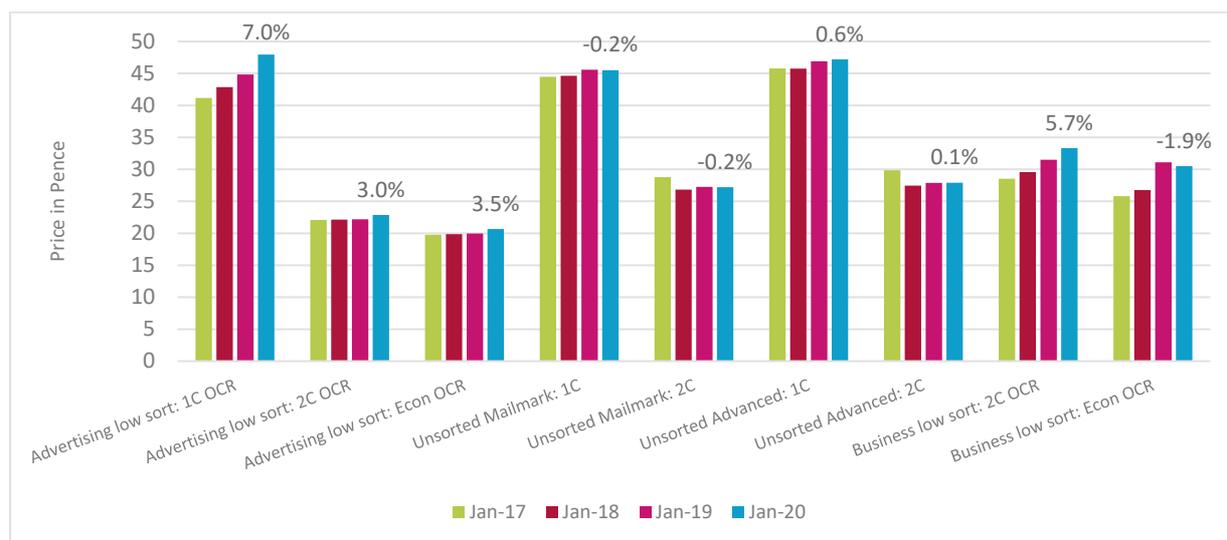
- 3.65 Overall spend on direct mail advertising continued to fall in 2019-20. The AA/WARC reported that expenditure (which includes production and elements of postage) fell by 14% in real terms to £1.3bn, compared to a 12% real-term decline in the prior year.<sup>45</sup>
- 3.66 In contrast to the parcels market, there has been comparatively little M&A activity in the letters sector. However, Opus Trust acquired Critiqom in December 2019.<sup>46</sup>

## Letters pricing

### Retail bulk mail prices

- 3.67 Royal Mail and other operators offer several products and services to business customers, who send larger volumes of mail, which are not within the universal service. This includes products offering discounts for sortation level, volumes sent and machine-readability (e.g. Mailmark barcodes). Figure 3.6 below sets out the prices that Royal Mail charges for retail business mail and advertising mail, adjusted for CPI.

**Figure 3.6: Royal Mail Retail Business Mail and Advertising Mail prices in real terms<sup>47</sup>**



Source: Royal Mail, Ofcom calculation based on maximum discounted prices and low sort barcode discount for standard letter sizes. Prices adjusted for CPI.

- 3.68 Page 12 of the Post Monitoring Interactive Data shows historic trends in business and advertising mail prices since 2010 and allows for a more tailored presentation of relevant data.<sup>48</sup>

<sup>45</sup> Source: AA/WARC Expenditure Report. Year-on-year growth rate adjusted for CPI at 2019-20 prices by Ofcom.

<sup>46</sup> Opus Trust, 19 December 2019. [Opus Trust acquires Critiqom](#).

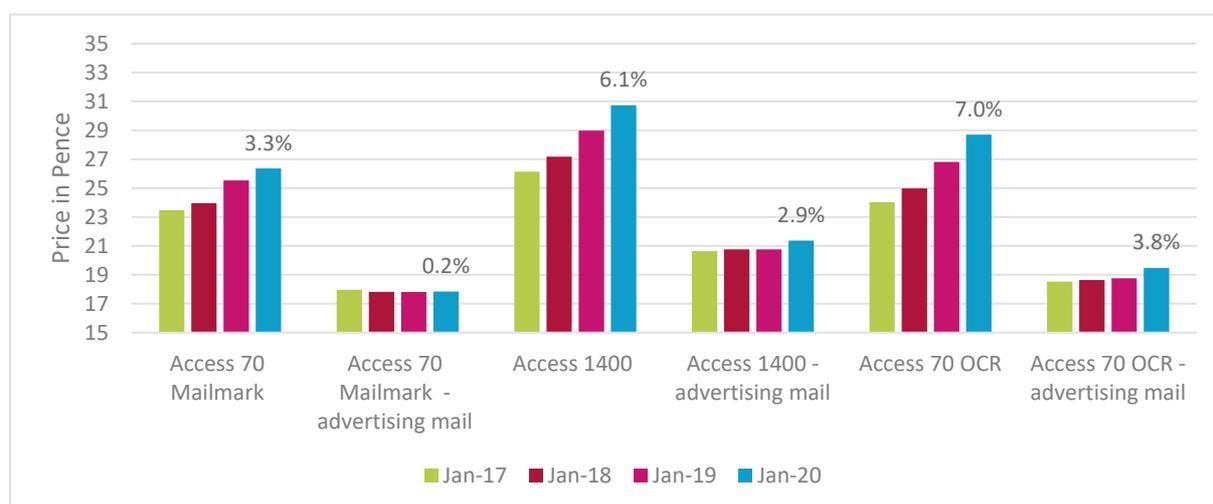
<sup>47</sup> Percentage figures represent price increases or decreases, relative to inflation, in percentage terms from January 2019 to January 2020.

<sup>48</sup> Access via [Annual monitoring updates on postal services website](#).

## Access prices

- 3.69 Royal Mail is under a regulatory obligation to offer access to its postal network to operators for letter and large letter services, which facilitates a routing time (at the retail level) of two working days or later. Figure 3.7 below sets out the prices that Royal Mail charges access operators for national access products.
- 3.70 Royal Mail increased its access prices in January 2020. In a letter to its customers, sent on 9 October 2019, it highlighted that its price rises were consistent with the Retail Price Index and stated that its prices remained competitive for customers and access operators.<sup>49</sup> Royal Mail also reiterated its longer-term aim of encouraging the take-up of Mailmark, highlighting that for Mailmark products the annual price rise would be below the average across all products (including Barcode and Optical Character Recognition (OCR) services)<sup>50</sup> thereby retaining the price differential to other business mail products.

**Figure 3.7: Royal Mail national access prices in real terms<sup>51,52</sup>**



Source: Royal Mail, Ofcom calculation based on National access prices, weighing 0-100g. Prices adjusted for CPI.

- 3.71 As illustrated in Figure 3.7, access prices have continued to rise in real terms across all products. Non-advertising product prices increased on average 5.5% across all products in the last year, relative to 2019 prices. Advertising product prices rose at a comparatively lower rate of 2.3% on average across all products compared to 2019 prices.<sup>53</sup>

<sup>49</sup> Royal Mail, 19 October 2019. [Price Changes for The Access Letters Contract](#).

<sup>50</sup> Royal Mail uses scanning software with OCR to allow mail to be machine sorted, but the address needs to be printed in specific fonts and sizes for this to work. See: <https://www.royalmailwholesale.com/addressing-your-mail>.

<sup>51</sup> Royal Mail offers a variety of access mail products, which vary by level of sortation, and type of mail, among other factors. The terms 'Access 70' and 'Access 1400' refer to two different levels of mail sorting which must take place before access mail enters Royal Mail's network. OCR is a mail format specification whereby the printed address can be read by Royal Mail's automated sorting machines.

<sup>52</sup> As above, percentage figures represent price increases or decreases, relative to inflation, in percentage terms from January 2019 to January 2020.

<sup>53</sup> The annual percentage increase in real terms prices for each product is specified in Figure 3.8 above the January 2020 columns. We have used a simple average across all national access products.

- 3.72 Royal Mail continues to offer a price differential between Access 70 Mailmark and Access 70 OCR, incentivising take-up of the Mailmark product.
- 3.73 Page 13 of the Post Monitoring Interactive Data shows historic trends in access mail prices since 2010 and allows for a more tailored presentation of relevant data.<sup>54</sup>

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<sup>54</sup> Access via [Annual monitoring updates on postal services website](#).

## 4. Consumer and SME research

4.1 In this section, we present data from our ongoing market research programme. We run two separate surveys to track use of, and attitudes to, post – one focused on residential consumers and the other focused on small and medium enterprise (SME) business customers. The data reported here is from the period of Q3 2019 to Q2 2020 reflecting the most up-to-date annual data we have at the time of publication of this report. The Post Monitoring Interactive Data<sup>55</sup> includes research findings taken from Ofcom’s Residential Postal Tracker and Ofcom’s SME Postal Tracker for financial years 2012-13 through to 2019-20.

### Key research findings

#### Residential consumer research:

- **Satisfaction with postal services** – Satisfaction levels remain high in relation to all postal services (85%) and when looking specifically at Royal Mail (82%). Satisfaction among senders in terms of value for money declined by 3% points compared to 2018-19, but is still high at 73%.
- **Problems experienced when using postal services** – While ‘misdelivered mail’ (37%) remains the concern reported the most by users of Royal Mail services, the biggest rise in reported concerns year-on-year was for ‘delayed mail’ (up to 23% in 2019-20 from 18% in 2018-19).
- **Factors considered important when sending or receiving letters and parcels** – Across both letters and parcels, importance ratings associated with postal services have gone up in 2019-20 for all factors tested. In relation to sending parcels, there were significant increases in the importance attributed to the ‘ability to track the delivery’ (up to 83% in 2019-20 from 70% in 2018-19) and ‘insurance against damage or loss’ (up to 75% from 59%), suggesting increased interest in the security of parcels in the post.

#### SME business customer research:

- **Satisfaction with postal services** – Satisfaction levels remain high and are stable year-on-year at 85% for Royal Mail services, and down 2% points to 82% for other operator services. For specific elements of Royal Mail services, 2019-20 satisfaction ratings for ‘collection reliability’ (59%) and ‘collection time of items you are sending’ (56%) both dropped 3-4% compared to 2018-19.
- **Factors considered important when sending or receiving parcels** – The importance rating for services being regarded as ‘low cost’ has increased from 58% to 70%, while the importance of ‘same price to send to anywhere in the UK’ has also increased from 59% to 69%. This aligns with the significant increase among those SMEs who have experienced a problem with Royal Mail in the last six months reporting ‘price of postage’ as a concern, up from 1% in 2018-19 to 17% in 2019-20.

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<sup>55</sup> Access via [Annual monitoring updates on postal services website](#).

- 4.2 Due to the Covid-19 pandemic, fieldwork for the face to face element of the residential consumer research (which we use to reach those who don't have access to the internet and those who may lack the digital literacy or confidence to complete the survey online) was paused.<sup>56</sup> This has affected our ability to fully include this section of the population in the sample. Therefore, the following analysis of residential consumers is based only on data collected using the main online survey methodology. The SME business tracker was also temporarily paused – to allow business participants time to adjust to pandemic restrictions – but resumed after a few weeks and we can report on the full annual sample.<sup>57</sup>
- 4.3 As we discuss in Section 8, Covid-19 has had significant impacts on the postal sector, and this is likely to have implications in terms of consumer experiences and attitudes. The research data we collected in Q2 2020 (when the initial lockdown restrictions were in place across the UK) suggests satisfaction levels with Royal Mail and other postal operators remained at high levels, and by some measures increased between Q1 and Q2 2020. We will continue to monitor this in the months ahead.
- 4.4 The data from these surveys is published on our website going back to 2012 when the research programme began.<sup>58</sup>
- 4.5 We have also conducted research into the views of residential and SME postal users as part of our review of post user needs. We asked them how content they are with current postal services, in particular the universal postal service, and whether their needs would be met if there were some changes to the minimum requirements of the universal service. The main research was conducted in 2019, followed by further research in summer 2020 to assess the extent to which users' views may have changed as a result of the Covid-19 pandemic. We have published our user needs research findings alongside this report.<sup>59</sup>

## Residential consumers

### Satisfaction ratings for postal services

- 4.6 As we found last year, high proportions of residential consumers are satisfied with Royal Mail (82%) and postal services overall (85%), with dissatisfaction levels remaining at 4% and 3% respectively. Almost three quarters (73%) are satisfied with the postal services in delivering value for money of sending mail, with 9% dissatisfied. These results are broadly in line with 2018-19.

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<sup>56</sup> Face to face fieldwork for the residential postal tracker was paused on 19 March 2020. The online element continued throughout.

<sup>57</sup> Computer Assisted Telephone Interviewing (CATI) fieldwork for the SME postal tracker paused on 20 March 2020 and resumed on 1 May 2020.

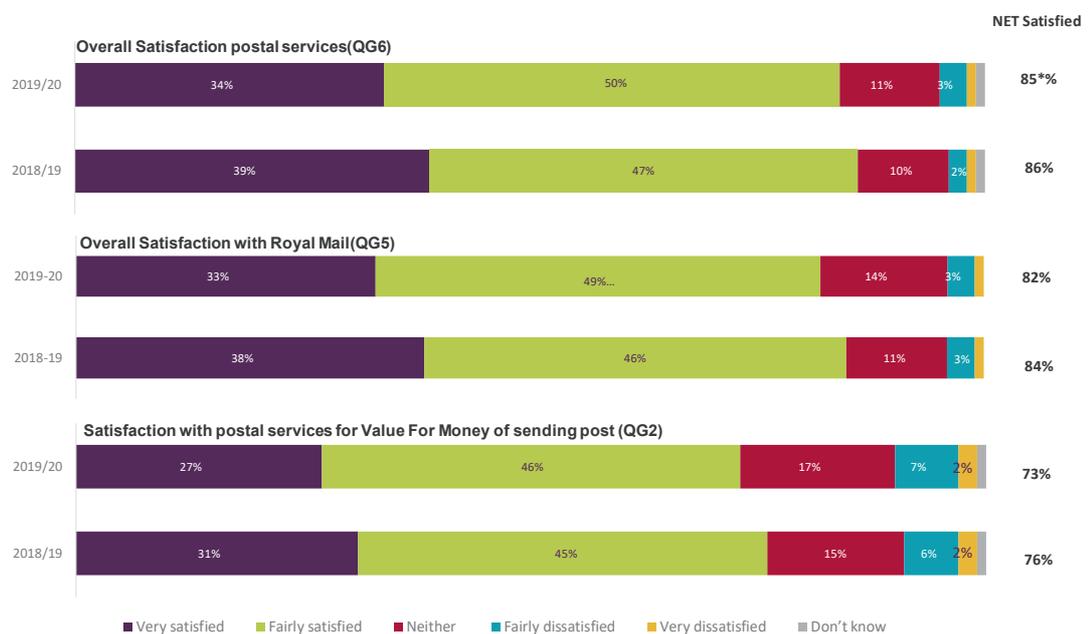
<sup>58</sup> Our Statistical Release Calendars can be found at our [Statistics website](#) residential and business postal tracker data is available from our Statistical Release Calendar on 2 September 2020. Our data files show further information on the results of the survey broken down by categories of customers, for instance by age groups or nations.

<sup>59</sup> Ofcom, 2020. *Review of postal services users' needs*.

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0014/208220/2020-review-of-postal-user-needs-report.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0014/208220/2020-review-of-postal-user-needs-report.pdf).

- 4.7 Overall satisfaction with Royal Mail remains stable in each of the UK nations, with Northern Ireland reporting the highest level of satisfaction (87%). At least eight in ten in the other nations are also satisfied with Royal Mail; 81% in England, 84% in Scotland, and 82% in Wales.
- 4.8 Satisfaction with postal services overall in terms of delivering value for money when sending mail stands at 73% in England, 71% in Scotland, 72% in Wales, and 78% in Northern Ireland. Satisfaction with value for money in rural locations is 71%, compared to 73% in urban areas. However, it is higher for consumers living in remote rural locations at 77%.

**Figure 4.1: Residential consumers' satisfaction with postal services**



Source: Ofcom Residential Postal Tracker Q3 2019 – Q2 2020 (5,012), Q3 2018-Q2 2019(5,956)

Base: All Participants

QG2: How satisfied are you overall with the postal services in terms of delivering value for money for sending mail? QG5: How would you rate your overall satisfaction with Royal Mail? QG6: How would you rate your overall satisfaction with postal services? (ALL providers)

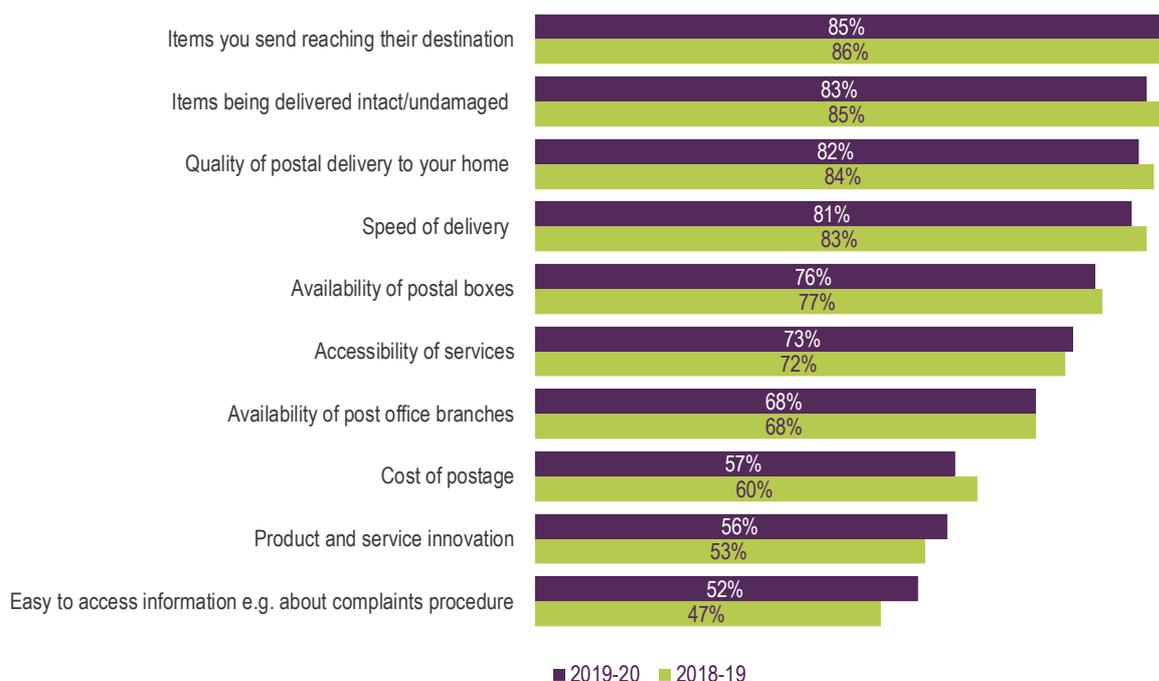
\* Due to rounding of decimal points net combined total adds up to 85%.

### Royal Mail services

- 4.9 Looking at specific aspects of Royal Mail's service, residential consumers continue to be satisfied with similar aspects to previous years i.e. 'items sent reaching their destination' (85%), 'items being delivered intact/undamaged' (83%) and the 'quality of postal delivery to the home' (82%). Meanwhile, in line with previous years, the lowest levels of satisfaction were with the 'cost of postage' (57%), 'product and service innovation' (56%) and 'easy access to information, for example about complaints procedures' (52%).

- 4.10 Participants in Northern Ireland were more likely to be satisfied with the ‘availability of post office branches’ than participants in the UK overall (net satisfaction 78% vs 68%).
- 4.11 Consumers in Northern Ireland are also more satisfied with the ‘quality of postal delivery to the home’ (89% vs 82% overall) and ‘accessibility of services’ (81% vs 73% overall).

**Figure 4.2: Residential consumers’ satisfaction with specific aspects of Royal Mail’s service**



Source: Ofcom Residential Postal Tracker, Q3 2019 – Q2 2020 (5,012), Q3 2018-Q2 2019 (5,779)

Base: All Participants

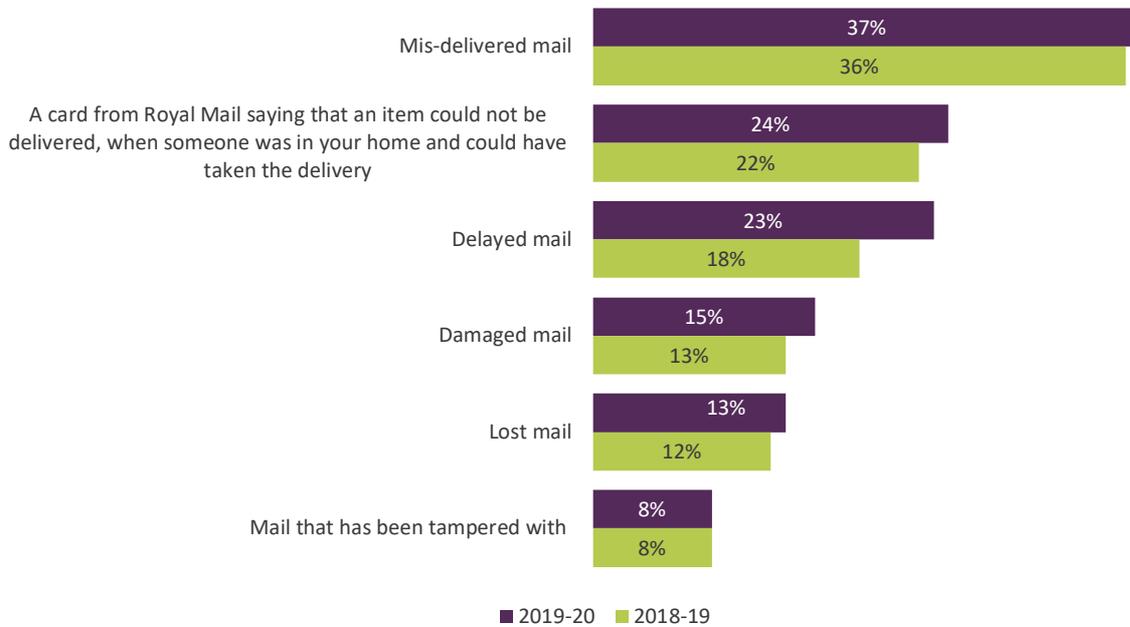
Q3: How satisfied are you with the following aspects of Royal Mail’s service? (NET: “very satisfied” and “fairly satisfied”)

- 4.12 More information about residential consumer views on cost of postage can be found in the Post Monitoring Interactive Data published alongside this report.<sup>60</sup> Our research shows just under two thirds (63%) of residential consumers think that First Class stamps represent good value for money, with a lower percentage (56%) thinking that Second Class stamps are good value. One in five (21%) said that Second Class stamps are poor value, while a lower proportion said this about First Class stamps (17%). In both cases, perceptions of good value for money are in line with 2018-2019 (65% for First Class stamps, and 57% for Second Class stamps).
- 4.13 Participants were asked whether they had experienced one or more of a range of problems with Royal Mail’s service over the past year. 39% overall reported that they had experienced a problem, and the problems experienced were similar to those reported in 2018-2019. Just over a third (37%) said their mail was mis-delivered, while about a quarter

<sup>60</sup> Access via [Annual monitoring updates on postal services website](#), see page 18.

(24%) said they had received a card from Royal Mail saying that an item could not be delivered when someone was at home and could have taken delivery. A similar proportion (23%) reported a problem with delayed mail. Reports of delayed mail were higher at 23% in 2019-20 than 18% in 2018-19.

**Figure 4.3: Residential consumers' problems with Royal Mail**



Source: Ofcom Residential Postal Tracker

Base: All Participants Q3 2019-Q2 2020 (5,012), Q3 2018 – Q2 2019 (5,779)

QH1: In the last 12 months, have you experienced problems with Royal Mail's service in terms of...

## Use of postal services

4.14 Consumers were asked if they were sending more, less or the same amount of different types of mail as two years ago. Similar to previous years, for each of the eight types of post asked about, the proportion of residential consumers saying that they are sending less than two years ago was higher than the proportion reporting that they are sending more, except for tracked post (where 4% more consumers say they are sending more than two years ago).

**Table 4.4: Consumers claiming to send different types of post compared to two years ago**

Type of mail	Sent more (%)	No change	Sent less (%)	Net more/ Less
Invitations/ greeting cards / postcards	10	54	34	<b>-24</b>
Personal letters (e.g. to a friend/ relative)	8	52	38	<b>-30</b>
Formal letters to organisations/ individuals	11	52	34	<b>-23</b>
Payment for bills	7	49	41	<b>-34</b>
Smaller parcels	19	57	22	<b>-3</b>
Larger parcels	18	57	23	<b>-5</b>
Items requiring a signature	16	61	19	<b>-3</b>
Tracked post	20	60	16	<b>+4</b>
Other items not mentioned	3	20	6	<b>-3</b>

Source: Ofcom Residential Postal Tracker

Base: All Participants Q3 2019-Q2 2020 (1,563) online only sample

QD12: Frequency of sending ... compared to two years ago (note this question was asked in alternate months)

- 4.15 Residential consumers were also asked about the amount of different types of post that they are receiving, compared to two years ago.
- 4.16 The biggest net increases reported were for both smaller parcels (that fit through a letter box) and larger parcels. A quarter (25%) each reported that they are receiving more of these types of mail, compared to 14% and 15% receiving fewer smaller and larger parcels respectively. A small increase was also noted for items received requiring a signature. Around a fifth (19%) reported receiving more items requiring a signature (that will fit through a letter box) compared to 16% receiving less.

**Table 4.5: Consumers claiming to receive different types of post compared to two years ago**

Type of mail	Received more (%)	No change	Received less (%)	Net change
Invitations/ greeting cards / postcards	8	58	33	<b>-25</b>
Personal letters	8	54	37	<b>-29</b>
Formal letters from known organisations	14	57	27	<b>-13</b>
Bills, invoices and statements	14	47	38	<b>-24</b>
Magazines you subscribe to	8	61	22	<b>-14</b>
Catalogues and brochures	18	47	33	<b>-15</b>
Newsletters, leaflets and promotions from known organisations	19	51	28	<b>-9</b>
Items requiring a signature	19	62	16	<b>3</b>
Addressed direct mail from unknown organisations	23	47	25	<b>-2</b>
Smaller parcels	25	59	14	<b>11</b>
Larger parcels	25	58	15	<b>10</b>

Source: Ofcom Residential Postal Tracker

Base: All participants in odd months only Q3 2019-Q2 2020 (n=1,012) online only sample

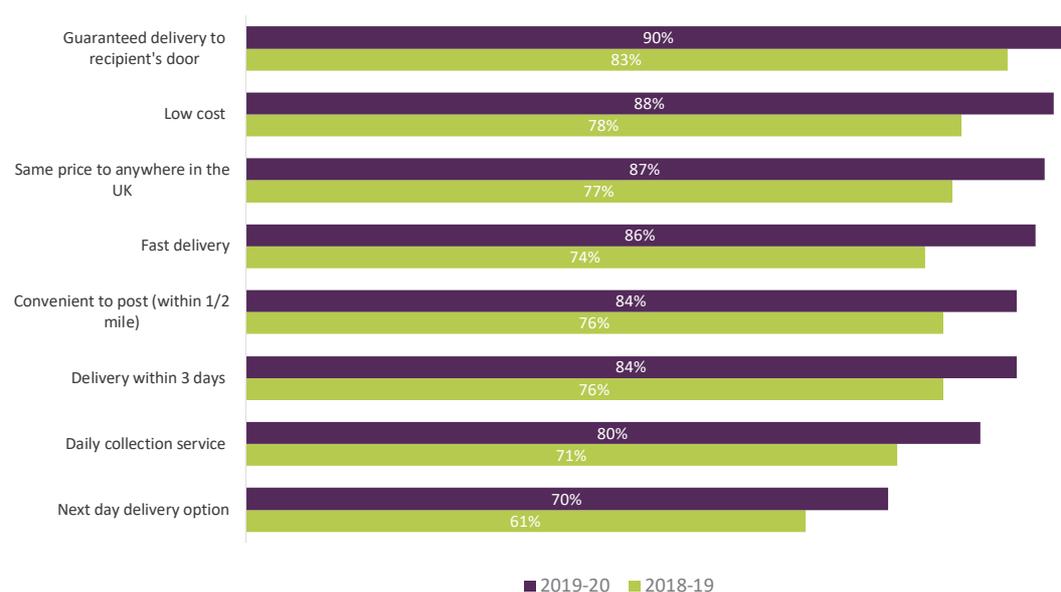
QE11. Thinking about these different types of mail, would you say that you now receive them more or less often than two years ago? Or has there been no change? Please think only about items that are addressed to you personally.

## Importance of factors when sending or receiving post

### Sending letters

4.17 Residential participants were asked to rate the importance of several factors when sending letters. Nine in ten (90%) said that ‘guaranteed delivery to recipient’ was ‘very important/important’. The option receiving the lowest level of importance attached was ‘a next day delivery option’ (70%). These are all higher than the results in 2018-2019.

**Figure 4.6: Factors rated as important for people when sending letters (2018-19 vs 2019-20)**



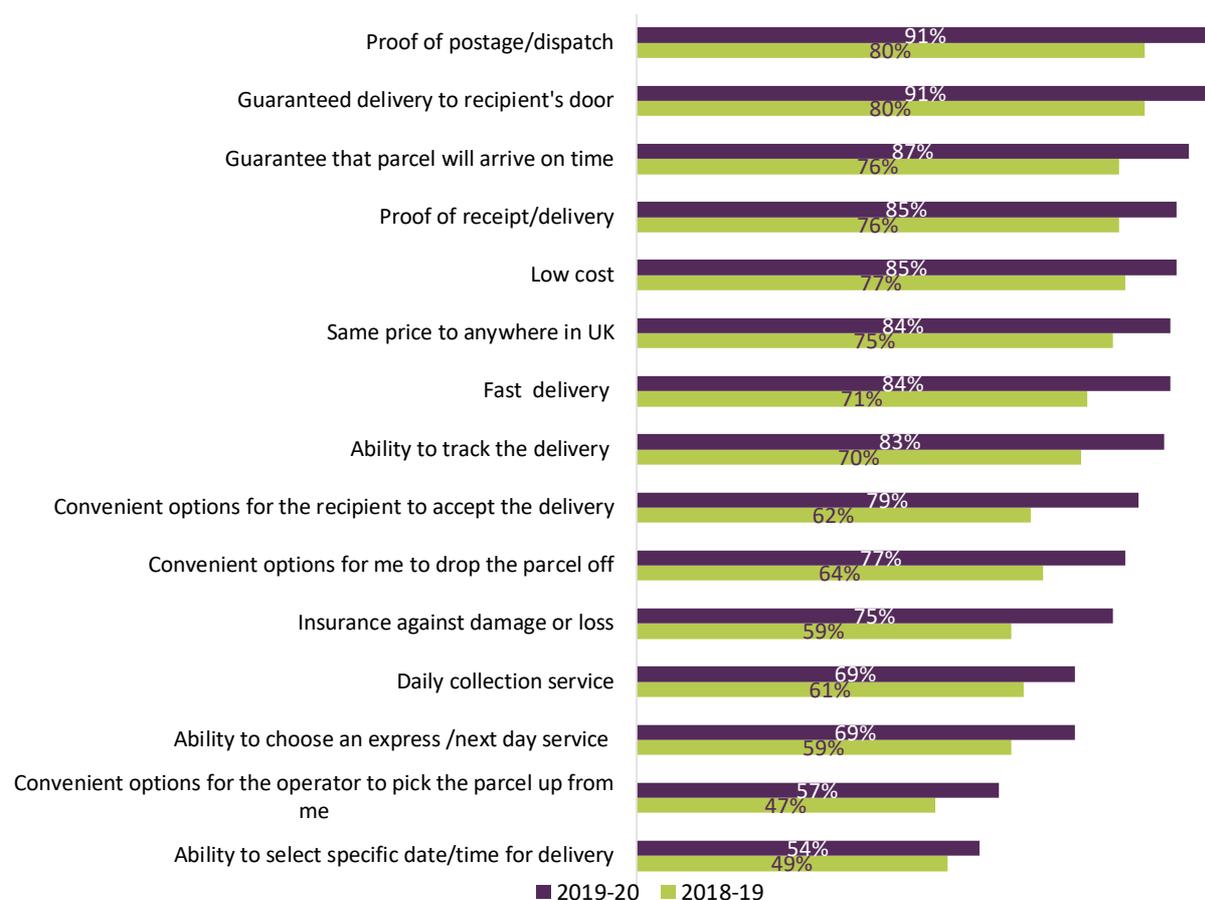
*QD10b. Below, are a list of factors people tell us they consider when sending letters. For each factor, please tell us how important it is to you in choosing a postal provider or service. (NET: “very important/important”)*

*Base: all who use Royal Mail for letters or large letters and selected a service 2019-20 (1,271) online only sample, 2018-19 (3,004)*

### **Sending parcels**

- 4.18 The same question was asked about sending parcels. A range of factors were rated as ‘very important’ or as ‘important’. The most important factors for parcels remain those around knowing the parcel has been sent and arrived within the desired time frame, i.e. ‘guaranteed delivery to recipient’s door’ and ‘proof of postage/dispatch’ (both 91%). ‘Guarantee that the parcel will arrive on time’ (87%), ‘low cost’ and ‘proof of receipt/delivery’ (both at 85%) were also very important.
- 4.19 The factors that were rated as the least important were the ‘ability to select a specific date/time for delivery’ (54%) and ‘convenient options for operator to pick parcel up’ (57%).
- 4.20 Similar to letters, these results suggest that more consumers are rating a number of the factors as important when it comes to sending parcels than was the case in 2018-19. The steepest increases in importance attributed were for ‘ability to track the delivery’ (up to 83% in 2019-20 from 70% in 2018-19); ‘insurance against damage or loss’ (up to 75% from 59%); and for convenient options for receiving (up to 79% compared to 62%) and dropping off parcels (up to 77% from 64%).

**Figure 4.7: Factors rated as important for people when sending parcels (2018-19 vs 2019-20)**



Source: Ofcom Residential Postal Tracker Q3 2019-Q2 2020 (1,533) online only sample, 2018-19 (3,499)

Base: Those who have sent a parcel or tracked item/item requiring signature in the past month

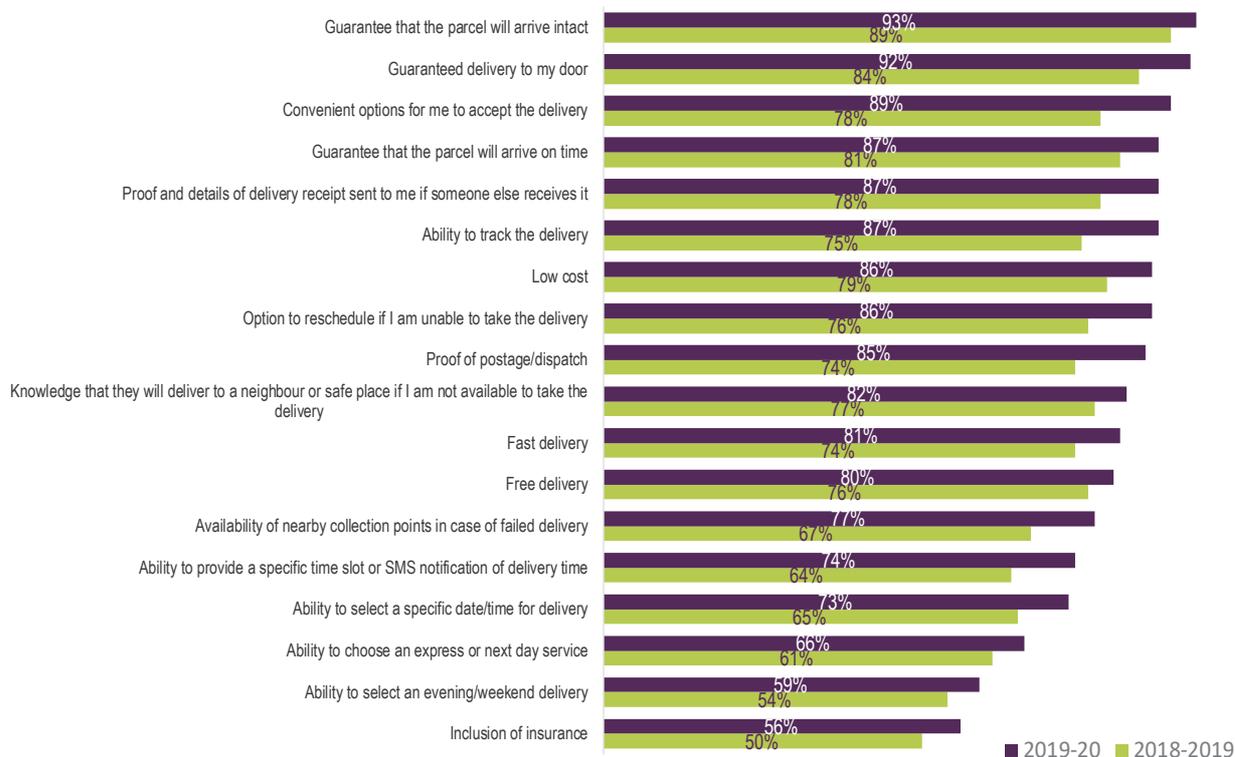
QD10a: List of factors people consider when sending parcels... (NET: "very important/important")<sup>61</sup>

### Receiving letters and parcels

4.21 Participants were also asked about the importance of various factors when choosing a delivery option for a letter or parcel they will receive. The results show that, similar to previous years, consumers are concerned with the safe delivery of parcels. When asked, 93% said that 'guarantee that parcel will arrive intact' was very important or important, followed by 'guaranteed delivery to my door' (92%) and 'convenient options for me to accept delivery' (89%). Factors which give users more information/choice in relation to delivery times – including 'ability to track delivery' (up to 87% from 75%) and 'option to reschedule if I am unable to take the delivery' (up to 86% from 76%) – also showed big increases in attributed importance over the last year.

<sup>61</sup> The scale definitions in 2018-19 were Mandatory (numerical score 5), Great to have (4), Nice to have (3), Not important (2), Negative to me (1)

**Figure 4.8: Factors rated as important for people when choosing delivery for letters/ parcels that they will receive. Nets: 2018-19, 2019-20**



Source: Ofcom Residential Postal Tracker) Q3 2018 – Q2 2019 (2,671), Q3 2019 – Q2 2020 (1,012) online only sample

Base: Those who were required to select a postal/delivery option for letters or goods that were delivered to themselves in the previous month.

QE10b: List of factors people consider when choosing delivery for letters/ parcels that they will receive... (NET: “very important/important”) (2018-19 NET: “Mandatory/Great to have”)

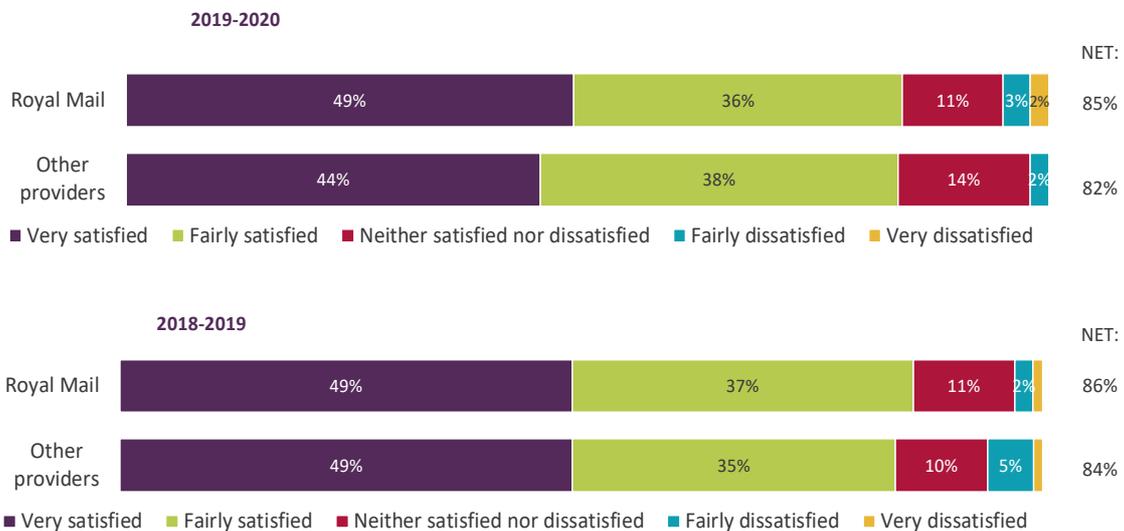
## Small and Medium Enterprise (SME) consumers

### Satisfaction ratings for postal services

- 4.22 Similar to residential consumers, SME satisfaction levels with the service from postal providers is high. Over eight in ten SMEs who use Royal Mail (85%) said they were satisfied, compared with a slightly lower proportion of those who use other providers (82%). Meanwhile, dissatisfaction levels were low, though slightly higher for Royal Mail (5%) compared to other providers (2%). The overall level of satisfaction with Royal Mail amongst SMEs remains in line with the previous year, while it is slightly lower amongst SMEs using other providers (82% vs 84%).
- 4.23 Seven in ten (71%) of SMEs also agree that postal services in the UK provide good value for money: 71% in England, 77% in Scotland, 74% in Wales, and 67% in Northern Ireland.

4.24 Satisfaction with value for money for SMEs in rural locations is 77% compared to 73% in urban areas. The data is not broken down by remote rural locations.

**Figure 4.9: SME satisfaction with postal services**



Source: Ofcom Business Postal Tracker

Base: Q3 2019 – Q2 2020 All who use Royal Mail (1,948), All those who use other providers than RM (479)

Q3 2018 – Q2 2019 All who use Royal Mail (1,869), All those who use other providers than RM (435)

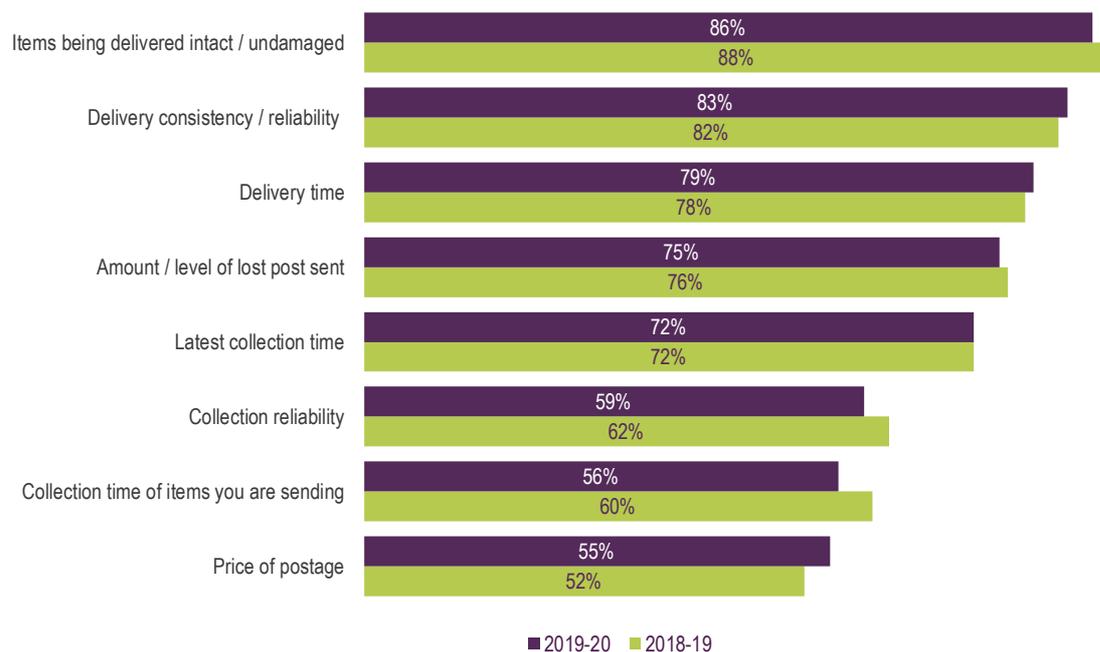
QRM2: Thinking generally about the service your organisation receives, how satisfied are you with the overall quality of the services you receive from Royal Mail as a recipient and sender?

QOP1a: Thinking generally about the service you receive as a whole... how would you rate the quality of the services you receive from [QV4 provider]?

### Royal Mail services

4.25 Looking at specific elements of Royal Mail’s service, similarly to 2018-19, SMEs are most satisfied with ‘items being delivered intact/undamaged’ (86%), ‘delivery consistency/reliability’ (83%) and ‘delivery time’ (79%). Satisfaction is lowest with ‘collection time of items being sent’ (56%) and ‘price of postage’ (55%), although the latter has increased year on year.

**Figure 4.10: SME satisfaction with specific elements of Royal Mail’s service**



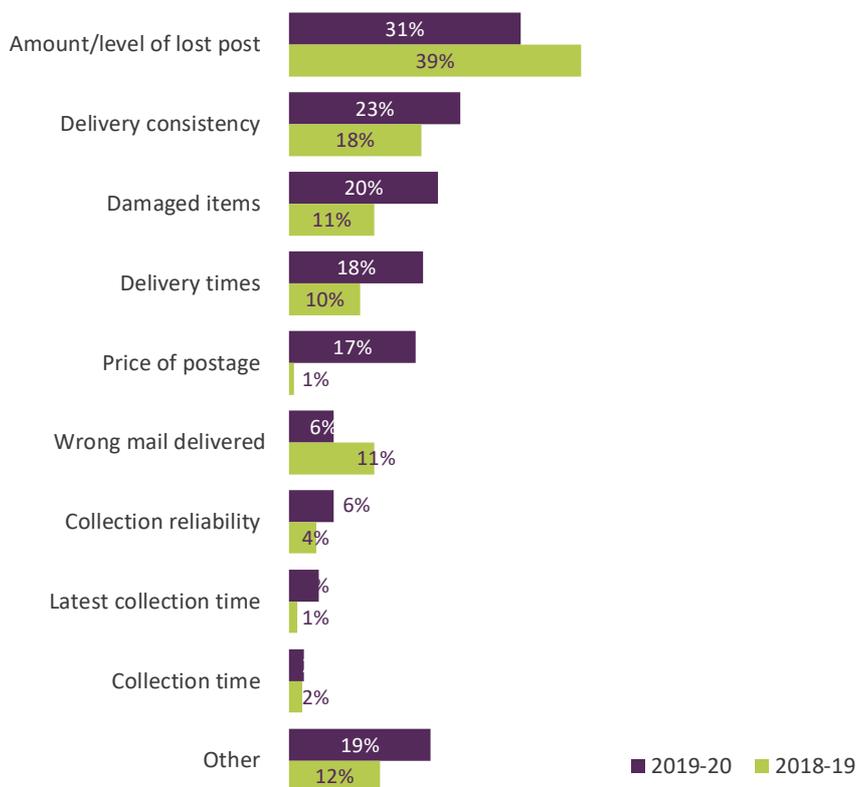
Source: Ofcom Business Postal Tracker

Base: All participants who use Royal Mail Q3 2019– Q2 2020 (1,948), Q3 2018-Q2 2019 (1,869)

QRM3: How would you rate the performance of Royal Mail, as a recipient and sender, in the following areas on a five-point scale where 1 is very dissatisfied and 5 is very satisfied? NET: % fairly/very satisfied

- 4.26 SMEs were asked whether they had experienced a list of possible problems with Royal Mail in the last six months. More than eight in ten (82%) reported that they had not experienced any problems. This is slightly lower than 85% who said the same in 2018-2019.
- 4.27 Where problems were reported, as with previous years, the biggest problem was the amount/level of lost mail reported. Around three in ten (31%) of those who have had a problem said it was with the amount/level of lost mail, this is lower than 39% who said the same in 2018-19. Consumers reported increased levels of problems in a number of areas. The biggest increase was with the price of postage which rose from just 1% in 2018-19 to 17% reporting a problem with the price of postage. Other big increases were with damaged goods rising from 11% to 20% and delivery times rising from 10% to 18% in the last year.

**Figure 4.11: SME problems experienced with Royal Mail**



Source: Ofcom Business Postal Tracker Q3 2019-Q2 2020 (336), Q3 2018 – Q2 2019 (251)

Base: All participants who use Royal Mail who had reported a problem in the last six months

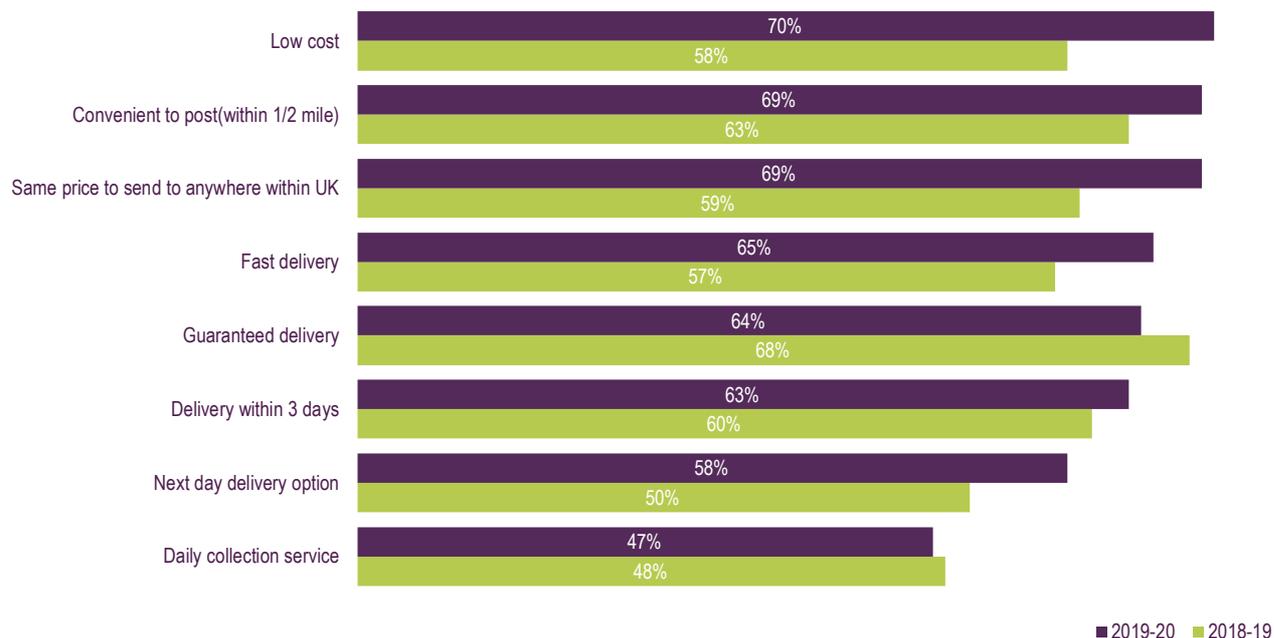
QRM4: Have you experienced any problems with your service from Royal Mail (as a sender or recipient of mail) in the last six months?

## Importance of factors when sending or receiving post

### Sending letters

4.28 SMEs were asked to rate the importance of various factors when choosing a provider to send letters. The most important factors for SMEs are ‘low cost’, which was rated as very important or important by seven in ten (70%), ‘convenience of posting items (within half a mile)’ and ‘same price to anywhere in the UK’ (both 69%), followed by ‘fast delivery’ (65%). The options that received the lowest importance ratings were ‘next day delivery option’ (58%) and ‘daily collection service’ (47%). The importance rating for ‘low cost’ has increased from 58% to 70%, while the importance of ‘same price to send to anywhere in the UK’ has also increased from 59% to 69%. The importance of ‘guaranteed delivery’ has decreased year on year from 68% to 64%.

**Figure 4.12: Factors rated as important for SMEs when sending letters**



Source: Ofcom Business Postal Tracker

Base: All participants who use Royal Mail to send letters or large letters and selected a service Q3 2019-Q2 2020 (1,380), Q3 2018 – Q2 2019 (1,620)

QD10b. Below, are a list of factors people tell us they consider when sending letters. For each factor, please tell us how important it is to you in choosing a postal provider or service. (NET: “very important/important”)

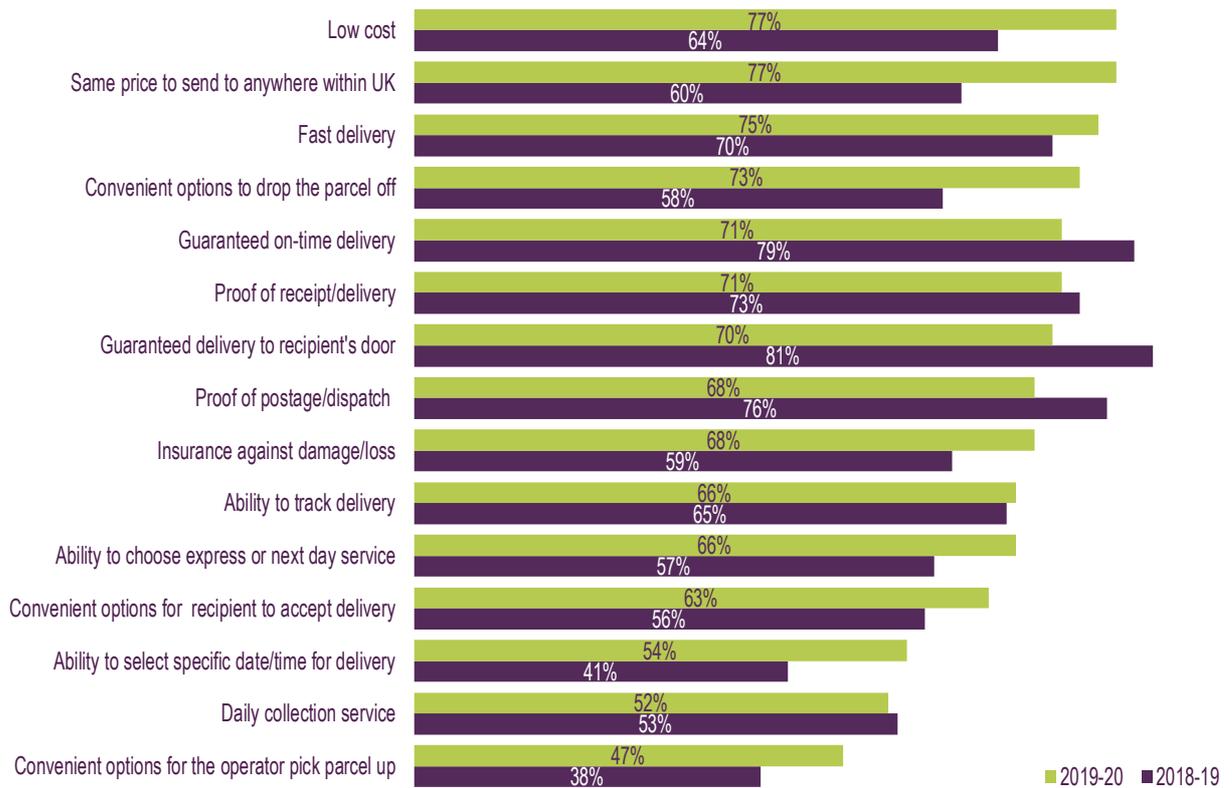
**Sending parcels**

4.29 SMEs were asked the same question in relation to sending parcels. ‘Low cost’ and ‘same price to send to anywhere within the UK’ are the most important factors rated by over three quarters of participants (both 77%). ‘Fast delivery’ is also rated as important by 75% and ‘convenient options to drop the parcel off’ by 73% of SMEs.

4.30 A number of factors had importance ratings considerably higher in 2019-20 as compared to 2018-19:

- ‘low cost’ increased from 64% to 77%;
- ‘same price to send to anywhere in the UK’ rose from 60% to 77%;
- ‘convenient options to drop the parcel off’ increased from 58% to 73%; and
- ‘ability to select specific date/time for delivery’ rose from 41% to 54%.

**Figure 4.13: Factors rated as important for SMEs when sending parcels. Nets: 2018-19, 2019-20**



Source: Business Postal Tracker

Base: All participants using Royal Mail to send parcels and packets Q2 2017-Q3 2018 (657), Q3 2018-Q2 2019(563)

QD10a. Below, are a list of factors people tell us they consider when sending parcels. For each factor, please tell us how important it is to you in choosing a postal provider or service

## 5. Financial performance

- 5.1 We monitor the financial performance of Royal Mail's Reported Business<sup>62</sup> and certain financial metrics relating to the wider Royal Mail Group, as we have a duty to have regard to the need for the provision of a universal service to be financially sustainable.<sup>63</sup>
- 5.2 This section summarises the results of our financial monitoring for 2019-20, including a comparison with 2018-19<sup>64</sup>, which informs our view of the sustainability of the universal postal service<sup>65</sup>. In particular, we discuss:
- changes in volumes and revenues for the Reported Business, highlighting particular product groups and formats to explain what is driving overall revenue and volume changes;
  - changes in the costs of the Reported Business (this information is also an important input when considering the efficiency of the universal postal service, which is discussed further in Section 6);
  - the profit margin (or 'EBIT margin') of the Reported Business; and
  - Royal Mail Group-level cash flow and financial health metrics<sup>66</sup> and Viability Statement.
- 5.3 For short term measures of sustainability, we consider group level metrics and we believe that these indicate that Royal Mail is likely to be sustainable in the short term.
- 5.4 The Reported Business's EBIT margin provides us with an indicator of the longer-term sustainability of the universal postal service. The downward trend in financeability EBIT margin in recent years is of concern. Revenue reductions have been the result of declining letter volumes which are expected to continue.
- 5.5 In considering sustainability we also have regard to the efficiency levels achieved. This is discussed in more detail in the following section.
- 5.6 Our assessment of sustainability as set out in this section, is based on indicators taken from before the main impacts of Covid-19 on the UK had been experienced. Section 8 provides a

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<sup>62</sup> The Reported Business is a part of Royal Mail's UK Parcels, International and Letters (UKPIL) business unit but excludes the activities and products of Parcelforce International and Royal Mail Estates Ltd. The services within the Reported Business include all universal service products and other 'non-USO' products which use the universal service network (for example, retail bulk mail and access). From 2020-21 Royal Mail will be referring to UKPIL as Royal Mail UK

<sup>63</sup> Ofcom, 2012, Securing the Universal Postal Service.

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0029/74279/Securing-the-Universal-Postal-Service-statement.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0029/74279/Securing-the-Universal-Postal-Service-statement.pdf).

<sup>64</sup> Royal Mail reports its financial statements using whole weeks, usually 52, but on occasion the timeframe is reset by adopting a 53-week year. In 2018-19 Royal Mail reported its financial year as a 53-week year. Where possible, 2018-19 results have therefore been adjusted to 52 weeks to enable a like-for-like, year-on-year comparison. Where we discuss changes, we are referring to the comparisons to the prior financial year - i.e. 2019-20 to 2018-19 - on a 52-week basis (unless otherwise stated).

<sup>65</sup> Data within this section is supplemented by an interactive data file which includes five year views on revenues, costs and volumes across different product splits, such as USO/Non-USO and Single Piece vs Bulk items and can be access using the following link: [https://www.ofcom.org.uk/postal-services/information-for-the-postal-industry/monitoring\\_reports](https://www.ofcom.org.uk/postal-services/information-for-the-postal-industry/monitoring_reports)

<sup>66</sup> In the Review of the Regulation of Royal Mail 2017 statement, we committed to monitoring the following short to medium term financial health metrics: Funds from operations/net debt, net debt/EBITDA and EBITDA/interest. While we cannot publish forward looking metrics as these rely on Royal Mail's confidential Business Plan, we can provide historic metrics as an indicator of financial health over the period considered.

high-level overview of how Covid-19 has impacted on Royal Mail and the wider postal sector in recent months.

- 5.7 There is uncertainty around how the recent significant changes in market trends may develop, and how they might affect the future sustainability of the universal service. We continue to monitor this. Our initial view is that the events of the last few months do not change our assessment as at the end of 2019-20. While Royal Mail is likely to be sustainable in the short-term, unless it modernises its network and becomes more efficient, there is a risk it will not be able to secure a commercial rate of return for the universal service business. This could put the sustainability of the universal postal service at risk in the longer term.

## Reported Business Volumes and Revenues

- 5.8 Total Reported Business volume performance in 2019-20 was lower than expectations. Letter volumes declined at an accelerated rate relative to both past trends and to Royal Mail's guidance from the start of 2019-20. Parcel volumes grew modestly, despite a decline in international import volumes.
- 5.9 Royal Mail was expecting to see addressed letter volume decline by 5 to 7% in 2019-20. However, volumes declined more quickly, reducing by 7.6% on the prior year (excluding election mail). In its 2019-20 Q3 trading update<sup>67</sup>, Royal Mail revised its forecast down for both 2019-20 and 2020-21 to a 7 to 9% decline, attributing the decline in letter volumes to "ongoing structural decline, weak economic activity and ongoing business uncertainty".<sup>68</sup>
- 5.10 Total parcel volume growth of 2.0% was below Royal Mail's expectations. Royal Mail set out in its Annual Report that this was due to the impact of both the threat of industrial action towards the end of 2019 and the impact of Covid-19 on international import volumes in the final quarter.<sup>69</sup> Domestic parcel volumes grew by 3.8%. This is significantly lower than our estimate of the growth rate for the domestic parcels market as a whole of 10% (see Section 3 on market developments), though there are differences between the two measures.<sup>70</sup>

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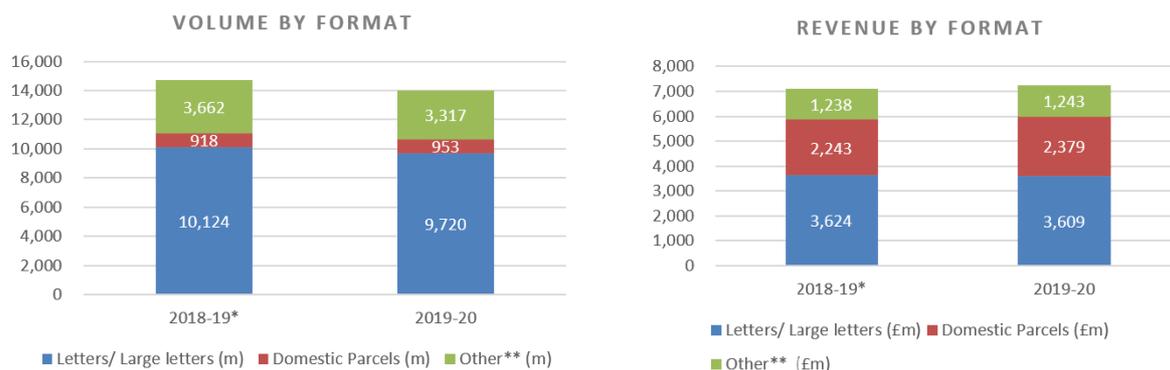
<sup>67</sup> Royal Mail PLC, 2020, Trading update for the nine months ended 29 December 2019, 6 February 2020, <https://www.royalmailgroup.com/media/11093/royal-mail-9m-2019-20-trading-update-6-2-20.pdf>.

<sup>68</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 38.

<sup>69</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 37.

<sup>70</sup> Parcel volumes referenced in this section are based on Royal Mail's definition of parcels and include RM 24/48 large letters, some fulfilment letters and large letters. They are therefore not directly comparable to the parcels market volumes collected by Ofcom and reported in Section 3 on market developments.

**Figure 5.1: Reported Business volumes (m) and revenues (£m) split by format**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

\*\* Other products mainly consist of international letters and parcels and unaddressed mail

5.11 Overall, despite lower than expected letter and parcel volumes, Reported Business revenue grew, in nominal terms, for the first time since 2013-14.<sup>71</sup> The growth in revenue was driven by parcel volume and price increases, together with revenue from the unplanned general and European elections. Letters revenue declined by 2.9%, highlighting that the letter volume decline was offset, in part, by letter price increases. In 2019-20, parcel revenue grew 5.4%, compared to revenue growth in 2018-19 of 2.0%. This is set out in Figure 5.1 above.

### Impact of change in mix of format on Reported Business revenues

5.12 We have undertaken some high-level analysis to ascertain how much of the overall change in total Reported Business revenue in 2019-20 was due to a change in mix of format, price and volumes. This is set out in Figure 5.2 below. The increase in letter and parcel prices had the largest impact on the increase in total revenues. However, this was not enough to offset the negative impact from letters volume decline. Election revenues also had a significant impact.

<sup>71</sup> In the period from 2014-15 to 2018-19, total revenue declined year-on-year alongside volume decline.

**Figure 5.2: Contributions to total revenue change of mix, price and volumes**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail, and Ofcom analysis.

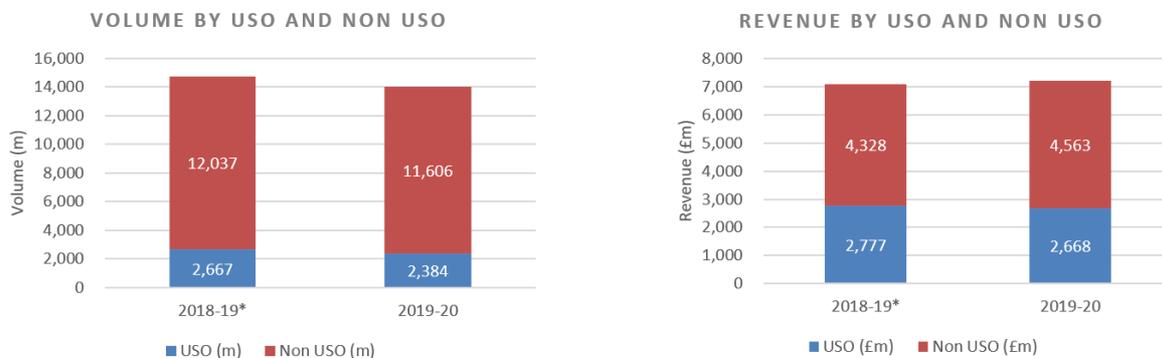
\* Adjusted to 52 weeks

\*\* Elections and Other includes election mail, specialist service and inter-company charges

### Changes in volume and revenue by universal and non-universal services

5.13 The services within the Reported Business include all universal service products, both letters and parcels, and other products which use the universal service network (for example, retail bulk mail and access mail).

**Figure 5.3: Reported Business volumes and revenues split by universal and non-universal service products**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

5.14 Universal service products accounted for 37% of the Reported Business revenues but only 17% of volumes. Price increases for single piece items offset some of the volume decrease, with USO volumes declining by 10.6% whilst revenues declined by 3.9% (see Figure 5.3).

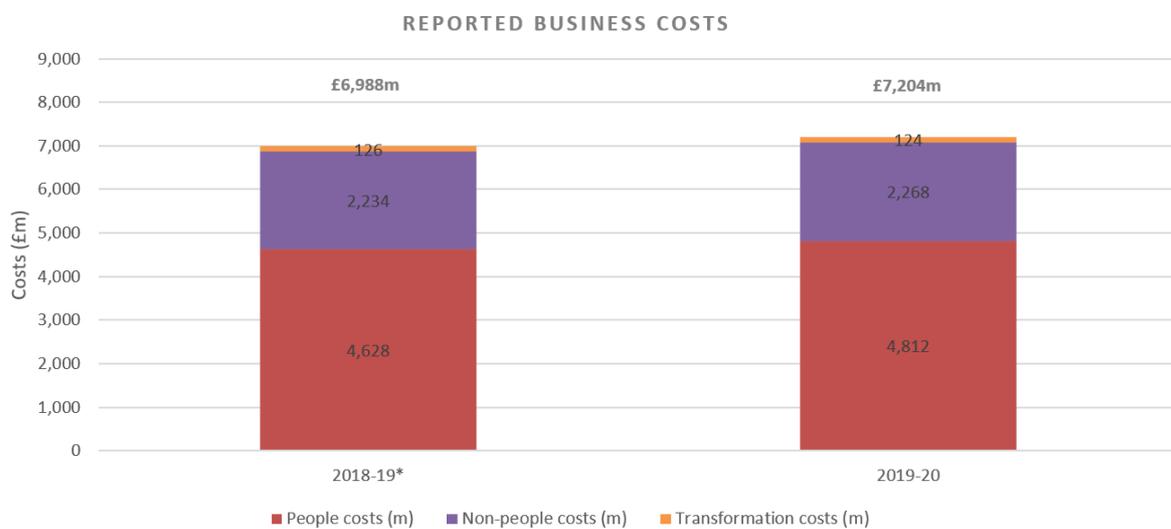
5.15 In contrast, revenues from non-universal service products increased by 5.4%. This was largely due to election mail but also due to an 18% increase in the use of tracked

products,<sup>72</sup> as well as some price rises in business and advertising mail. These mix and pricing changes more than offset the volumes decline of 3.6%.

## Reported Business Costs

5.16 Total Reported Business costs, including transformation costs, rose by 3.1% in 2019-20 to £7.2bn, see Figure 5.4 below. This was an increase on the previous year's movements, when costs increased by 2.6%. This was driven mainly by an increase in people costs. We summarise the cost movements in this section. A discussion of Royal Mail's efficiency is included in Section 6.

**Figure 5.4: Reported Business costs**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

## People costs<sup>73</sup>

5.17 People costs increased by 4.0% to £4.8bn. According to Royal Mail this was mainly driven by:

- frontline and manager pay awards, including the impact on pay of the shorter working week (see Section 6 on Efficiency);
- costs related to additional staff to protect quality of service over the UK General Election and Christmas; and
- costs of additional staff to support services during higher absence rates due to the onset of the Covid-19 pandemic at the end of 2019-20.<sup>74</sup>

<sup>72</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 37.

<sup>73</sup> Adjusted to reflect the cash cost of the defined benefit pension scheme rather than the accounting charge.

<sup>74</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 38.

## Non-people costs

- 5.18 Non-people costs increased by 1.5% to £2.3bn. This was largely driven by:
- an increase in distribution and conveyance costs, mainly due to higher payments to overseas postal operators caused by higher export volumes, as well as increased fuel costs; and
  - an increase in other operating costs, including an increase in the bad debt as a result of the economic environment, and the purchase of protective equipment at the onset of the Covid-19 pandemic.<sup>75</sup>

## Transformation costs

- 5.19 Transformation costs decreased by 1.6% to £124m in 2019-20, despite being the first year of Royal Mail's new transformation plan. Voluntary redundancy costs reduced by almost half, but there was an increase in project costs of 22.5%.<sup>76</sup> We discuss progress against the transformation plan in more detail in Section 6 on Efficiency.

## Reported Business profit margin

- 5.20 The Reported Business's profit margin, and its trend over time, is one of the indicators we monitor in considering the longer-term financial sustainability of the universal postal service. Specifically, we consider earnings before interest and tax (EBIT), calculated to include transformation costs<sup>77</sup> and with pension costs restated on a cash basis.<sup>78 79</sup> In our March 2017 Statement on the postal regulatory framework<sup>80</sup>, we concluded that an indicative EBIT margin range between 5 and 10% was consistent with a commercial rate of return. We refer to this metric as the "financeability EBIT margin".
- 5.21 In 2019-20, the financeability EBIT margin was 0.4%, well below the 5-10% range, see Figure 5.5 below. This was a reduction on the prior year margin of 1.6%, and a continuation of the downward trajectory shown since 2015-16. It included revenues from the

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<sup>75</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 39.

<sup>76</sup> Royal Mail PLC, 2020, Regulatory Financial Statements 2019-20, August 2020, page 8, <https://www.royalmailgroup.com/media/11242/rfs-2019-20-signed.pdf>

<sup>77</sup> Transformation costs are restructuring or redundancy costs which are likely to recur year-on-year and are not considered to be exceptional costs. Exceptional costs are considered to be large and uncommon (non-recurring) costs. See Ofcom, 2012, Securing the Universal Postal Service, paragraph 5.41 and footnote 69. [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0029/74279/Securing-the-Universal-Postal-Service-statement.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0029/74279/Securing-the-Universal-Postal-Service-statement.pdf).

<sup>78</sup> In the 2014 Review of End-to-End Competition Statement, we said it was appropriate to adjust Royal Mail's Reported Business EBIT margin to restate pension costs on a cash basis (i.e. the rate the contributions are actually paid at), rather than the rate calculated using the accounting standards. We considered that this methodology takes account of the true cost of pensions and we refer to this EBIT margin measure as the 'financeability EBIT margin'. See Ofcom, 2014, Review of end-to-end competition in the postal sector, page 15. [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0024/31956/end-to-end.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0024/31956/end-to-end.pdf)

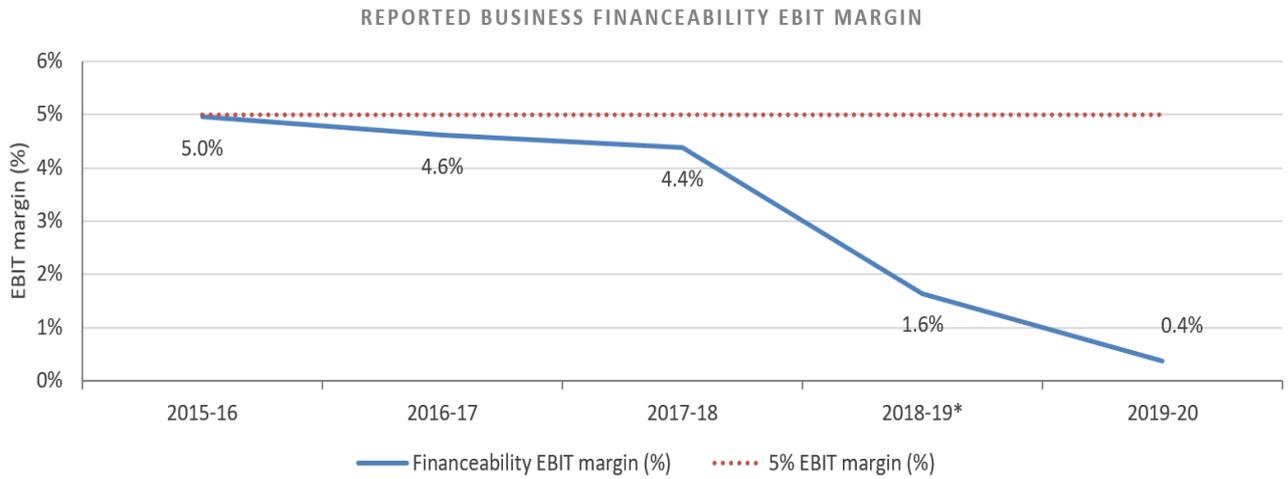
<sup>79</sup> In 2019-20, the accounting pension rate was 20.8% (compared to 18.9% in 2018-19) whereas the cash pension rate was 15.6% (same as in 2018-19).<sup>79</sup> The changes to accounting and cash pension rate were as a result of the closure of the Royal Mail Pension Plan.

<sup>80</sup> Ofcom, 2017, Review of the Regulation of Royal Mail, paragraph 3.60.

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0033/97863/Review-of-the-Regulation-of-Royal-Mail.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0033/97863/Review-of-the-Regulation-of-Royal-Mail.pdf).

unanticipated General and European elections in 2019. In the absence of these revenues, the Reported Business would have been loss-making in 2019-20.

**Figure 5.5: Reported Business financeability EBIT margin**

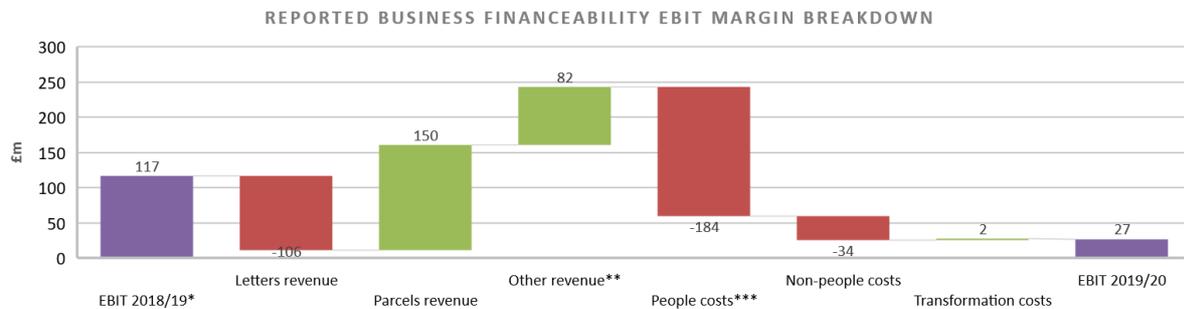


Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\*Adjusted to 52 weeks

5.22 Figure 5.6 below breaks down the change in profit from 2018-19 to 2019-20. As set out above, the decline was predominantly the result of increased people costs, which significantly exceeded the net rise in revenues.

**Figure 5.6: Reported Business financeability EBIT margin breakdown**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

\*\*Other revenue includes election mail, specialist services and inter-company charges

\*\*\* People costs include the costs associated with the delivery of election mail

## Royal Mail Group financial health metrics

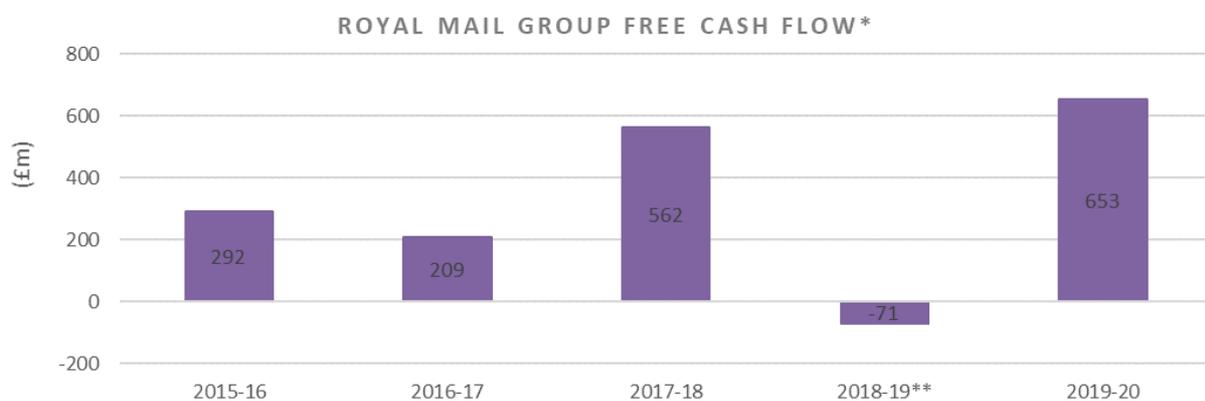
5.23 In addition to reviewing the Reported Business' financeability EBIT margin to assess the financial sustainability of the USO, we also consider other financial health indicators. The

relevant measures below are in relation to the wider Royal Mail Group,<sup>81</sup> rather than the Reported Business, as this is the entity which manages the cash for all the Group companies and business, is listed on the stock market, and the investors invest in or lend funds to.

5.24 In the March 2017 Statement,<sup>82</sup> we confirmed our decision to include a wider range of financial health metrics. This included indicators such as Standard & Poor’s (S&P) credit rating, Funds from Operations (FFO)/Adjusted Net Debt, and metrics underpinning covenants on borrowing assessed at Royal Mail Group level, to give us a better understanding of the short to medium-term financial sustainability of the universal service. We discuss each metric below.

## Cash flow and cash headroom

**Figure 5.7: Royal Mail Group free cash flow\***



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Free cash flow: net cash flow before financing activities (except finance costs paid), less the net cash purchase/sale of financial asset investments, including profit on disposal of properties

\*\* 53-week year (unadjusted)

5.25 Cash flow is an important component in ensuring the financial sustainability of the universal service. In 2019-20, free cash flow of the Royal Mail Group increased to an inflow of £653m, see Figure 5.7 above. The main drivers for this were trading working capital inflow, lower capital expenditure, and higher profits from the disposal of properties.<sup>83</sup>

5.26 During the year Royal Mail renewed its revolving credit facility, which is the overdraft loan facility provided by a syndicate of banks. The total available facility was revised down from £1,050m to £925m. The maturity date of the facility was extended to September 2024 with

<sup>81</sup> Royal Mail Group is made up of the Reported Business, as well as a number of other entities including ParcelForce Worldwide (PFW) and GLS. The Reported Business and PFW are reported in Royal Mail Group annual report as part of UKPIL.

<sup>82</sup> Ofcom, 2017, Review of the Regulation of Royal Mail, paragraph 3.63.

<sup>83</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 48. Royal Mail proposed no dividend for 2019-20, however the cash benefit for this will not be seen until 2020-21.

options to extend for a further two years.<sup>84</sup> This facility was approximately two-thirds drawn at 29 March 2020.<sup>85</sup>

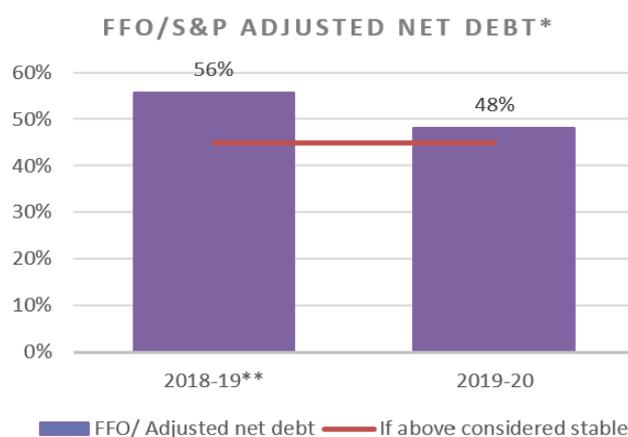
5.27 In addition, on 8 October 2019, Royal Mail issued €550m of Guaranteed Notes with an interest rate of 1.25% a maturity date of 8 October 2026. This was in addition to its €500m Eurobond with an interest rate of 2.375% and maturity date of 29 July 2024.<sup>86</sup>

5.28 As a result of the above, Royal Mail Group had a significant cash headroom<sup>87</sup> of £1.9bn as at 29 March 2020.<sup>88</sup> This cash can be drawn upon depending on business needs.<sup>89</sup>

## Funds from Operations/Adjusted Net Debt

5.29 FFO/Adjusted Net Debt looks at the ability of an entity to pay off its debt relying on its operating income alone and is one of the key metrics that S&P uses to assess the credit worthiness of Royal Mail Group. As part of its assessment, S&P reviews Royal Mail Group’s historical and forecast performance against this and other metrics. Royal Mail has also informed us that this is a key metric that it monitors. Royal Mail Group’s FFO/S&P adjusted net debt<sup>90</sup> of 48%<sup>91</sup> in 2019-20 just exceeds the 45% threshold which is considered to be stable by S&P (see Figure 5.8 below).

**Figure 5.8: FFO/Net Debt**



\*S&P make certain adjustments to Royal Mail’s reported net debt. S&P ratings methodology can be found on its website.

<sup>84</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 46.

<sup>85</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 46.

<sup>86</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 46.

<sup>87</sup> The cash headroom is the difference between the available cash resources and required cash resource i.e. total undrawn committed borrowing facility less the amount utilised plus the available cash less the loan-to-value (LTV) constraint.

<sup>88</sup> The syndicated bank loan facility was amended in September 2019 and its maturity date extended to September 2024, with options to extend for a further two years.

<sup>89</sup> Royal Mail also received approval for the Covid-19 Corporate financing facility of up to £600m, Royal Mail PLC, 2020. Annual Report and Financial Statements for the full year ended 29 March 2020, page 174

<sup>90</sup> S&P have a specific method which is used to calculate net debt for the purpose of this ratio, these calculations are available for subscribers to the S&P Ratings Direct service.

<sup>91</sup> S&P Rating Direct, 2020, Royal Mail plc (LSE:RMG), CreditStats Direct ® Select stats and Ratios, FFO/Debt (%) for 12 month ended 31 March 2020.

<https://www.capitaliq.com/CIQDotNet/Financial/SelectStatsAndRatios.aspx?CompanyId=876551&mode=creditstatsdirect>

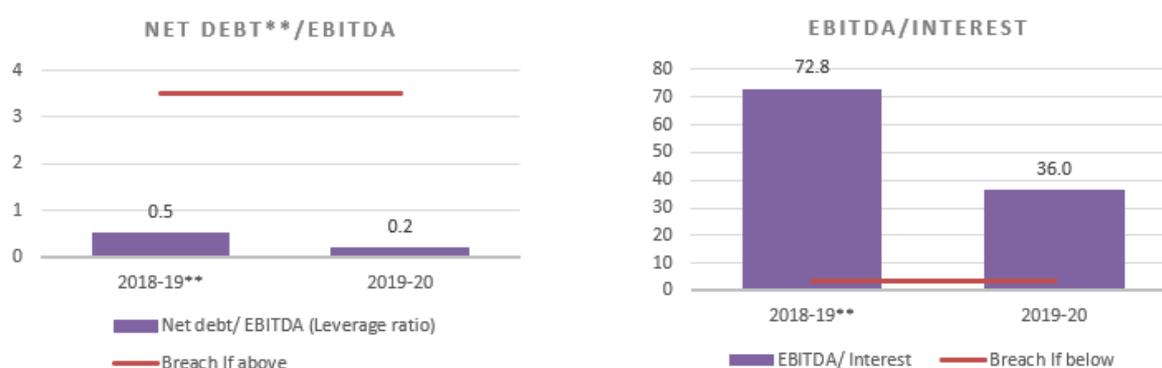
5.30 S&P’s latest credit research affirmed Royal Mail Group’s credit rating at BBB but revised the outlook to negative as it considered Royal Mail's operating profits and cash flows will decline materially in the fiscal year ending 28 March 2021. S&P believed that cash preserving and cost containment measures announced by Royal Mail’s management may not be enough to offset the decline in earnings and prevent an increase in leverage from its current low level in the short term. S&P expect Royal Mail's credit metrics to deteriorate in the fiscal year 2020-21, before recovering in the fiscal year 2021-22. However, uncertainty remains over the timing and magnitude of the general economic recovery.<sup>92</sup> S&P categorised Royal Mail Group as modest risk from a financial risk viewpoint as its FFO/Adjusted Net Debt percentage was in the range of 45-60%.<sup>93</sup>

## Loan covenants

5.31 The Net Debt/EBITDA (leverage ratio) and EBITDA/Interest (interest cover) metrics are used to assess compliance with covenants relating to Royal Mail Group’s revolving credit facility. The leverage ratio metric helps assess the Group’s ability to repay its debts using its operating profits (measured before non-cash elements of depreciation and amortisation). It broadly represents the number of years of annual profit required to repay all of the company’s net debt. The interest cover metric is used to assess how easily Royal Mail Group can pay interest on its outstanding debt. Royal Mail Group’s loan covenants require its leverage ratio to remain below 3.5 and its interest cover to remain above 3.5.

5.32 Royal Mail Group passed its loan covenants in 2019-20 (as shown in Figure 5.9 below).<sup>94</sup>

**Figure 5.9: Loan covenants**



Source: FFO/Net Debt - S&P Ratings Direct and EBITA ratios - Royal Mail Annual Report and Accounts (page 213)

\*\* 53-week year (unadjusted)

<sup>92</sup> Alacra Store, 2020. S&P Global Ratings’ Credit Research: Royal Mail Plc. <http://www.alacrastore.com/company-snapshot/Royal-Mail-PLC-8979044>

<sup>93</sup> S&P Ratings Direct, 2013. Corporate methodology, page 35. <https://www.spratings.com/scenario-builder-portal/pdf/CorporateMethodology.pdf>.

<sup>94</sup> Royal Mail PLC, 2019. Annual Report and Financial Statements for the full year ended 29 March 2020, page 213.

- 5.33 The fall in the EBITDA/Interest metric is mainly due to a fall in the profitability and EBITDA of Royal Mail Group.
- 5.34 Royal Mail Group has renegotiated the covenants on its revolving credit facility with its syndicated banks until March 2022 and replaced the covenants with a minimum liquidity covenant of £250m.<sup>95</sup> This was in light of the developing economic situation due to Covid-19.

## Viability Statement

- 5.35 In addition to the above financial health metrics, we also have regard to Royal Mail Group's Viability Statement as published in its Annual Report and Financial Statements. Under the 2014 Corporate Governance Code, directors are required to make a statement that they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary. In order to do this, they must take into account the company's current position and principal risks. Here we lay out the broad themes Royal Mail's directors considered and the conclusion to their assessment.
- 5.36 In its Annual Report and Financial Statements for the year ended 29 March 2020, which was published on 17 July 2020, Royal Mail Group explained that it stress-tested the key assumptions within its detailed annual forecasts, projected performance to March 2023 and quantified any risks to create a downside scenario.<sup>96</sup> It concluded that the business was viable even against the severe but plausible downside they identified.
- 5.37 Key risks considered by the directors of Royal Mail Group included a second wave of Covid-19 resulting in a three-month lockdown, deteriorating economic and market conditions, Brexit transition ending without a trade deal, increased competition in the parcels sector, potential industrial action and delays to the UK transformation plan. The downside scenario took into account committed capital and expenditure, as well as other short-term costs and cash actions which would mitigate the impact of risks.
- 5.38 Based on the results of their analysis, the directors explained that they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2023.

## Summary

- 5.39 In summary, the key trends for the 2019-20 financial year were:
- Reported Business addressed letter volumes and revenues declined by 7.6% and 2.9% respectively. This was due to an acceleration of the ongoing structural decline, weak economic activity and ongoing business uncertainty. Letter volume decline was offset in part by price rises.

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<sup>95</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 174.

<sup>96</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 73.

- Total parcel volumes and revenues grew by 2.0% and 5.4% respectively year-on-year, largely driven by a growth in domestic account parcels.
- Overall, Reported Business revenues increased by 1.8% as the European and General elections, supplemented by price changes and a change in mix towards parcels, offset the effect of addressed letter volume decline.
- Reported Business costs increased by 3.2% year-on-year due to an increase in people costs of 3.9%, an increase in non-people costs of 2.0%, and a decrease in transformation costs of 1.6%.
- As a result of the trends noted above, the financeability EBIT margin decreased from 1.6%<sup>97</sup> to 0.4% in 2019-20.
- Free cash flow turned positive to £653m. As at 29 March 2020, Royal Mail Group had access to c. £1.9bn of funds, including its banking facilities.
- Royal Mail Group's FFO/S&P adjusted net debt ratio of 48%<sup>98</sup> in 2019-20 just exceeds the 45% threshold which is considered to be stable by S&P. It also passed its loan covenants in 2019-20.
- In Royal Mail Group's Viability Statement, the directors have said they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2023.

- 5.40 We consider that the short-term indicators of financial sustainability show that the universal service is likely to be sustainable in the short term. This is because the Group's financial health metrics do not indicate any short-term financial health issues. It had significant cash headroom as at the end of 2019-20 and the Group's overall profitability has been supported by the strong performance of GLS, its international parcels business.
- 5.41 Our view on sustainability in the short term has not altered during the first half of 2020-21, despite Covid-19 having had mixed impacts on the business and causing increased uncertainty about the future.
- 5.42 However, the downward trend in the Reported Business's EBIT margin in recent years is of concern, as we consider that the EBIT margin provides us with an indicator of the longer-term sustainability of the universal postal service. Of most concern is that reductions in letter revenues in recent years, primarily due to declining letter volumes, have not been offset by corresponding reductions in costs and efficiency improvements.
- 5.43 Over the last few years there has been a growth in parcel volumes<sup>99</sup>, which presents an opportunity for Royal Mail. We consider that the longer term sustainability of the universal service is dependent on Royal Mail's ability to fully realise this opportunity, ensuring it is modernising its network, improving efficiency and controlling costs.

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<sup>97</sup> 2018-19 figures are on a 52-week basis.

<sup>98</sup> S&P Rating Direct, 2020, Royal Mail plc (LSE:RMG), CreditStats Direct ® Select stats and Ratios, FFO/Debt (%) for 12 month ended 31 March 2020.

<sup>99</sup> This has accelerated in the first half of 2020-21 as we discuss in Section 8 which summarises the impacts of Covid-19 on the postal sector.

5.44 Royal Mail set out its ambition to transform its parcel operation in May 2019 and we set out progress against some of the initiatives, along with our view on the efficiency performance, in the following section.

## 6. Efficiency performance

- 6.1 This section summarises the efficiency performance of Royal Mail's Reported Business in the financial year 2019-20, including comparisons to 2018-19 and other prior years.
- 6.2 We outline the information which informs our view of the efficiency of Royal Mail's provision of the universal postal service. In particular, we discuss:
- Why efficiency is an important aspect of our monitoring regime;
  - Our estimate of Royal Mail's efficiency performance in 2019-20;
  - Royal Mail's views on its efficiency;
  - Royal Mail's progress against its strategic transformation plan; and
  - A comparison against international postal operators
- 6.3 While Royal Mail has made some improvements, notably an increase in parcel automation from 12% to 33%, efficiency achievements continue to be disappointing. The ambition set out at the start of 2019-20 to transform the business, including making significant productivity improvements, has yet to be realised. We are concerned that many of the enablers of efficiency improvements identified by Royal Mail are behind schedule and have yet to be implemented.
- 6.4 Efficiency performance continues to be of concern, as efficiency, alongside modernising the network, is critical to the longer-term sustainability of the universal service.

### Efficiency is an important aspect of our monitoring regime

- 6.5 In discharging our duties in relation to post, we monitor the efficiency of the Reported Business. The Postal Services Act 2011 requires us to have regard to the need for the provision of a universal service to be financially sustainable, and for it to become efficient within a reasonable period and then remain efficient at all subsequent times.
- 6.6 In the March 2017 Statement<sup>100</sup>, we decided against the imposition of additional price controls or efficiency targets on parts of Royal Mail's business. In reaching this view, we considered Royal Mail's efficiency performance and the incentives on Royal Mail to make further efficiency improvements in the future. We also highlighted the importance of our monitoring regime in providing a safeguard. We will review our approach to efficiency as part of our review of the future regulatory framework for post, which we expect to conclude in 2022.

### Indicators of Royal Mail's efficiency performance

- 6.7 In the March 2017 Statement, we set out the metrics and framework we proposed to adopt to monitor Royal Mail's efficiency performance.

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<sup>100</sup> Ofcom, 2017, Review of the Regulation of Royal Mail.

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0033/97863/Review-of-the-Regulation-of-Royal-Mail.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0033/97863/Review-of-the-Regulation-of-Royal-Mail.pdf).

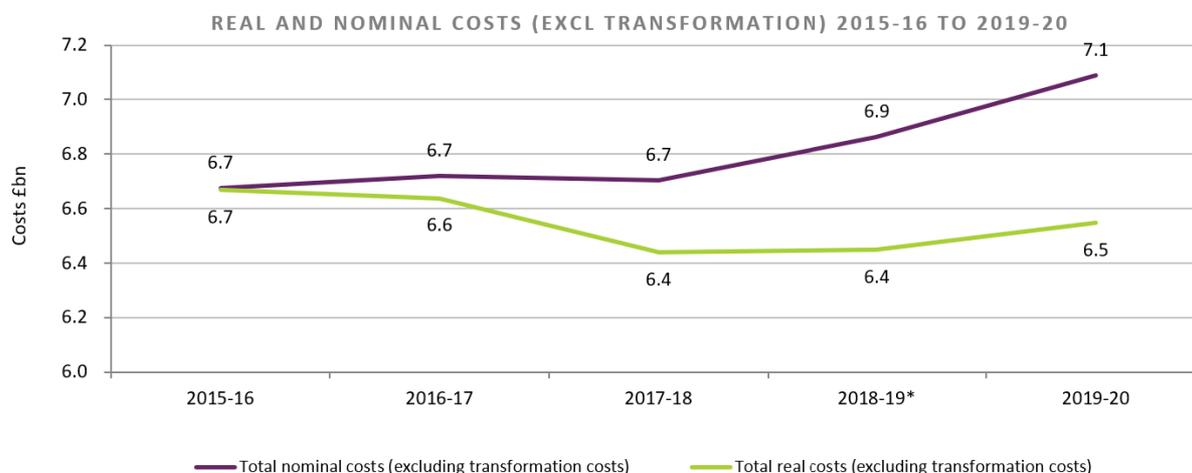
6.8 Here we report on the following high-level indicators of efficiency:

- a) the overall change in real costs, which provides a high-level simplified view of efficiency;
- b) Price, Volume, Efficiency and Other (PVEO)<sup>101</sup> analysis, which provides a measure of efficiency by disaggregating movements in costs in terms of price changes (i.e. cost inflation), volume effects, efficiencies achieved, and other one-off costs;
- c) frontline gross hours in delivery and processing<sup>102</sup>, which captures year-on-year changes in paid hours. These will change as a result of volume changes as well as efficiency; and
- d) productivity, which is the ratio of workload (weighted volumes) to frontline gross hours.

### Overall change in real costs<sup>103</sup>

6.9 Real costs (excluding transformation costs)<sup>104</sup> increased by 1.4% in 2019-20, so no real cost savings were realised (Figure 6.1 below). Section 5 on financial performance provides more discussion on the cost movements driving this result.

**Figure 6.1: Total real and nominal costs (excluding transformation costs) from 2015-16 to 2019-20**



Source: Royal Mail Regulatory Financial Statements and Ofcom analysis

\* Adjusted to 52 weeks

<sup>101</sup> PVEO analysis provides a measure of efficiency by disaggregating movements in costs in terms of price changes (i.e. cost inflation), volume effects, efficiencies achieved and other one-off costs.

<sup>102</sup> Gross hours are the hours paid for by Royal Mail for its frontline delivery and processing activities, which account for the majority of people costs and include both worked hours and paid absences such as sickness and leave. The gross hours metric captures year-on-year changes in hours worked as a result of volume changes as well as efficiency.

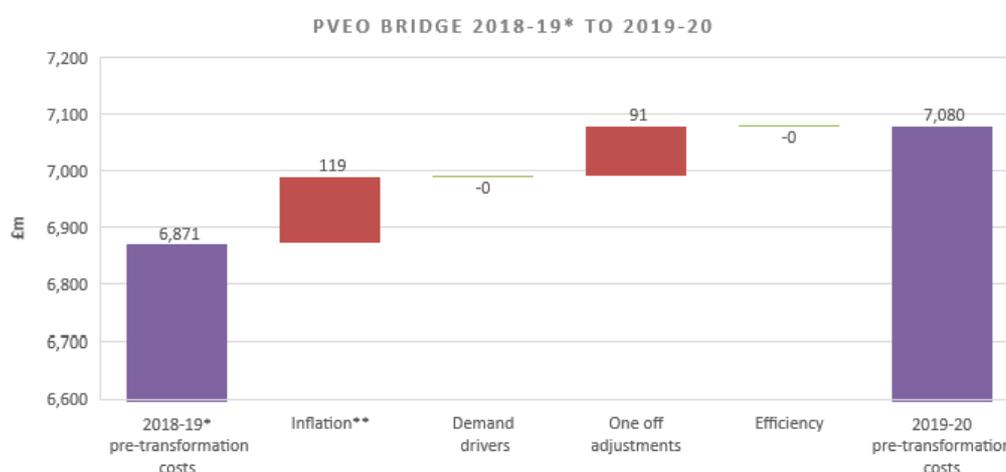
<sup>103</sup> Total costs (excluding transformation costs) have been adjusted by CPI based on 2014-15 values. Annual CPI change calculated based on average monthly CPI across financial year April to March.

<sup>104</sup> Real cost reduction provides a high-level simplified view of efficiency, as cost changes due to volume and one-off costs are not adjusted for in this metric.

## Price, Volume, Efficiency and Other (PVEO) Analysis

- 6.10 Royal Mail achieved no efficiencies in 2019-20 according to our PVEO analysis<sup>105</sup> (Figure 6.2 below). This is a slight improvement on the inefficiency of 0.6% in 2018-19, but this is the second consecutive year that Royal Mail has struggled to achieve any efficiency improvement.
- 6.11 Frontline pay increased due to the October 2019 pay rise of 5% and the impact of the shorter working week (details in paragraph 6.12 below) and this was not fully offset by hours reductions. However, this increase in frontline people costs was offset by savings in other staff. Non-people costs showed a slight inefficiency of 0.1%.

**Figure 6.2: PVEO bridge 2018-19\* to 2019-20**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

\*\*ONS 12-month trailing average CPI figures (April to March)

## Frontline gross hours (delivery and processing)

- 6.12 In October 2018, Royal Mail reduced the weekly contract of full-time staff from 39 hours to 38 hours at the same pay. This is known as the Shorter Working Week (SWW)<sup>106</sup>. This effectively increased the hourly full time pay rate by 2.6%<sup>107</sup> and was in addition to the

<sup>105</sup> Our analysis assumes an inflation index of CPI across all costs. Cost movements due to volume (demand drivers) apply to a subset of the total cost base: frontline costs of delivery and processing, payments to Post Office Limited (POL) and international terminal dues. Change in frontline costs due to volume are calculated based on the year-on-year change in workload using Ofcom's methodology. The remainder of costs are considered to be fixed. Efficiency is calculated to be the residual cost movement once price, inflation, volume and one-off items have been taken into account.

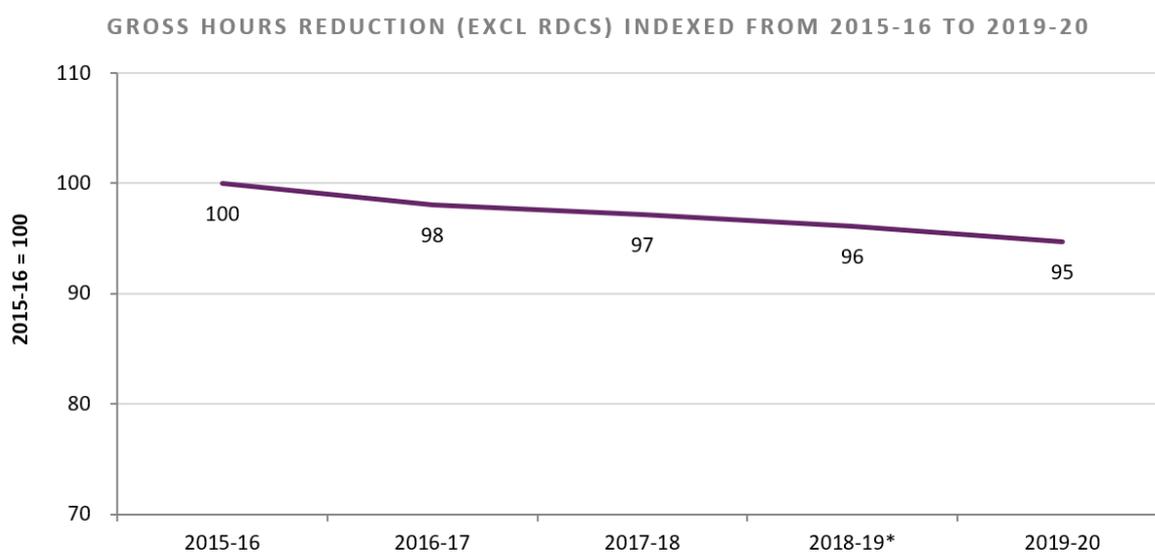
<sup>106</sup> The SWW was introduced as part of the Pension, Pay and Pipeline Agreement. The agreement included a 5% pay increase and a reduction in the weekly contract. The 2019-20 impact of the SWW was a 1.3% reduction in full time ordinary hours at the same pay, hence it resulted in an increase in the hourly rate paid. The implementation of the SWW, as part of the Pay, Pension and Pipeline agreement, was expected to accelerate efficiency savings to partly offset the additional cost.

<sup>107</sup> 2.6% can be derived from the change in the ratio of hours i.e. 39 / 38 - 1

April 2019 pay rise. The timing of the change meant that the impact of the contract change was split across 2018-19 and 2019-20 and was approximately equivalent to both a 1.3% p.a. increase in hourly pay rate and a 1.3% p.a. reduction in contracted full-time hours.

- 6.13 In 2019-20, there was a total gross hours<sup>108</sup> reduction in delivery and processing of 1.5%<sup>109</sup>, slightly improved from the reduction of 1.2% in 2018-19, on a 52-week basis.
- 6.14 Both of these years include the enabler of hours reductions due to the SWW. However, Royal Mail has failed to “obtain all the cost saving measures to pay for it”.<sup>110</sup> Figure 6.3 below shows the indexed gross hours reduction in delivery and processing that Royal Mail achieved between 2015-16 and 2019-20.

**Figure 6.3: Gross hours reduction (excluding RDCs) indexed from 2015-16 to 2019-20**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

## Productivity

- 6.15 Productivity is a measure of efficiency which captures the rate of doing work. Royal Mail uses a productivity metric to record and manage its operational performance. The metric adopted is calculated as the ratio of workload (weighted volumes) to gross hours (gross

<sup>108</sup> Gross hours are the hours that Royal Mail pays its frontline staff and include paid absences such as annual leave, as well as the hours spent working.

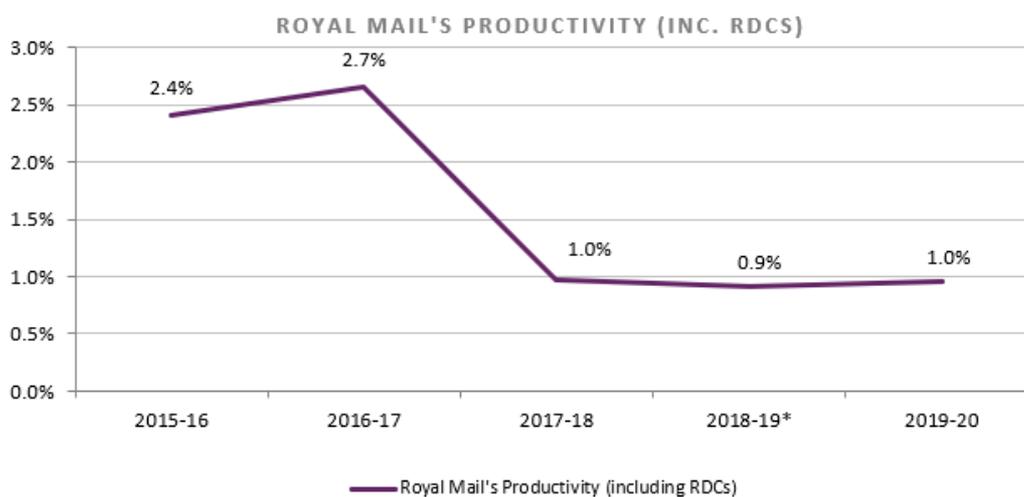
<sup>109</sup> Royal Mail now includes hours related to centrally held hours, not attributable to a function, and regional distribution centres (RDCs) in its total hours’ calculation. To present data on a consistent basis, we have excluded these hours from the calculation. If we were to include them in 2019-20, total hours would have decreased by 1.4% on 52-week basis, as stated by Royal Mail. These hours represent a small percentage of total hours and therefore do not influence the calculation significantly.

<sup>110</sup> Royal Mail PLC, 2020. Annual Report and Financial Statements for the full year ended 29 March 2020, page 22. Royal Mail stated, “We implemented the first hour’s reduction of the Shorter Working Week, although we did not obtain all the cost saving measures to pay for it”.

hours include worked hours and non-working paid absences for sickness, annual leave etc.).<sup>111</sup>

- 6.16 Royal Mail set out at the start of the year that its focus for 2019-20 would be on making productivity improvements. In the previous year it said productivity had slowed, “due to the absence of both new working tools and network enhancements”.<sup>112</sup> Royal Mail said it would return to greater than 2% productivity in 2019-20 and productivity would accelerate from 2020-21 onwards.<sup>113</sup>
- 6.17 Royal Mail did not achieve its target. Its estimated productivity improvement was 1.0% for 2019-20<sup>114</sup>, see Figure 6.4 below. Royal Mail stated that this was due to necessary additional investment to protect quality of service<sup>115</sup>, which included increased levels of temporary staff during the General Election and over the Christmas period, and to support high absence rates due to the onset of Covid-19 in March 2020.

**Figure 6.4: Productivity gains 2015-16 to 2019-20**



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

\* Adjusted to 52 weeks

## Royal Mail’s own statements on efficiency

- 6.18 Royal Mail’s public statements on efficiency performance reference cost avoidance as well as hours reductions and productivity (both of which were discussed earlier in this section).

<sup>111</sup> Royal Mail PLC, 2019. Annual Report and Financial Statements for the full year ended 31 March 2019, page 38. Defined as ‘Percentage change year-on-year in the number of weighted items per gross hour paid in Delivery Units and Mail Centre Units (delivery and processing, including regional logistics and collections) and Regional Distribution Centres’.

<sup>112</sup> Royal Mail PLC, 2019. Annual Report and Financial Statements for the full year ended 31 March 2019, page 65.

<sup>113</sup> Royal Mail PLC, 2019, Royal Mail PLC, Full year 2018-19 results and strategy presentation “Journey 2024”, 22 May 2019, page 84.

<sup>114</sup> Royal Mail’s estimate of productivity improvement, excluding RDCs, was 0.8% for 2019-20.

<sup>115</sup> Royal Mail PLC, 2020, Annual Report and Financial Statements for the full year ended 29 March 2020, page 7.

- 6.19 Cost avoidance is a measure of savings made relative to expected cost increases. It therefore includes an element of judgement as to the level of costs that would have been incurred had action not been taken.
- 6.20 Royal Mail's costs avoidance guidance for UKPIL for 2019-20 was £150-200m.<sup>116</sup> In its full year results announcement, Royal Mail said that it was able to avoid costs of £188m in line with its guidance range. Royal Mail stated that, "This was largely driven by a reduction in core network hours including the partial absorption of the one hour reduction in the working week, management headcount reduction arising from the organisational structure review at the end of 2018-19, supplier contract renegotiations and the annual linehaul review".<sup>117</sup>
- 6.21 Since its announcement of the transformation plan, "Journey 2024", in May 2019, Royal Mail has provided updates on progress against the milestones within it, many of which are enablers of efficiency improvements. We outline the transformation plan and Royal Mail's progress in achieving it below.

## Royal Mail's Transformation programme

- 6.22 In May 2019, Royal Mail announced a strategy to transform its business. The plan was to drive forward UK revenue growth from parcels, while containing costs. The strategy outlined a focus on efficiency in its UK operation enabled by both a network and digital transformation.
- 6.23 In particular, Royal Mail has explained that increased use of digital technology and data, will allow it to improve its existing processes and increase productivity. For example, it has suggested that the introduction of an automated hours system (which records total hours worked) and the ability to record hours spent on outdoor delivery will ensure resource can be planned, and delivery routes updated, to support demand. The use of barcodes could also support both tracking of product journeys and more accurate billing, improving revenue integrity and quality of service.<sup>118</sup>
- 6.24 The network redesign would lead to greater separation of the letter and parcel operation; with large, tracked and late acceptance parcels being processed via three new automated parcel hubs and delivered using a new dedicated van delivery network, eliminating a sortation step. Smaller parcels would follow existing processes but would benefit from increased automation at Royal Mail's mail centres.<sup>119</sup>
- 6.25 The expectation was that the initial period would set the foundations for future change. Royal Mail's ambition was that by the end of 2020 it would have completed the roll out of

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<sup>116</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, page 7

<sup>117</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, page 39

<sup>118</sup> Royal Mail PLC, 2019, Full year 2018-19 results and strategy presentation "Journey 2024", 22 May 2019, page 91.  
<https://www.royalmailgroup.com/media/10705/fy-2018-19-results-and-strategy-presentation.pdf>

<sup>119</sup> Royal Mail PLC, 2019, Full year 2018-19 results and strategy presentation "Journey 2024", 22 May 2019, page 96.  
<https://www.royalmailgroup.com/media/10705/fy-2018-19-results-and-strategy-presentation.pdf>

small parcel sorting machines, have the first parcel hub in place, have undertaken delivery trials and also improved its productivity and quality of service performance.<sup>120</sup>

- 6.26 Progress against these objectives has been limited. There have been delays and changes to the original plan. In its annual report of 2019-20 Royal Mail stated that, “There is a risk we will not be able to deliver our transformation programme and meet our required cost avoidance and productivity improvement targets during the life of the plan”.<sup>121</sup> Below we set out a brief overview of the progress made.
- 6.27 Additionally, Royal Mail has stated that it has undertaken a review of capital expenditure. As a result, spend across 2020-21 and 2021-22 will reduce by around £250m. This is from the cancellation and deferral of projects, although Royal Mail has stated that it remains committed to the transformation plan<sup>122</sup>.

## Increasing the use of Data and Technology

- 6.28 A key enabler of efficiency improvements outlined by Royal Mail was the use of new digital tools. These are summarised, together with our understanding of the progress to date, in Table 6.5:

**Table 6.5 – Progress update for Royal Mail’s Data and Technology transformation initiatives**

Initiative	Overview	Progress in 2019-20
<b>Postal digital assistants Outdoor Actuals (“PDA OA”)</b>	PDA’s capture hours worked in outdoor delivery. This information can then be used to make changes, such as updating routes.	PDA Outdoor Actuals deployed and increasingly utilised. <sup>123</sup>
<b>Auto Hours Data Capture (“AHDC”)</b>	AHDC is a digital system which captures actual hours worked. It would replace handwritten sign-on.	Deployment of AHDC was behind schedule in 2019-20. It remains in discussion between CWU and management.
<b>Final Mile Optimisation (“FMO”)</b>	FMO is a digital tool to optimise delivery and collection planning (incl. route planning) as it improves the visibility of changes to delivery routes.	Royal Mail have completed the deployment of the route optimisation tool. It is used to undertake delivery revisions. <sup>124</sup>

<sup>120</sup>Royal Mail PLC, 2019, Full year 2018-19 results and strategy presentation “Journey 2024”, 22 May 2019, page 98 <https://www.royalmailgroup.com/media/10705/fy-2018-19-results-and-strategy-presentation.pdf>

<sup>121</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, page 64

<sup>122</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, page 10

<sup>123</sup> Royal Mail PLC, 2020, Full Year 2019-20 Results and Business Update 25 June 2020, page 34,

<https://www.royalmailgroup.com/media/11198/royal-mail-group-fy2019-20-results-presentation.pdf>

<sup>124</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, page 20.

## Delivery Revisions

6.29 Delivery revisions are changes to delivery routes using information gathered from data analytics tools to realise efficiency savings. As the level of traffic and mix of products changes, these revisions can be made to allow resources, people and vehicles, to be matched to demand. In 2019-20 Royal Mail implemented 73 delivery revisions and stated that it is targeting a further 300 in 2020-21. The implementation of and process for delivery revisions is one of the areas under discussion between management and the union.

## Parcel Hubs and Small Parcel Automation

6.30 Royal Mail set out a plan to significantly increase parcel sortation automation over the five-year period to 2023-24 (from 12% to over 80%). In 2019-20, ten additional parcel machines were installed, bringing the total to 20 machines across 16 mail centres. This increased the percentage of parcels sorted by machine to 33% at the end of 2019-20, close to three times the average number sorted automatically during 2018-19.<sup>125</sup>

6.31 However, the rollout of the first automated parcel hub is a year behind schedule. The first hub is now due to open in Warrington around March 2022. Royal Mail has also reached an agreement on the land for the Midlands hub in Daventry, but it is behind schedule. The expectation is now that two, rather than three hubs, will be required.<sup>126</sup>

## Dedicated parcel routes

6.32 The rollout of dedicated parcel routes was due to be trialled up to 2020 before being rolled out across 200-300 delivery offices, with an expectation that 7,000 dedicated delivery routes would be required<sup>127</sup>. In January 2020, Royal Mail launched a van-based trial to test a separate daily delivery of larger parcels and Next Day items. The trial began in Swindon and was expanded to a small number of additional sites. These trials are ongoing<sup>128</sup> and their implementation is one of the areas under discussion between management and the union.<sup>129</sup>

## International Benchmarks

6.33 In autumn 2019, Ofcom commissioned WIK-Consult to conduct a study to examine the operation and efficiency of five comparable postal operators to Royal Mail (Deutsche Post DHL, PostNL, LaPoste, PostNord Denmark and PostNord Sweden). WIK then conducted a high-level comparison of these operators to Royal Mail.

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<sup>125</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, page 20.

<sup>126</sup> Royal Mail PLC, 2020, Full year 2019-20 Results and Business update Transcript, page 21,

<https://www.royalmailgroup.com/media/11236/fy-2019-20-results-and-business-update-transcript.pdf>

<sup>127</sup> Royal Mail PLC, 2019, Full year 2018-19 results and strategy presentation "Journey 2024", 22 May 2019, pages 12 and 39, <https://www.royalmailgroup.com/media/10705/fy-2018-19-results-and-strategy-presentation.pdf>

<sup>128</sup> Royal Mail PLC, 2020, Annual Report and Financial Statement for the full year ended 29 March 2020, Page 20.

<sup>129</sup> <https://www.cwu.org/lfb/lfb-459-20-joint-statement-pay-and-shorter-working-week/>

6.34 The report found that Royal Mail was behind these European peers in terms of parcel automation. It also found that greater separation of letter and parcel activity, and the use of parcel hubs, were methods of operation which had widely been adopted by Royal Mail’s European peers. As outlined in the sub-section on transformation, Royal Mail is proposing to adopt these measures; opening parcel hubs and separating out the delivery of larger parcels.

6.35 Table 6.6 compares the levels of automatic sortation across the operators, distinguishing between the size of parcels for which automation is available. It also shows the level of sortation adopted, with some carriers sorting parcels to the level of postal rounds.

**Table 6.6 – Automation in parcel sorting by operator (2019)**

	Deutsche Post	La Poste	PostNL	PostNord DK	PostNord SE	Royal Mail <sup>130</sup>
Automated sorting of parcels (all sizes)	●	●	●	●	●	◐
Automated sorting of small parcels	●	n/a	●	●	●	◐
Sorting of parcels to the drivers’ round	◐	◐	●	●	●	○

Notes: ○ - not applied, ◐ - partly applied, ● - largely applied (>90% of parcels).  
n/a: information not available.

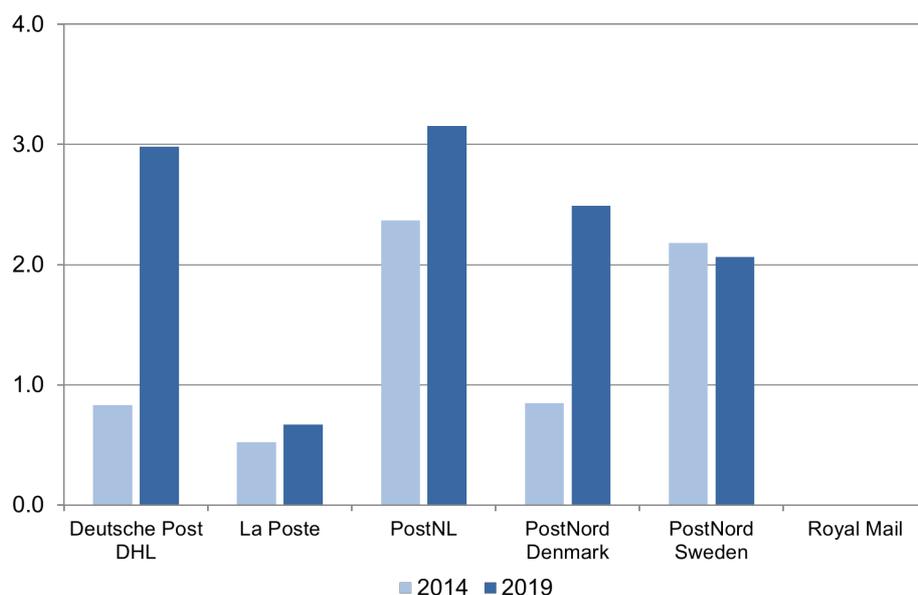
6.36 The table shows Royal Mail’s peers have high levels of automation in parcels across all sizes. Royal Mail has been late to invest in this area, beginning the year with only 12% parcel automation. But it has made some recent progress, and the ambition from its transformation plan is to bring this to 80%, more in line with these European peers.

6.37 Royal Mail’s approach to small parcel sortation aligns with its peers whereby priority has been given to achieving small parcel sortation. This is due to the large growth in this type of parcel and the fact that small format parcel sorters have a smaller footprint and a higher processing rate than sorters for large format items. Machines are either placed in letter sorting centres (e.g. PostNord Sweden, Deutsche Post DHL and Royal Mail) or in parcel specific sorting centres. PostNL is planning a dedicated sorting centre only for small format parcels.

6.38 Figure 6.7 shows the rollout of parcel specific sorting centres or hubs, which are critical to meet customer demand for next day (or even faster) delivery. The hubs process parcel volumes, adopting a hub and spoke model to connect directly to delivery offices. PostNL does not apply a hub and spoke model - its parcel specific sorting centres combine the sorting and the delivery function.

<sup>130</sup> Excluding Parcelforce.

**Figure 6.7 – Parcel specific sorting centres (hubs) per one million households by operator**



Source: WIK-Consult (2016), WIK research and interviews.

Note: Deutsche Post & La Poste includes mechanised parcel delivery offices.

6.39 Royal Mail still remains reliant on a traditional model where parcels are mainly delivered through its letters network rather than through a discreet hub network directly connecting with delivery offices. However, its transformation plan sets out the objective to develop its operation in this way.

## Summary

6.40 In summary, whilst Royal Mail did improve its performance against some of our efficiency metrics in 2019-20, we continue to be disappointed by its overall efficiency performance. Considering its performance against 2018-19 on a 52-week basis:

- Total real costs for the Reported Business increased by 1.4% against an increase of 0.1% in the prior year.
- The PVEO analysis indicates no underlying efficiency (excluding transformation costs) against a 0.6% inefficiency in the prior year.
- Royal Mail reduced frontline gross hours in delivery and processing by 1.5%, higher than the reduction of 1.2% in the prior year.
- Royal Mail's estimate of productivity improvement was 1.0%<sup>131</sup>, below its target of above 2%.
- Royal Mail achieved cost avoidance of £188m against a target range of £150-200m.

<sup>131</sup> Royal Mail includes RDCs in its calculation of productivity whereas Ofcom's estimate of productivity does not. Excluding RDCs, Royal Mail's estimate of productivity improvement was 0.8% for 2019-20.

- 6.41 The comparisons with European benchmarks indicate that Royal Mail's transformation plan would bring it more closely in line with the parcel operation and levels of automation of its European peers, against which it is currently behind.
- 6.42 While there has been some progress around Royal Mail's transformation journey, in particular, the rollout of automated parcel sortation, progress in other areas has been limited. Meanwhile productivity targets, the focus of the early part of the plan, have been missed. There have been delays with the proposed parcel hubs, and Royal Mail's management and union continue to struggle to reach agreement on details surrounding the use of data tools and other aspects of implementation of the transformation plan. Additionally, there is a reduction in the capital expenditure budget for 2020-21 and 2021-22 due to the deferral and cancellation of projects.
- 6.43 In summary, efficiency progress has been limited and continues to be of concern, as efficiency is critical to the longer-term sustainability of the universal service. The transformation plan sets out ambitions to improve, but the timings and likelihood of this being achieved are unclear.

## 7. Regulatory compliance

- 7.1 As part of its role as the designated universal service provider, Royal Mail is subject to a set of minimum requirements and service standards in the provision of universal services. In this section we discuss Royal Mail's compliance with its regulatory obligations, including its obligations to:
- a) maintain delivery (to all UK addresses) and collection (from all access points<sup>132</sup>) of letters (six days a week) and parcels (five days a week);
  - b) provide services at affordable prices under uniform public tariffs to all UK addresses and comply with safeguard price caps;
  - c) consult on changes to non-price terms and conditions;
  - d) meet quality of service performance standards; and
  - e) report on the most common causes for complaint and, where relevant, provide appropriate compensation.
- 7.2 In this section, we also discuss recent enforcement action taken by Ofcom.

### Universal service delivery and collections

- 7.3 Royal Mail is required to collect and deliver letters six days a week, and parcels five days a week, to all UK addresses as part of the universal service. Royal Mail may only depart from these requirements in exceptional circumstances and, given the impact on consumers, we have put in place rules to limit the application of these exceptions.
- 7.4 These rules set the circumstances which we consider may be exceptional and in relation to which Royal Mail's universal service obligations do not need to be met. These include where there is a risk to the health and safety of postal staff, the delivery point is not sufficiently secure, and/or it is difficult to access the delivery point.<sup>133</sup> Where Royal Mail determines that such exceptional circumstances exist in relation to a given delivery point for a sustained period of time, it must carry out a review every 12 months.
- 7.5 To provide transparency, we also require Royal Mail to submit to Ofcom an annual report of the addresses of the delivery points in relation to which exceptional circumstances have persisted for 12 months or more and the relevant circumstances which Royal Mail considers justifies that exception. Royal Mail has published a non-confidential, summary version of this information on its website.<sup>134</sup>

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<sup>132</sup> As defined in section 29(11) of the Postal Services Act 2011, "'access point' means any box, receptacle or other facility provided for the purpose of receiving postal packets, or any class of postal packets, for onwards transmission by post".

<sup>133</sup> Ofcom, December 2013. [Direction relating to exceptions to the postal deliveries Universal Service Obligation and approval of alternative delivery points](#); Ofcom, December 2013. [Direction relating to exceptions to the postal collections Universal Service Obligation and minor amendment to Designated Universal Service Provider Condition 1](#).

<sup>134</sup> See Royal Mail's [USO Delivery Exceptions 2019-20 report](#).

- 7.6 A total of 3,820 delivery points were reported by Royal Mail to be subject to exceptional circumstances in its 2019-20 report, meaning that they are not able to receive deliveries to the frequency required under the universal service obligation.<sup>135</sup> There are around 30million delivery points in the UK, so excepted delivery points represent a very small proportion of the total footprint.
- 7.7 We have also put in place rules setting out the circumstances in which Royal Mail may except certain access points (typically postboxes or Post Offices) from collections. Royal Mail is required to review any ongoing collections exceptions every 12 months. Royal Mail has explained that, due to the impact of Covid-19, it has been delayed in collating this data. This means Royal Mail has not yet submitted this data to Ofcom or published a summary of it.
- 7.8 We will continue to monitor levels of both exceptions to delivery and collections as part of our wider monitoring programme.

## Pricing of universal services

- 7.9 In March 2012, Ofcom removed the majority of price controls to give Royal Mail commercial freedom to enable it to return the universal service to a financially sustainable position. At the same time, we introduced a number of safeguards, including a cap on the price of Second Class stamps (for letters, large letters and parcels up to and including 2kg) so that vulnerable consumers, in particular, remain able to access a basic universal service.
- 7.10 While the majority of the analysis in this report relates to 2019-20, the pricing information detailed below focuses on Royal Mail's pricing announcements for 2020-21, which is in line with previous monitoring updates. Page 10 of the Interactive Data shows historic trends in prices for letters and large letters, and page 11 shows historic trends for parcel prices.

## Standard letter stamp and meter prices

- 7.11 In March 2020, First Class stamp prices rose by 6p to 76p (an 8.6% increase) and meter<sup>136</sup> prices rose by 5p to 69p (a 7.8% increase), in nominal terms. In real terms this amounts to a 6.7% rise for stamp prices and 6% rise for meter prices.
- 7.12 Second Class stamp prices rose by 4p to 65p and meter prices rose by 3p to 50p. This represents a real terms increase of 4.7% for stamp prices and 4.6% for meter prices.

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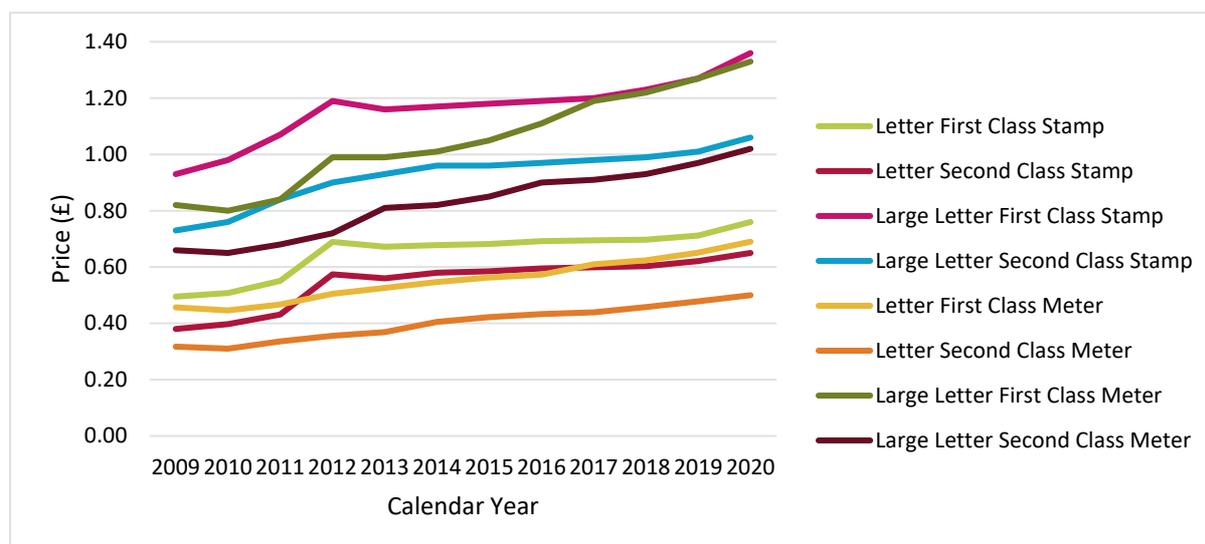
<sup>135</sup> Reported delivery exceptions may include delivery points that receive deliveries but on fewer days a week than required under the universal service obligations. This might be the case where, for example, an excepted delivery points is on an island where there is a ferry service only on certain days of the week. Reported delivery exceptions would also include delivery points where daily deliveries are made but to an alternative delivery point (i.e. to a secure box on the perimeter of an address rather than to a building where there may be access difficulties).

<sup>136</sup> Metered mail refers to a method of payment or payment channel for Royal Mail services where customers pre-pay for postage and apply an impression to the envelope, label or wrapper using a franking machine licensed by Royal Mail.

## Large letter stamp and meter prices

- 7.13 There are four weight steps for large letters: 0-100g, 101-250g, 251-500g and 501-750g. Prices rose in real terms across all weight steps in March 2020.<sup>137</sup>
- 7.14 For First Class large letters, prices rose between 7p and 23p, a 5.02% to 9.33% increase. The highest price rise affected First Class items between 101-250g, with meter pricing benefiting from smaller price increases (in both nominal and real terms). This was also true for Second Class large letter products, with the new prices varying from 82p to £2.48, increases of between 5.56% to 6.49% across the mix of products.
- 7.15 With more significant price rises found in relation to First Class stamp products, these figures continued recent pricing trends observed since 2017. In relation to Second Class products, we noted at the highest weight step, 501-750g, the differential between the stamp price and meter price increased due to stamps going up 15p to £2.48 (6.4%) and the meter price only going up 11p to £2.09 (5.6%).

**Figure 7.1: Standard letter and Large letter pricing trends (2009-2020)**



Source: Ofcom analysis, Royal Mail Pricing Guides for March 2020, in real terms.

For First Class and Second Class services, Large letter prices vary based on weight and size – average prices based on 2019-20 volumes presented to show year on year trends.

## Parcel prices

- 7.16 Since March 2016, Royal Mail has offered two prices for each parcel product that it provides within the universal service, depending on whether postage is purchased via an online account or at the Post Office. Pricing information for parcels can be explored in more detail within the Post Monitoring Interactive Data published alongside this report.<sup>138</sup>

<sup>137</sup> Royal Mail, 23 March 2020. [Our Prices Guide](#).

<sup>138</sup> Access via [Annual monitoring updates on postal services website](#)

- 7.17 Since 2017, Royal Mail prices for parcels have shown small real terms decreases year-on-year. This is likely a reflection of the fact that there is competition in this market. In 2020, while prices have risen slightly in real terms at the below 1kg weight step, all First Class prices at 1-2kg have dropped by between 0.4% and 1.5% in real terms. Price increases were lower in nominal terms for online purchases than for Post Office prices, which may reflect the nature of competition in the parcels sector.
- 7.18 For First Class parcels, prices went up by between 2p and 15p – equating to increases of between 0.2% and 4.2% in nominal terms. For Second Class parcels, prices increased by between 5p and 15p – a nominal terms rise of between 1% and 3.3%.

## Safeguard caps in 2019-20

- 7.19 We impose a safeguard cap on certain products as an affordability measure to ensure that consumers, particularly vulnerable consumers, continue to have access to a universal service at affordable prices.<sup>139</sup>
- 7.20 We have two safeguard caps in place for stamp prices:
- the basket cap for Second Class large letters and small and medium parcels up to and including 2kg<sup>140</sup>; and
  - the cap for Second Class standard letters.
- 7.21 In 2018-19, we reviewed the level of the caps, publishing our decision in January 2019.<sup>141</sup> We decided:
- to maintain the basket cap at the same level; and
  - to amend the Second Class standard letters cap to 65p, a 5% real terms rise, which took effect on 1 April 2019.
- 7.22 Both the Second Class basket cap and the Second Class letter cap increased by CPI on 1 April 2020 and will increase by CPI inflation on 1 April every year, until they expire on 31 March 2024.
- 7.23 During the financial year 2019-20, Royal Mail's prices complied with the safeguard caps. We discuss below at paragraphs 7.44-7.45 Royal Mail's failure to comply with the letters cap during 2018-19.

## Affordability of universal services

- 7.24 One of the key safeguards in the current regulatory framework is ensuring that universal postal services are affordable. We monitor the affordability of postal services through the responses to questions in our postal tracker surveys and where appropriate through reviewing Office for National Statistics (ONS) data.

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<sup>139</sup> Ofcom, March 2017. [Review of the Regulation of Royal Mail](#).

<sup>140</sup> The level of the basket cap is calculated using a weighted average.

<sup>141</sup> Ofcom, January 2019. [Review of the Second Class Safeguard Caps 2019](#).

- 7.25 We remain of the view that postal services are currently affordable for most residential consumers. We note net satisfaction levels from our residential tracker data remain high, although our research shows a small drop in the numbers of consumers who consider that postal services offer value for money (down to 73% in 2020 from 76% in 2019).<sup>142</sup> When considering Royal Mail services, consumer satisfaction levels have also dropped in terms of cost of postage, down to 57% in 2020 from 60% in 2019.<sup>143</sup> Perceptions of value for money of First and Second Class stamps have declined more slowly, with net positive scores now at 63% for First Class and 56% for Second Class.<sup>144</sup>
- 7.26 Consumer research information can be explored in more detail within our Post Monitoring Interactive Data published alongside this report.<sup>145</sup> We will continue to monitor respondents' views regarding affordability.

## Non-price terms of universal services

- 7.27 As part of our monitoring programme, we also consider the impact of non-price changes to the terms of universal services. This involves changes to Royal Mail's Postal Schemes.
- 7.28 Postal Schemes set out the terms and conditions of postal services for consumers and business customers who use Royal Mail's services but who do not hold an individual contract with Royal Mail. Customers who use stamps, online postage or franking meters to pay for Royal Mail services do so under a Postal Scheme rather than a contractual arrangement. Details of the Postal Schemes are available on Royal Mail's website.<sup>146</sup>
- 7.29 Before making changes to the Schemes, Royal Mail must consult customers and stakeholders, including Ofcom, and the consumer advocacy bodies, including Citizens Advice. This must occur at least one month before the date on which Royal Mail proposes to implement the change.
- 7.30 During 2019-20, Royal Mail made two changes to non-price items:
- In August 2019, in the context of the Offensive Weapons Act 2019, Royal Mail made proposals to prohibit bladed items, including knives, being delivered using its universal service postal products. Its consultation closed on 12 September 2019 and its decision was published on 15 May 2020. In its decision, Royal Mail confirmed it would make changes in the Schemes to reflect changes in legislation restricting the carriage of bladed items in the post.<sup>147</sup>

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<sup>142</sup> Source: Ofcom Residential Postal Tracker Q3 2019 – Q2 2020 (5,012), Q3 2018-Q2 2019 (5,956) Base: All Participants QG2: *How satisfied are you overall with the postal services in terms of delivering value for money for sending mail?*

<sup>143</sup> Source: Ofcom Residential Postal Tracker, Q3 2019 – Q2 2020 (5,012), Q3 2018 – Q2 2019 (5,779) Base: All Participants QG3: *How satisfied are you with the following aspects of Royal Mail's service?* (NET: "very satisfied" and "fairly satisfied")

<sup>144</sup> Source: Ofcom Residential Postal Tracker Q3 2019-Q2 2020 (5,012), Q3 2018 – Q2 2019 (5,779) Base: All Participants QF4: *A First Class stamp currently costs 70p/76p. How would you rate Royal Mail's First -Class service in terms of value for money?* QF5: *A Second Class stamp currently costs 61p/65p. How would you rate Royal Mail's Second-Class service in terms of value for money?*

<sup>145</sup> Access via [https://www.ofcom.org.uk/postal-services/information-for-the-postal-industry/monitoring\\_reports](https://www.ofcom.org.uk/postal-services/information-for-the-postal-industry/monitoring_reports)

<sup>146</sup> Royal Mail. [Non-contract terms and conditions.](#)

<sup>147</sup> Royal Mail, May 2020. [Royal Mail Decision: Changes to Postal Schemes covering changes to the carriage of Bladed items due to changes in legislation.](#)

- In March 2020, Royal Mail made proposals for five changes<sup>148</sup> to the Overseas Letter Post Scheme. Its consultation closed on 29 April 2020 and its decision was published on 28 May 2020, in which Royal Mail confirmed its decision to implement the changes to the Scheme as consulted upon.<sup>149</sup>

7.31 We had no concerns with the changes Royal Mail implemented during 2019-20 and we will continue to monitor any changes Royal Mail makes to non-price terms of universal services.

## Quality of Service

7.32 Royal Mail is subject to annual quality of service (QoS) targets. We monitor its performance against these targets so that we can take prompt and appropriate action, where we consider it necessary to do so, if we identify failures.

7.33 Figure 7.1 below summarises Royal Mail's QoS performance in 2019-20 and, for comparison, 2018-19, against the QoS targets we have set. Pages 14-15 of the Post Monitoring Interactive Data shows historic trends for each target below.

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<sup>148</sup> The changes related to alternative identification in lieu of signature, items resembling restricted or prohibited goods, scam mail including fraudulent foreign lottery tickets, zonal price changes, and mandated customs data.

<sup>149</sup> Royal Mail, May 2020. [Royal Mail Decision: Changes to the Overseas Post Scheme covering: \(i\) alternative identification in lieu of signature, \(ii\) items resembling restricted or prohibited goods, \(iii\) scam mail including fraudulent foreign lottery tickets, \(iv\) zonal prices changes, \(v\) mandated customs data.](#)

Figure 7.2: Quality of Service 2019-20 summary

KPI	Target	2019-20 Result	2018-19 Result	Change from prior year
First Class delivery	93.0%	Items delivered day after collection 92.6% <span style="color:red">✗</span>	91.5% <span style="color:red">✗</span>	<span style="color:green">▲</span>
Second Class delivery	98.5%	Items delivered within three days of collection 98.7% <span style="color:green">✓</span>	98.6% <span style="color:green">✓</span>	<span style="color:green">▲</span>
Postcode Area (PCA) <sup>150</sup> Target: First Class single piece mail	118/118 PCAs	91.5% items delivered day after collection 105/118 <span style="color:red">✗</span>	75/118 <span style="color:red">✗</span>	<span style="color:green">▲</span>
PCA Target (with confidence interval)	118/118 PCAs	91.5% items delivered day after collection 117/118 <span style="color:red">✗</span>	105/118 <span style="color:red">✗</span>	<span style="color:green">▲</span>
Special Delivery	99.0%	Items delivered day after collection 98.5% <span style="color:red">✗</span>	98.2% <span style="color:red">✗</span>	<span style="color:green">▲</span>
European International Delivery	85%	Items delivered in three days 86% <span style="color:green">✓</span>	86.6% <span style="color:green">✓</span>	<span style="color:red">▼</span>
Collection points: 6 days per week	99.90%	Collection points served 99.90% <span style="color:green">✓</span>	99.85% <span style="color:red">✗</span>	<span style="color:green">▲</span>
Delivery routes: 6 days per week	99.90%	Delivery routes completed 99.52% <span style="color:red">✗</span>	99.55% <span style="color:red">✗</span>	<span style="color:red">▼</span>
Correct delivery: 6 days per week	99.50%	Items correctly delivered 99.70% <span style="color:green">✓</span>	99.76% <span style="color:green">✓</span>	<span style="color:red">▼</span>

Source: Royal Mail Quality of Service Reports<sup>151</sup>, Year End Adjusted 2018-19 and 2019-20.

7.34 While Royal Mail has missed a number of targets, its performance has significantly improved in general when compared to its performance in 2018-19. As explained in more detail below at paragraphs 7.42-7.43, we found that Royal Mail had failed to comply with

<sup>150</sup> The postcode area is the largest geographical postcode unit and forms the initial characters of the alphanumeric UK postcode. There are 121 PCAs in the UK, however this target excludes three PCAs in Scotland (HS Hebrides, KW Kirkwall, ZE Lerwick). This is principally because logistically it is not practical to achieve a next day service for 91.5% of First Class mail sent from across the UK to these remote destinations. In addition, these offshore areas are more frequently subject to weather-related disruption of ferry and air services.

<sup>151</sup> Royal Mail, [Quality of Service](#).

first class national and PCA targets during 2018-19. In both cases we found that these failures were significant and without reasonable explanation. However, during 2019-20 Royal Mail performance in relation to both targets improved significantly.

- 7.35 In our view Royal Mail was on track to meet both of these targets during March 2020 before the Covid-19 outbreak. Accordingly, in July 2020, we announced that, taking into account the impact of Covid-19 on Royal Mail's operations, we were satisfied that Royal Mail had met these regulatory obligations.<sup>152</sup>

## Complaints and compensation

- 7.36 Ofcom requires Royal Mail, as the universal service provider, to publish an annual report setting out the number of complaints received in each financial year and the amount of compensation paid in relation to those complaints. It is also required to report the top ten categories of complaint.
- 7.37 Overall complaint volumes decreased to 1,082,979 in 2019-20, representing a decrease of 3.4% from 2018-19. There was a decrease in complaints in all of the top ten complaint categories, except for loss (showing the largest increase of 9.1%), denial of receipt, and damage. We note significant drops in redelivery failure (down 19.4%) and redirection issues (down 16.5%).
- 7.38 Page 16 of the Post Monitoring Interactive Data contains the top ten categories of complaint to Royal Mail since 2013-14 in further detail. More information is available in Royal Mail's [Annual Consumer Complaints and Compensation Report 2019-20](#).
- 7.39 Royal Mail is required to provide compensation on a fair and reasonable basis where a customer experiences loss, delay or damage in relation to certain universal postal services.
- 7.40 When compensation was given, the average compensation paid per complaint decreased by 28p to £22.86. The total number of complaints where compensation was paid increased by 7,963 to 429,683. Total compensation paid by Royal Mail rose marginally by 0.6% from last year, increasing from £9.76 m to £9.82 m.
- 7.41 We will continue to examine complaints and compensation data on an ongoing basis as part of our monitoring programme.

## Enforcement

### Investigation into Royal Mail's quality of service performance in 2018-19

- 7.42 We require Royal Mail to meet specified performance targets associated with the quality of service of the provision of universal service products. This includes requirements on Royal Mail to deliver 93% of all First Class mail on the next working day after collection and

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<sup>152</sup> See media release [here](#).

98.5% of all Second Class mail within three days of collection.<sup>153</sup> Royal Mail is also subject to Postcode Area (PCA) targets which requires it to deliver 91.5% of First Class mail the day after collection to 118 specified postcode areas.<sup>154</sup> Royal Mail reported that in 2018-19 it did not achieve its First Class performance target of 93%, with a performance of 91.54%, and it only met its First Class PCA performance target of 91.5% in 75 of 118 PCAs.

- 7.43 We opened an investigation into Royal Mail's performance in 2018-19 and published our final decision in July 2020, finding that Royal Mail had contravened DUSP condition 1.9.1 by failing to meet certain performance targets associated with First Class mail delivery during 2018-19. We considered Royal Mail's failure to meet its First Class national performance target to be a serious breach and, as a result, we imposed a penalty of £1.5m on Royal Mail. We decided not to impose a financial penalty in relation to Royal Mail's failure to comply with the First Class PCA performance target.<sup>155</sup>

### **Investigation into Royal Mail's compliance with the safeguard price control on Second Class letters**

- 7.44 Royal Mail announced in February 2019 that it would be raising the price of a Second Class letter stamp by 3p to 61p on 25 March 2019, exceeding the price cap of 60p which was due to stay in place until 1 April 2019.
- 7.45 We determined that there were reasonable grounds for believing Royal Mail had contravened its obligations under DUSP condition 2.2.2 by charging over the maximum price for Second Class standard letters. We opened an investigation and found that Royal Mail had contravened the condition in exceeding the price cap between 25 March and 31 March 2019. We published our final decision on 10 July 2020, imposing a financial penalty of £100,000 on Royal Mail for overcharging customers.<sup>156</sup>

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<sup>153</sup> These targets are set below 100% to allow for commonly experienced circumstances that may arise in the transportation, processing and delivery of mail (for example, disruption of aircraft flights due to bad weather or missed network connections due to road traffic delays and breakdowns).

<sup>154</sup> As noted above, the HS (Hebrides), KW (Kirkwall, Orkney) and ZE (Shetlands) postcode areas are excluded from this target.

<sup>155</sup> Further details about this case are available in our [Decision finding Royal Mail contravened its quality of service performance targets in 2018/19 and imposing a financial penalty under paragraph 6 of Schedule 7 to the Postal Services Act 2011](#).

<sup>156</sup> Further details about this case are available in our [Decision finding Royal Mail contravened the safeguard price control cap on Second Class letters and imposing a financial penalty under paragraph 6 of Schedule 7 to the Postal Services Act 2011](#).

## 8. Covid-19 and the postal sector

### Introduction

- 8.1 As we have outlined in previous sections, Covid-19 began to influence international parcels volumes in the UK in the early months of 2020, as the pandemic first emerged in other countries. However, in the UK, Covid-19 related restrictions on businesses and households were first introduced in the second half of March 2020, at the end of the 2019-20 financial year. The impacts of the pandemic on the postal sector during the time period reviewed in this report were therefore limited.
- 8.2 The significant implications for the UK postal sector became apparent in Q1 of 2020-21, when the full 'lockdown' restrictions were in place. Covid-19 has had major consequences for postal sector businesses, their employees and their customers (both residential and businesses of all sizes). It is likely to continue to have significant implications on the sector for the remainder of the 2020-21 financial year, and potentially beyond.
- 8.3 In this section we provide a brief overview of the main impacts of Covid-19 in 2020-21 so far on the postal sector, including the implications for our regulation of the universal service.
- 8.4 Given that we are in the middle of this financial year, and in light of the considerable uncertainty about the development of the pandemic, we are not publishing a full assessment of events in 2020-21. However, as part of our post monitoring programme we have, and will, continue to track and assess the implications of Covid-19 for Royal Mail, the broader postal services market and consumers on an ongoing basis.<sup>157</sup>

### Summary of Covid-19 impacts

- 8.5 We provide below a summary of the impacts of Covid-19 on postal users and postal workers; the letters market; the parcels market; and Royal Mail specifically.

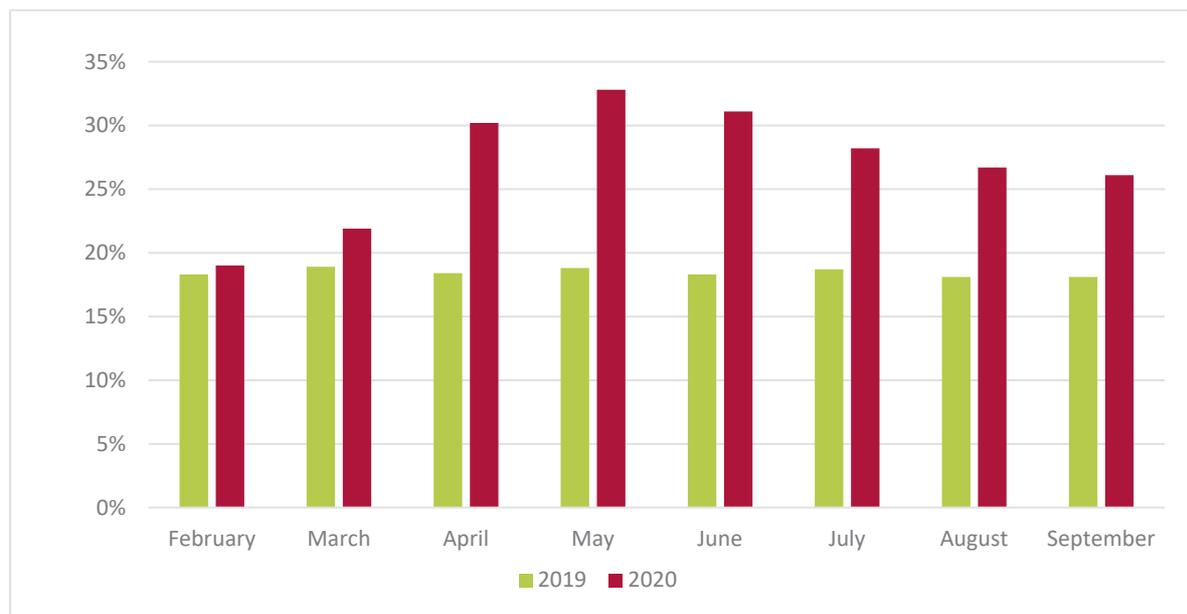
### Impacts on postal users and postal workers

- 8.6 Covid-19 has led to significant changes in consumer demand for parcels and letters services from March 2020. The temporary closure of many retail outlets led to a sharp rise in online shopping, and hence significantly increased demand for parcel delivery services from retailers. This was largely sustained in Q2 of 2020-21, even when restrictions on shops were (partially) removed for a few months. As illustrated in Figure 8.1, internet sales as a proportion of total retail sales increased between February and September 2020 compared to the same period in 2019.<sup>158</sup>

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<sup>157</sup> For example, Ofcom hosted a CEO roundtable on the early impacts of Covid-19 on the postal sector on 1 April 2020.

**Figure 8.1: Internet Sales as a Proportion of Total Retail Sales<sup>158</sup>**



- 8.7 A study commissioned by Royal Mail found there to be 315,000 UK company start-ups between March and July 2020, a 7% increase on the same period for the year prior. Of these, 16,000 e-commerce businesses were created, contributing to an increase in demand for parcel delivery services experienced across the sector.<sup>159</sup>
- 8.8 In May 2020, the Post Office reported a 30% increase in the use of its fast track mail service, as businesses sought to adapt to increasing mail order and online sales. The service allows businesses to register items online and pay in advance via a ‘Drop & Go’ account to save time in store.<sup>160</sup>
- 8.9 The growth in e-commerce is also likely to have had knock-on implications for the returns of unwanted goods. In addition, the use of online marketplaces increased during the initial lockdown period. eBay UK reported a 256% increase in the number of new businesses joining the platform compared to the same period in 2019.<sup>161</sup> Online marketplaces often act as a platform for consumers as well as businesses, allowing individuals to resell used or unwanted items.
- 8.10 In addition to increased demand for online shopping deliveries, the pandemic has also highlighted the importance of the postal sector in providing key services to citizens. This includes the delivery of important government, NHS, administrative and bank communications to households during the crisis. Postal sector operators also play a critical role in supporting the delivery and collection of Covid testing kits. Postal workers and

<sup>158</sup> ONS, 23 October 2020. [Internet Sales as a Percentage of Total Retail Sales.](#)

<sup>159</sup> Royal Mail Group, 16 October 2020. [Lockdown fuels rise in start-ups.](#)

<sup>160</sup> Post Office, May 2020. [Post Office sees 30% increase in fast track mail service use during Covid-19.](#)

<sup>161</sup> eBay, June 2020. [Surge in new businesses joining eBay.](#)

delivery drivers are defined as key workers by the Government, given their critical role in ensuring people have access to letters and parcels services.

- 8.11 Social distancing measures have had implications for normal postal delivery practices for consumers and frontline workers, prompting postal providers to amend their procedures. For example, for items requiring proof of delivery, signatures have largely been replaced with photographic evidence or surname confirmation, avoiding the need for close physical contact. These measures, and other safety requirements associated with the pandemic, are likely to have increased operational costs for postal operators. Staff absence rates are also likely to have increased.
- 8.12 Ofcom issued ‘tips’ for postal users on post and parcel deliveries during the pandemic, to set consumer expectations and support postal workers and deliverers to keep items moving safely.<sup>162</sup> We also supplemented our regular consumer research, into the experiences of postal users (see Section 4), with further research into postal user needs in summer 2020 to assess the extent to which users’ views may have changed as a result of the Covid-19 pandemic.<sup>163</sup>

## Impacts on the letters market

- 8.13 In Q1 of 2020-21 Covid-19 accelerated the decline in the letters market, in terms of both volumes and revenues. The lockdown restrictions imposed on businesses, coupled with the economic downturn, caused an initial significant reduction in demand for letter services (particularly advertising mail).
- 8.14 Royal Mail reported that its addressed advertising mail volumes were down 49% in the first half of 2020-21, whilst it said business mail volumes declined at a rate “just under half that seen for advertising mail”.<sup>164</sup>
- 8.15 This has created a challenging environment for access operators that provide bulk mail services to businesses. Demand for advertising mail reduced due to the negative economic impacts of Covid-19 on some business sectors. Expenditure on direct mail advertising in the UK in Q1 2020-21 fell by 62.4% compared to the same period the previous year. The Advertising Association has forecast an overall decline in direct mail expenditure in the 2020 calendar year of 29.7% year on year, but anticipates it will recover somewhat in 2021 with growth of 8.6% forecast.<sup>165</sup>
- 8.16 The impact on individual access operators is likely to vary depending on their particular business model and client base, given the mixed implications of the pandemic for different parts of the economy. Those with a higher exposure to direct mail – as opposed to transactional mail (such as bank statements and bills) – are likely to have experienced the

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<sup>162</sup> Ofcom, 2020. [Getting post and parcels during the coronavirus.](#)

<sup>163</sup> Ofcom, 2020. *Review of postal services users’ needs.*

[https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/208220/2020-review-of-postal-user-needs-report.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/208220/2020-review-of-postal-user-needs-report.pdf).

<sup>164</sup> Royal Mail PLC, 19 November 2020, Results for the half year ended 27 September 2020, page 22,

<https://www.royalmailgroup.com/media/11354/royal-mail-group-half-year-results-19-november-2020.pdf>.

<sup>165</sup> Advertising Association (AA) and World Advertising Research Council (WARC), 29 October 2020. [2021 UK Ad spend Forecast \(Quarterly Expenditure Report\).](#)

greatest impacts. However, the temporary closure of some businesses, and increasing use of online services, may also have reduced demand for transactional mail. Meanwhile, the increase in online sales is likely to have driven higher volumes of large letters and access parcels for operators that offer fulfilment services.

## Impacts on the parcels market

- 8.17 Covid-19 has had a vastly different impact on the parcels market, when compared to the letters market. As outlined above, the growth in online shopping has driven a sustained increase in demand for parcel delivery services.
- 8.18 Parcel operators are responding to an increase in demand for their services by investing in their businesses and creating new jobs. For example:
- a) Royal Mail is set to recruit 33,000 temporary workers over the Christmas period in 2020. It said this sits alongside plans to deploy eight additional temporary parcel sort centres, as part of increased investment of around £100 million over the peak period.<sup>166</sup>
  - b) DPD announced in June 2020 it would create 6,000 new jobs and open 15 new regional depots, as well as investing in its vehicles, technology and expanding its next-day parcel capacity.<sup>167</sup>
  - c) Hermes said in July 2020 that it would create over 10,500 jobs across the UK, with c.1,500 full-time jobs across its delivery network and head office, alongside c.9,000 freelance couriers.<sup>168</sup>
  - d) In September 2020, Yodel announced plans to recruit 2,950 new colleagues across its 50 nationwide locations, including 2,500 self-employed delivery drivers and permanent parcel sorters. Yodel stated that its recruitment drive was in response to the impact of the Covid-19 enforced lockdown on consumer behaviour which led to a dramatic increase in demand for online retail.<sup>169</sup>
- 8.19 The Covid-19 pandemic has also created demand for new services from parcel operators. In March 2020, the Department of Health and Social Care partnered with Royal Mail and Amazon Logistics to help with the logistics of distributing Covid-19 testing kits.<sup>170</sup> In August 2020 Amazon Logistics stated that it had delivered in excess of two million home testing kits.<sup>171</sup> Royal Mail established a designated Covid-19 testing kit collection team and reports to have handled over 90% of all testing kits.<sup>172</sup>
- 8.20 In addition to supporting the logistics of Covid-19 testing, parcel delivery operators took on some responsibilities for the delivery of 'essential' items during the first national lockdown.

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<sup>166</sup> Royal Mail PLC, 19 November 2020. Results for the half year ended 27 September 2020, page 4,

<https://www.royalmailgroup.com/media/11354/royal-mail-group-half-year-results-19-november-2020.pdf>.

<sup>167</sup> DPD Group, 18 June 2020. [6,000 new UK jobs as DPD scales-up to meet "new normal" demand from online retailers.](#)

<sup>168</sup> Hermes, 4 July 2020. [Hermes creates 10.5k new jobs across the UK and announces £100 million investment.](#)

<sup>169</sup> Yodel, September 2020. Yodel creates more than 2,900 roles as it bolsters resource in time for Christmas peak.

<sup>170</sup> Department for Health and Social Care, 27 March 2020. [Government launches new drive on coronavirus tests.](#)

<sup>171</sup> Amazon, 28 August 2020. [Amazon Logistic network..](#)

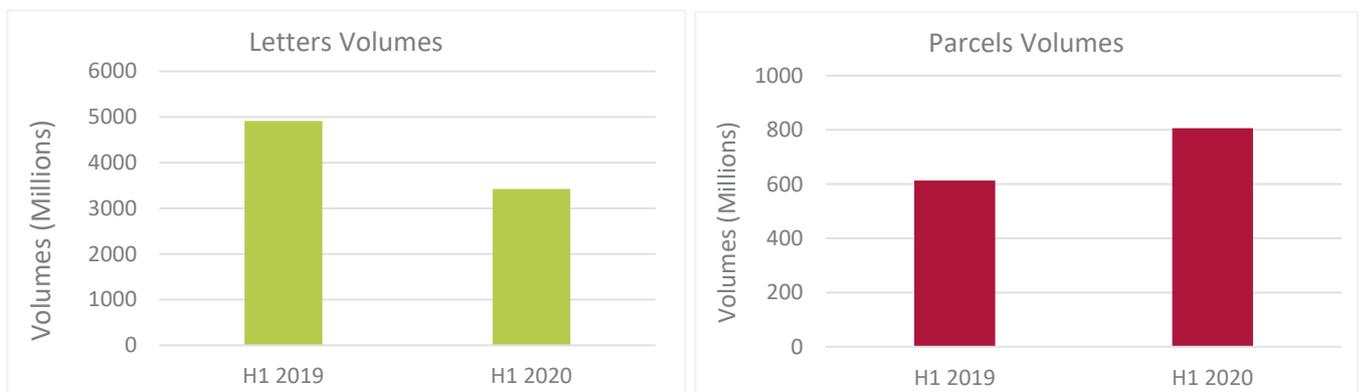
<sup>172</sup> Royal Mail plc, 19 November 2020. [Half Year 2020-21 Results \(Slide Pack\).](#)

For example, DPD stated that it delivered 10.3 million masks, 6.7 million gloves and 5.2 million aprons for the NHS, in addition to 2 million weekly food deliveries.<sup>173</sup> Amazon Logistics reported that it also delivered 50,000 care boxes of donated gifts to support key workers as well as 800,000 breakfasts to vulnerable children all over the UK.

## Impacts on Royal Mail

8.21 As a provider of both letters and parcels, Royal Mail is experiencing significant and mixed impacts from the Covid-19 pandemic. Addressed letter volumes (excluding elections) fell by 28% in the first six months of the financial year, and letter revenues were down 20.5%. By contrast, Royal Mail’s parcel volumes and revenues rose by a third (31% and 33% respectively).<sup>174</sup>

**Figure 8.2: Royal Mail Addressed Letter Volumes and Parcels Volumes<sup>171</sup>**



8.22 The onset of Covid-19 has also increased Royal Mail’s cost base. This includes direct costs associated with the pandemic, such as protective equipment and overtime/agency staff to cover high absences (particularly in Q1 2020-21, when at peak 20% of employees were off absent/sick<sup>175</sup>). It also reflects the extra costs associated with handling more parcels, partly because some of the processes are still manual. Royal Mail said Covid-19 related costs in the first half of the financial year were £85m, and the costs associated with the changing product mix had reached £95m.<sup>176</sup>

8.23 Although Royal Mail’s overall revenues grew by 4.9%, the Reported Business recorded a first half adjusted operating loss of £180m (though this includes voluntary redundancy costs for a management restructure).<sup>177</sup>

<sup>173</sup> DPD, [DPD News](#).

<sup>174</sup> Royal Mail PLC, 19 November 2020, Results for the half year ended 27 September 2020, page 22, <https://www.royalmailgroup.com/media/11354/royal-mail-group-half-year-results-19-november-2020.pdf>

<sup>175</sup> Royal Mail PLC, 2020, Full Year 2019-20 Results and Business Update 25 June 2020, page 33, <https://www.royalmailgroup.com/media/11198/royal-mail-group-fy2019-20-results-presentation.pdf>.

<sup>176</sup> Royal Mail PLC, 19 November 2020, Results for the half year ended 27 September 2020, page 1, <https://www.royalmailgroup.com/media/11354/royal-mail-group-half-year-results-19-november-2020.pdf>.

<sup>177</sup> Royal Mail PLC, 19 November 2020, Results for the half year ended 27 September 2020, page 1, <https://www.royalmailgroup.com/media/11354/royal-mail-group-half-year-results-19-november-2020.pdf>.

8.24 The pace of change is so great – amid ongoing uncertainty about the development of the pandemic and the broader economic climate – that it is difficult to predict the full impact on revenues and costs across the financial year. Royal Mail has highlighted the difficulties in providing guidance given the level of uncertainty regarding future demand. It initially provided two potential scenarios in June 2020, then revised Scenario 1 in September and again in November.<sup>178</sup> Royal Mail has explained that the rise in parcel revenues has remained at higher levels than expected throughout the year, though some costs are also higher. Royal Mail said it anticipates it would be better than break even across the full year, if revenues outturn at the higher end of its updated scenario.<sup>179</sup>

### Regulatory emergency period

8.25 Royal Mail’s obligation to provide the universal postal service is set out in Designated Universal Service Provider (DUSP) Condition 1. This imposes, among other things, the requirements for Royal Mail to deliver and collect letters six days a week, to offer certain products such as First and Second Class services, and to meet quality of service standards.

8.26 This condition also contains an exception which provides that nothing in the condition requires Royal Mail to continue a service without interruption, suspension or restriction in an emergency.<sup>180</sup> The statutory framework therefore allows Royal Mail to modify its operations without formal authorisation, if it considers this necessary to respond to the emergency challenges it faces in sustaining the universal postal service.

8.27 In April 2020, we acknowledged that there was an emergency period for the purposes of DUSP Condition 1.

8.28 We have since closely monitored the steps that Royal Mail has taken to respond to the emergency challenges it faces in sustaining the universal postal service as a result of the pandemic, in order to ensure that the impact on consumers is minimised. These steps have included the following:

- Between 2 May and 13 June 2020, Royal Mail suspended the Saturday delivery of letters. Royal Mail cited Covid-19 related absences and social distancing requirements as reasons for the suspension, as well as reducing the burden on staff who were able to work.
- In March Royal Mail suspended the guaranteed delivery time associated with USO special delivery (normally 1pm). From 31 March, Royal Mail reinstated a 9pm guarantee and, from 28 September 2020, Royal Mail brought this forward to a 4pm guarantee.

8.29 In relation to quality of service, we recognise that Royal Mail has been, and continues to be, materially impacted by the pandemic. In particular, Royal Mail has provided evidence

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<sup>178</sup> The high degree of uncertainty is illustrated by Royal Mail’s presentations to the market. Having presented two views on 26 June 2020 about how Covid-19 may impact on trading under two possible ‘scenarios’, by the time of its 8 September 2020 trading update it had revised Scenario 1 to include up to an additional £400m in revenue across the financial year.

<sup>179</sup> Royal Mail PLC, 19 November 2020, Results for the half year ended 27 September 2020, pages 3 and 6, <https://www.royalmailgroup.com/media/11354/royal-mail-group-half-year-results-19-november-2020.pdf>.

<sup>180</sup> See, in particular, DUSP Condition 1.3.4(a). This reflects section 33 of the Postal Services Act 2011.

that ongoing social distancing requirements have had, and continue to have, a significant impact on its operational capacity and service levels. This includes, for example, the ability of postal workers to share a single delivery vehicle, which is a delivery method relied upon by Royal Mail for a considerable proportion of its delivery routes. Ofcom's current view is that, in light of these impacts, it remains appropriate for the regulatory emergency period to continue.

- 8.30 We will, on an ongoing basis, review whether the regulatory emergency period continues to be justified, ensuring that it lasts no longer than necessary. We will also continue to closely monitor the steps taken by Royal Mail in response to the pandemic.

### **Royal Mail's Business Diversion service**

- 8.31 Many businesses were required to divert their mail due to temporary business building closures resulting from the Covid-19 pandemic. Royal Mail offers a Business Diversion service for businesses that need to divert their mail if they move premises – this product is ordinarily used when only part of a business is moving premises (e.g. a department of a large business), or if a business is located in a multi-occupancy building. Royal Mail also offers a Business Redirection service which tends to be relied upon when whole businesses relocate and are not located in multi-occupancy buildings.<sup>181</sup>
- 8.32 During the pandemic, we raised concerns with Royal Mail about the affordability of its Business Diversion service, particularly for small businesses and not-for-profit organisations using shared workplaces. For example, a Business Diversion service lasting three months costs £1,206, compared to £216 for a Business Redirection service for the same duration.
- 8.33 In response to our concerns and those raised by consumer groups, Royal Mail has introduced a Small Business Diversion service for businesses and not for profit organisations with fewer than 50 employees. This service, which began in September 2020, is significantly more affordable than a typical Business Diversion, with a three-month diversion costing £259.20.

### **Next steps**

- 8.34 We will continue to monitor the impacts of Covid-19 on Royal Mail, the postal sector more generally, and consumers. For example, we will monitor the consumer experience of postal services as the impacts of Covid-19 evolve, through our regular tracking research.
- 8.35 We plan to report on our findings on the financial year 2020-21 as a whole (including the impacts of Covid-19) when we publish our annual monitoring update in late 2021.

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<sup>181</sup> See Royal Mail, [Moving Business Premises](#) for more information.