Annual monitoring update on the postal market

Financial year 2014-15

Market update

Publication date: 27 November 2015

About this document

This report sets out the key data and trends in the postal sector for the 2014-15 financial year. An effective and on-going monitoring regime is one of the key safeguards of the regulatory framework that Ofcom put in place in the postal sector in March 2012, alongside greater pricing freedom for Royal Mail. We also committed to publishing an annual report summarising the results of our monitoring programme. This is our fourth annual monitoring update on the postal sector.

This report covers five key areas: the impact of Royal Mail's pricing and quality of service on residential and small business consumers; the bulk mail letters sector, the parcels sector; the financial performance of the Royal Mail's Reported Business (i.e. the part of Royal Mail's business responsible for the universal service); and Royal Mail's efficiency. For the first time, this report includes new data on the parcels sector gathered from market participants.

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Section 1

Executive Summary

1.1 As part of the regulatory framework introduced in our 27 March 2012 Statement – *Securing the Universal Postal Service, Decision on the new regulatory framework* (the March 2012 Statement)[1] – Royal Mail was given greater pricing freedom.[2] This decision was taken to provide Royal Mail with the opportunity to return the universal service to financial sustainability, subject to certain safeguards. One such safeguard was an effective and on-going monitoring regime to track Royal Mail's performance. As part of this safeguard, we committed to publishing an annual monitoring update summarising the results of our monitoring programme. This is our fourth annual monitoring update on the postal sector.

1.2 This update covers the four key areas that we set out in the March 2012 Statement that our monitoring regime would focus on, i.e. financial performance, operating performance, customers and consumers, and competition. It also sets out the key data and trends for the 2014-15 financial year.[3]

1.3 The metrics in this update are, unless otherwise stated, consistent with those in our 2013-14 Monitoring update on the postal market published in December 2014[4] (enabling year-on-year comparisons). We also present some additional data in this document, including on the parcels sector.

Fundamental review of regulation of Royal Mail

1.4 On 16 June 2015 we announced a fundamental review of the regulation of Royal Mail.[5] The aim of the review is to ensure regulation remains appropriate and sufficient to secure the efficient and financially sustainable provision of the universal postal service. The review incorporates our existing work to assess Royal Mail's efficiency, consider its position within the parcels sector, and assess the company's potential ability to set wholesale prices in a way that might harm competition. In addition, the review will address the implications of Whistl's withdrawal, which represents a significant change in the potential level of competition for end-to-end letter delivery. For the avoidance of doubt this report does not cover the outputs of the review. In the event that we propose to make changes to the regulatory framework, we will consult on proposals in the first quarter of 2016.

Residential and small business consumers

1.5 Our research indicates the vast majority of consumers are satisfied with their postal services (89%) and that prices remain affordable for almost all consumers. In March

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[1] http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf .

[2] The March 2012 statement removed the majority of price controls on Royal Mail.

[3] Although our report also considers the impact of price changes that took effect from April 2014.

[4] Ofcom *Annual monitoring update on the postal market - Financial year 2013-14*, 2 December 2014 http://stakeholders.ofcom.org.uk/binaries/post/monitoring-report-13-14/annual-monitoring-update-postal-2013-14.pdf .

[5] http://stakeholders.ofcom.org.uk/consultations/royal-mail-regulation-review/ .

2015, First and Second Class stamp letter prices increased by 1p to 63p and 54p, respectively. These increases were above inflation, as were the increases for the equivalent large letters.[6] However, the increase was less than in 2014-15 in both real and nominal terms for Second Class stamp letters. For First Class stamp letters the increase was less than the increase in previous year in nominal terms but flat in real terms. Reported Business parcel prices on average remained static or reduced in some cases. The safeguard cap on Second Class stamps continues to protect vulnerable consumers.

1.6 Royal Mail continued to meet or exceeded the majority of its quality of service targets for the second sequential year. First and Second Class national targets were met as were the Postcode Area (PCA)[7] results (with a small number within the margin of error). See Section 3.

UK letters market

1.7 Total addressed letters volumes continued to fall in 2014-15, declining by 1.1% to 12.6bn items. Although the rate of decline has been slowing in the past couple of years, and the rate of decline in the past year is slower than the previous year (which was 3.2%), it still represents an 18% decline since 2010-11. The slower rate of decline has been attributed to the improvement in UK economic conditions[8].

1.8 Despite the fall in volumes, total letters revenue remained broadly flat (0.1% decline) at £4.2bn. See Section 4.

Bulk mail services

1.9 Business mail volumes (retail bulk mail and access) continued to decline in 2014-15, falling by 3.2% overall. Access volumes also declined for the second year running, falling by 1.3% in 2014-15. However, as total volumes fell faster than the decline in access volumes, the proportion of access in total volume has grown from c.46% in 2011-12 to c.56% in 2014-15. Although access volumes fell, the volume of end-to-end letter letters delivered by other operators grew. This was due to the growth of Whistl's end-to-end delivery service during 2014-15 (largely due to further roll out in 2013-14). As Whistl's volume was primarily gained from its access customers, a significant amount of the 92 million items that were lost from access volumes will have contributed to the additional 90 million end-to-end letter items delivered by competitors to Royal Mail. However, end-to-end competition still only accounted for c. 1.3% of the addressed letter mail market volumes. This is likely to fall significantly in 2015-16 following Whistl's exit from the end-to-end delivery market in June 2015. See Section 4.

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[6] CPI was -0.1% and RPI was 0.9% comparing March 2015 against March 2014. First and Second Class stamp letter prices increased by 1.6% and 1.9% respectively. Weighted average First Class and Second Class large letter stamp prices increases by 1.9% and 1.6% respectively.

[7] PCAs are the geographic areas into which the UK is divided by Royal Mail for operational purposes. The postcode area is the largest geographical unit used by Royal Mail for mail processing purposes, and forms the initial characters of the alphanumeric UK postcode; for example, Cardiff postcodes begin 'CF', Glasgow postcodes 'G', and Leicester postcodes 'LE'. Royal Mail's target is 118 out of the 121 PCAs achieving at least 91.5% of its First Class items delivered on time.

[8] Royal Mail Annual Report and Financial Statements 2015, page 21.

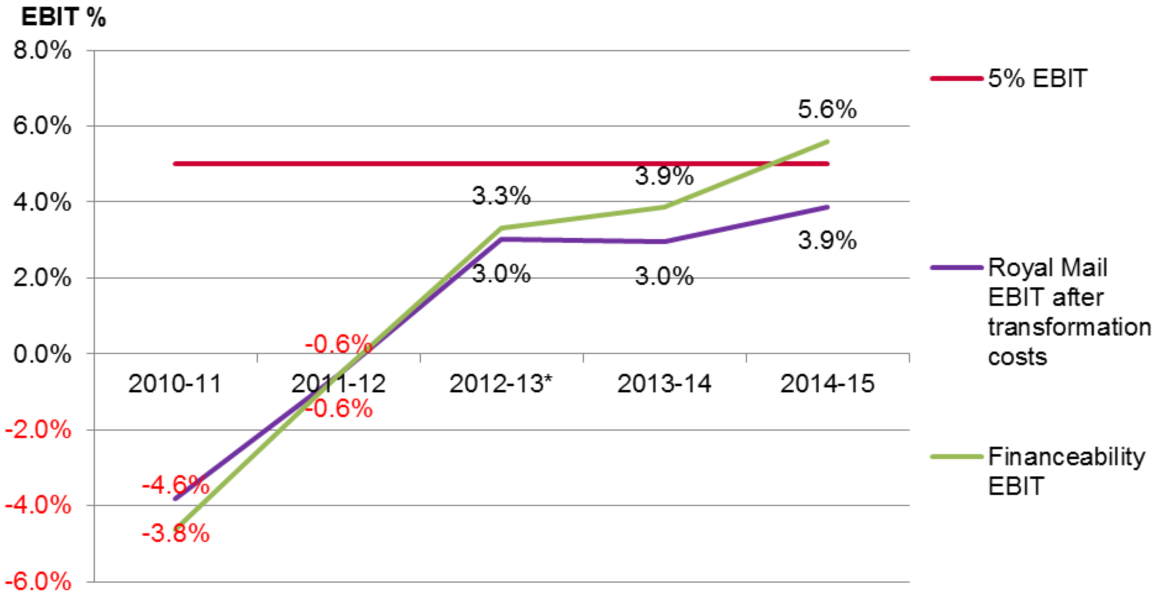
Parcels

1.10 Measured national parcel volumes increased in 2014-15 by 7%. While revenues also increased, they increased at a slower rate (6%) than volumes, which is consistent with the level of competition in the sector.[9] See Section 5.

Financial performance of the Reported Business

1.11 In summary, the financeability EBIT[10] margin of the Reported Business increased,[11] to 5.6%.[12] See Figure 1.1 below. This is an improvement on the previous year (3.9%) and is now within the indicative 5% to 10% range that we considered in March 2012 was consistent with a reasonable commercial rate of return for a financially sustainable universal service in the longer term. The improvement in margin was driven by a reduction in non-people and transformation costs offset by worsening trading performance and greater people costs. See Section 6 for more detail.

Figure 1.1 – Reported Business EBIT margin



Source: Royal Mail audited regulatory accounts and unpublished submissions from Royal Mail

** 2012-13 EBIT margin is based on 53 weeks*

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[9] These are volumes and revenues relating to parcels weighing up to 31.5kg carried by postal operators with an UK-wide network, as well as revenues related to a major regional operator in the Scottish Highlands and Islands. See Section 5 for a full definition of parcels and list of operators.

[10] Financeability EBIT margin is EBIT after transformation costs adjusted for pension costs on a cash basis. This measure was introduced in the 2013-14 Annual monitoring update. It is the financeability EBIT margin that we measure against the indicative 5-10% range which we considered in March 2012 was consistent with a commercial rate of return, and therefore use to assess the financial sustainability of the universal service.

[11] The part of Royal Mail's business that is responsible for the universal service. This is explained further in Section 2.

[12] Based on Earnings before Interest and Tax (EBIT) after transformation exceptional costs as a proportion of revenue, calculated using the cash pension rate.

Royal Mail's efficiency

1.12 Price, volume, efficiency and other (PVEO) analysis indicates that in 2014-15 Royal Mail reduced costs by c.2.6% due to efficiency improvements. The cost per unit workload adjusted for inflation decreased by c.2.2 % in 2014-15, which was largely due to the reduction in non-people costs. Royal Mail's productivity improved by 2.5%. This increase was greater than the 1.7% increase in 2013-14 and within Royal Mail's target of 2-3%. Productivity has continued to improve since 2010-11 due to a decline in gross hours worked. We continue to monitor Royal Mail's efficiency. Ofcom is currently reviewing Royal Mail's progress on efficiency as part of the fundamental review of the regulation of Royal Mail announced in June 2015.[13] See Section 7.

[13] http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/summary/Review_of_RM_regulation.pdf.

Section 2

Introduction

Background

2.1 Ofcom gained responsibility for regulation of the postal sector in October 2011 when the Postal Services Act 2011 (the 'PSA 2011') came into force. Our duty under the PSA 2011 is to secure the provision of a universal postal service. In performing this duty,[14] we must have regard to the need for the provision of a universal postal service to be:

- financially sustainable (including the need for a commercial rate of return on the universal service);[15] and
- efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.

2.2 Our approach to regulating the postal sector was set out in our March 2012 Statement. This included the decision to give Royal Mail greater pricing freedom to enable it to return the universal service to financial sustainability, subject to certain safeguards.

2.3 One of these safeguards was an effective and on-going monitoring regime to track Royal Mail's performance (for example, on quality of service and affordability of universal services, and progress on efficiency), as well as monitoring changes in the postal industry. As part of this regime, we committed to publishing an Annual monitoring update which set out key data and trends in the postal sector, focusing on the progress towards securing the provision of a universal service.

2.4 On 16 June 2015 we announced a fundamental review of the regulation of Royal Mail.[16] The aim of the review is to ensure regulation remains appropriate and sufficient to secure the efficient and financially sustainable provision of the universal postal service. The review incorporates our existing work to assess Royal Mail's efficiency, consider its position within the parcels sector, and assess the company's potential ability to set wholesale prices in a way that might harm competition. In addition, the review will address the implications of Whistl's withdrawal from end-to-end, which represents a significant change in the potential level of competition for end-to-end letter delivery. For the avoidance of doubt this report does not cover the outputs of this review.

2.5 In summary, this review will examine:

- whether any changes to the overall postal regulatory framework might be appropriate to secure the universal postal service;

[14] Under Section 29(3) of the PSA 2011.
[15] Section 29(4) of the PSA 2011.

- how best to ensure Royal Mail continues to become more efficient in the absence of significant end-to-end competition for letters, and (so helping the universal postal service to remain sustainable);

- whether Royal Mail's wholesale and retail prices are both affordable and sufficient to cover the costs of the universal service; and

- whether Royal Mail's commercial flexibility remains appropriate in the changing market; and, if not, whether wholesale or retail charge controls might be appropriate.

2.6 We expect to complete our review of the regulation of Royal Mail and to put in place any revised regulatory framework during 2016. In the event that we propose to make changes we intend to consult on them in the early part of 2016.

2.7 Our monitoring regime remains in place during the course of this review. To the extent that we may wish to make changes to the regulatory framework, we will assess any consequential or complementary changes which may be necessary to the on-going monitoring regime.

Measuring the outcomes of the regulatory regime

2.8 This report focuses on the 2014-15 financial year and continues to address the four key areas that the March 2012 Statement noted our monitoring regime would initially focus on, i.e. financial performance, operating performance, customers and consumers, and competition. However, this year we have presented for the first time additional information on the parcels sector. We have also decided to restructure the monitoring report as set out below:

- Residential and small business consumers – Section Three;
- Bulk Mail services – Section Four;
- Parcels – Section Five;
- The financial performance of the Reported Business – Section Six; and
- Royal Mail's efficiency – Section Seven.

2.9 We will continue to monitor market developments and Royal Mail's performance in relation to the four key areas outlined above.

The wider monitoring programme

2.10 In addition to this Annual monitoring update, the aims of which are discussed above, the wider programme includes:

- industry stakeholders providing market specific information, identifying any concerns with how the regime is operating and potential market developments; and

- regular internal review of data and indicators for the four key areas set out above (including through our internal governance process).

2.11 At the same time, within the Annual monitoring update we provide our view of how the regulatory regime is meeting our duty to secure the provision of a universal service and we increase transparency through publishing some Royal Mail data on its financial performance, changes to terms and conditions of its products and highlighting market developments in the past year.

2.12 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 cannot publish it, it will nonetheless inform our on-going internal monitoring programme, and be used to identify any potential or emerging problems in relation to the provision of the universal service.

2.13 In January 2014, we published a Statement to update the March 2012 regulatory financial reporting requirements in order to ensure the information we collect and use remains fit for purpose.[17] So that stakeholders are aware of the information that we gather, a list of data that we currently collect, some of which is not published for confidentiality reasons, is listed in Annex 1 to this report.

Royal Mail is the focus of our monitoring regime

2.14 The focus of our monitoring is Royal Mail. It is currently the only postal business in the UK which operates a network capable of delivering letters and parcels to over 29 million business and household addresses nationwide.[18] As such it is the designated provider of the universal postal service (universal service provider).

2.15 However, not all of Royal Mail's business is subject to regulation. The parts that are subject to our monitoring regime are known as the 'Reported Business', which sits within a group of business units referred to as Royal Mail UK Parcels, International and Letters (UKPIL). This, in turn, sits within a wider group of companies – the 'Relevant Group'. The structure of Royal Mail plc as at 13 October 2015 is shown in Figure 2.1 below.

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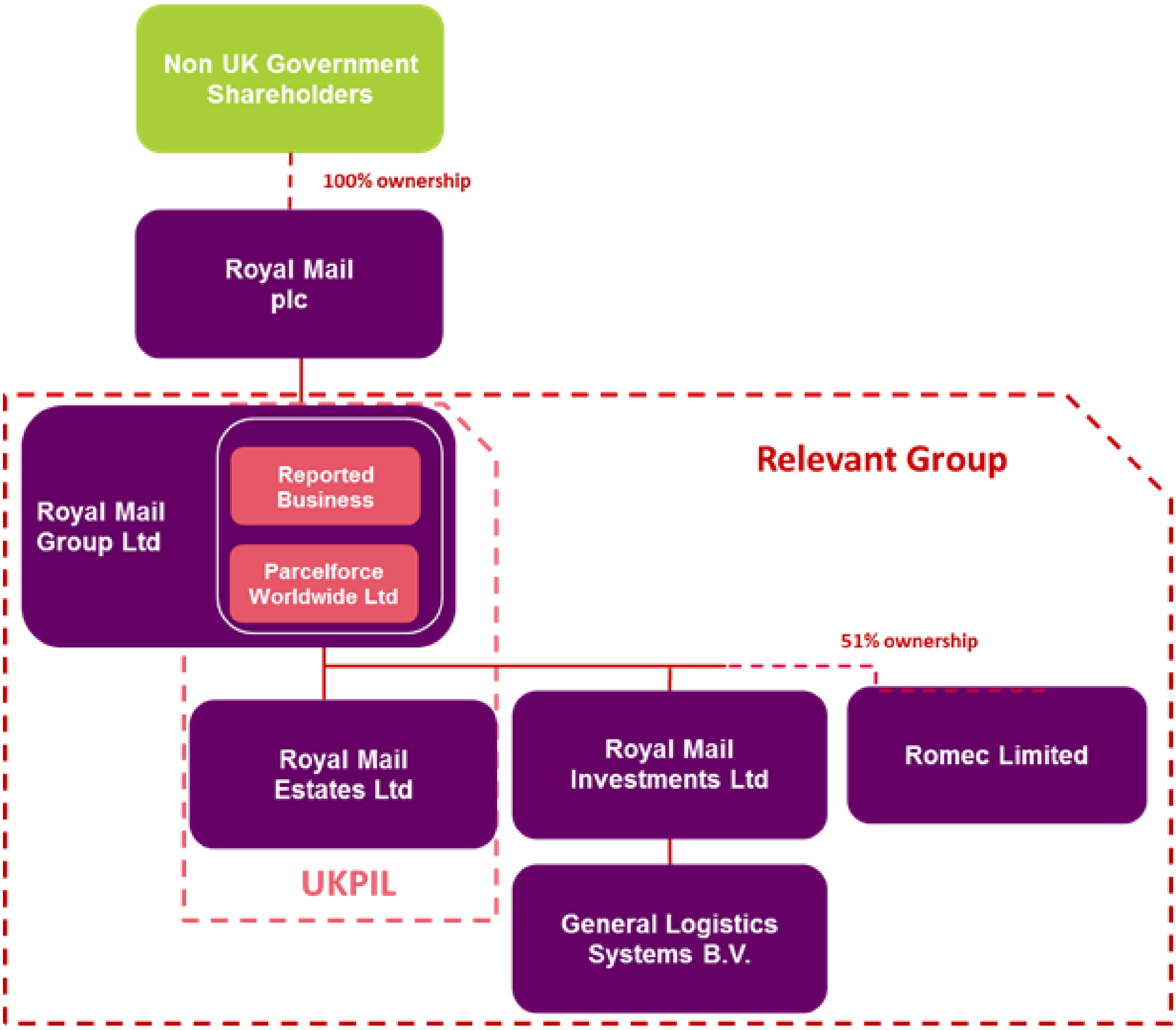
[17] http://stakeholders.ofcom.org.uk/binaries/consultations/regulatory-reporting-framework/statement/statement.pdf. The statement included requirements for new information, which we now consider as relevant and important for our monitoring regime; a reduction or removal of certain information, which is not essential or necessary for our regular monitoring needs; and amendments to the deadline or frequency of some of the information provided to us, so that the information is available in a more timely and expedient manner for our monitoring purposes.

[18] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 2. http://www.royalmailgroup.com/sites/default/files/Annual%20Report%20and%20Accounts%202014-15_0.pdf .

Figure 2.1 – Structure of Royal Mail plc



2.16 Ofcom has imposed requirements on Royal Mail as the universal service provider to provide certain services.[19] The services we have required Royal Mail to provide include undertaking collection and delivery services for letters six days per week and parcels five days per week; providing priority (next day) and standard (within three days) delivery services; and minimum quality of service targets. The Reported Business includes all universal services,[20] as well as retail bulk mail,[21] access products and parcels which also use the universal service network.[22]

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[19] Ofcom imposed a designated USP condition on Royal Mail in March 2012; it has been amended from time to time since that date. A consolidated version of the condition is available at http://stakeholders.ofcom.org.uk/binaries/post120713/dusp1.pdf .

[20] http://www.royalmailgroup.com/regulation/how-were-regulated/universal-service-obligation.

[21] Retail bulk mail relates to a range of services provided directly to sending customers by Royal Mail that are subject to volume or presentation discounts. This category represents bulk mail collected and delivered by Royal Mail itself, as opposed to bulk mail delivered by Royal Mail under an access agreement. Access is discussed further in Section 4.

[22] In December 2013, we published a Statement implementing technical and minor amendments to the Universal Postal Service Order and related regulatory conditions. See Ofcom *Technical and*

Privatisation of Royal Mail

2.17 In October 2013 the UK Government sold some 60% of the shares in Royal Mail to private investors via a stock market flotation. A further 10% of shares were transferred to Royal Mail employees and the remaining 30% were held by the Government.

2.18 On 20 June 2015 the UK Government sold 15% of its remaining share of Royal Mail to institutional investors. In September 2015 the UK Government transferred 1% of its shareholding to the Royal Mail Share Incentive Plan. This left the UK Government with 14% of Royal Mail shares remaining.

2.19 On 13 October 2015 the UK Government sold its remaining stake in Royal Mail with 13% sold to institutional investors and the remaining 1% transferred to the Royal Mail Share Incentive Plan.

Presentation of data in this report

2.20 Data presented in the Annual monitoring update on the postal market is, unless otherwise stated, in nominal terms.

2.21 Where we discuss absolute or percentage movements, we are referring to the comparisons to the previous financial year i.e. 2013-14 to 2014-15 (unless otherwise stated).

2.22 We use the Consumer Price Index (CPI) as the basis for calculating real movements in Royal Mail's costs. This is primarily because of a tendency for the Retail Price Index (RPI) to over-state inflation in a way that is not true of the CPI as a result of differences in the way the indices are constructed. While employees' inflation expectations may (at least in the past) have been informed by RPI, we note that non-people costs make up a significant minority of Royal Mail's cost base. Also recently there does not seem to have been a particularly strong empirical relationship between changes in Royal Mail's costs and either measure of inflation. Given the Office of National Statistics' (ONS) work in 2012[23] and findings in 2013[24], there is now wider recognition of the upward bias in the RPI formula and therefore there may be less expectation that it would be an appropriate measure of general price inflation, at least compared to CPI.

Minor Amendments in Postal Regulation, 10 December 2013, http://stakeholders.ofcom.org.uk/binaries/consultations/post/statement/statement.pdf None of the amendments has any practical impact on users, Royal Mail and other postal operators as they do not require any changes to Royal Mail's current provision of the universal postal service.

[23] *National Statistician's consultation on options for improving the Retail Prices Index*, October 2012, http://www.ons.gov.uk/ons/about-ons/get-involved/consultations-and-user-surveys/archived-consultations/2012/national-statistician-s-consultation-on-options-for-improving-the-retail-prices-index/index.html .

[24] *National Statistician announces outcome of consultation on RPI*, January 2013, http://www.ons.gov.uk/ons/dcp29904_295002.pdf.

Section 3

Residential and small business consumers

3.1 In this Section we discuss the impact of Royal Mail's pricing and operational decisions on those customers primarily using the universal service products, usually residential and small business consumers. As noted in our March 2012 Statement we are monitoring:

- Prices of universal service products – particularly any impact on vulnerable groups and those that rely on postal services. We discuss Royal Mail's price rises (as well as changes to non-price terms) within this Section; and

- The quality of service achieved by Royal Mail in the provision of universal services.[25] Our March 2012 Statement set out the quality standards that Royal Mail is required to meet. This was to ensure appropriate levels of universal service performance were maintained for consumers.

3.2 This Section also includes relevant findings from our residential and business consumer surveys on postal services, which were introduced in July 2012. These surveys help us monitor public perceptions about the postal market. In this Section we cover the results for the year April 2014 to March 2015. We intend to cover year-on-year analysis for the same period in our future monitoring updates.

Pricing of universal services

3.3 Until 2012 the majority of Royal Mail's retail and wholesale prices were subject to price controls imposed by the previous regulator Postcomm. In March 2012, we considered it necessary to give Royal Mail sufficient commercial freedom to enable it to return the universal service to a financially sustainable position. Therefore, we removed nearly all of these price controls in order to give Royal Mail greater freedom to respond to changes in the market.

3.4 We expected that there would be some restructuring of prices given the low and negative returns that Royal Mail had been making in recent years in the Reported Business and the threat that this posed to the financial viability of the universal service. We also put in place a number of safeguards to protect consumers, including a cap on the price of Second Class stamps (for letters and parcels less than 2kg) to ensure that a basic universal service is available to all.

3.5 In its 2013 share prospectus, Royal Mail noted its expectation that any letter price increases for the years ending in the 2015-16 financial year would be broadly in line with RPI. It also stated that its parcel prices would increase broadly in line with RPI after the implementation of size-based pricing in 2013-14. We note below that the

[25] We also monitor Quality of Service closely given the risk Royal Mail could degrade quality in order to reduce costs rather than improve efficiency.

stamp price increases on 30 March 2015 were more than inflation[26], while certain size-based parcel prices reduced.

Royal Mail has complied with the safeguard caps

3.6 As noted above, the new regulatory framework gave Royal Mail more pricing flexibility subject to certain key safeguards. This included a safeguard cap on Second Class stamp Letters and Second Class stamp Large Letters and parcels up to 2kg. This was to ensure all consumers could afford a basic universal postal service.[27]

3.7 For Second Class standard letters, the cap was 55p in 2012-13 plus the relevant CPI inflation rate for the remaining seven year period of the regulatory framework. This means that the level of the cap was 58p in 2014-15, remaining at 58p for 2015-16. The large letter and parcel (up to 2kg) cap is a basket which allows Royal Mail to increase the prices of these products by up to 53%[28] on average in 2012-13, increasing by CPI for the remainder of the regulatory framework. This reflects the same percentage price increase as the letter cap over 2011-12 prices.

3.8 Royal Mail's prices for Second Class stamps complied with these safeguard caps in 2014-15.

3.9 We said in the March 2012 Statement that we would review the level of the caps if we considered they were unduly affecting Royal Mail's pricing flexibility and therefore its ability to return the universal service to a sustainable footing, or if we had evidence to suggest the prices were no longer affordable. We do not consider there is any evidence to suggest pricing flexibility or affordability (as explained later in this Section in paragraphs 3.24 to 3.28) are currently under threat.

All letter prices increased in 2015. Single piece parcel prices remained static or reducing, except for First Class small parcels 1-2kg, which increased by 3%

3.10 In this subsection, we discuss the prices which took effect from 30 March 2015 including First and Second Class stamp and meter prices for letters, large letters and parcel prices. Our analysis is conveyed in nominal terms, i.e. excluding any adjustment for inflation.

Standard letter stamp and meter prices

3.11 As shown in Figure 3.1, Royal Mail increased its prices for both First and Second Class stamp and meter on 30 March 2015. First Class standard letter stamps increased by approximately 2% to 63p whilst First Class meter prices increased by approximately 4% to 51p.

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[26] Change in CPI comparing March 2015 against March 2014 showed a decrease of 0.1%.
[27] The safeguard cap on Second Class stamp Letters came into effect on 1 April 2012 and can be found at: http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/annex7.pdf. The safeguard cap on Second Class stamp Large Letters and packets up to 2kg came into effect on 20 July 2012 and was subsequently modified in our March 2013 statement: http://stakeholders.ofcom.org.uk/binaries/consultations/safeguard-cap/statement/statement.pdf.
[28] Over 2011-12 prices.

3.12 Second Class standard letter stamps increased by approximately 4% to 54p whilst Second Class meter prices increased by approximately 3% to 36p.

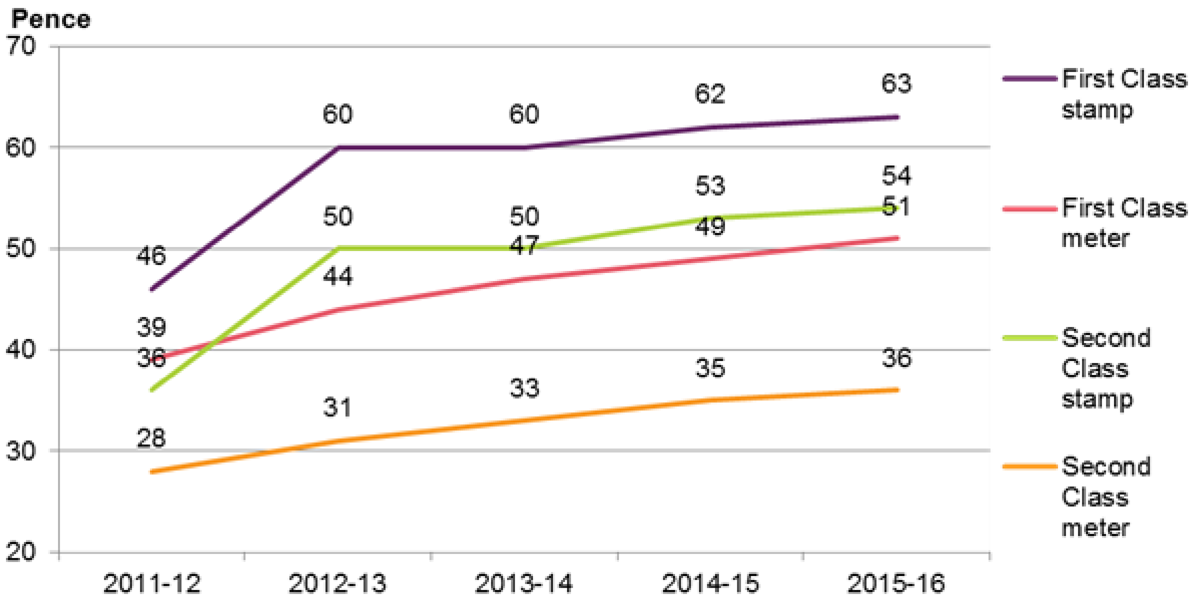
3.13 The differential between stamp and meter prices for a First Class letter decreased by 1p to 12p. The differential between stamp and meter prices or a Second Class letter remained the same at 18p.

3.14 The differential between First Class and Second Class stamp prices remained at 9p for the second year running, however the percentage differential reduced by 3% to 24%.

3.15 Since March 2011-12, prices for First Class and Second Class stamps have increased by 37.0% and 50.0% respectively. Over the same period CPI was 8.0%. The greatest part of these increases were in April 2012 when prices for First Class and Second Class stamps increased by 30% and 39%, respectively. As we noted in the annual monitoring report for 2012-13, it was expected that following the removal of most price controls there would be some restructuring of prices given the low and negative returns that Royal Mail had been making in recent years on the reported business and the threat that this posed to the financial viability of the universal service

3.16 However, since the 2012 price increases, prices for First and Second Class stamp have increased by 5.0% and 8.0% respectively. Over the same period CPI has increased by 4.4%

Figure 3.1 – Standard Letter First and Second Class stamp and meter prices 2011-12 to 2015-16



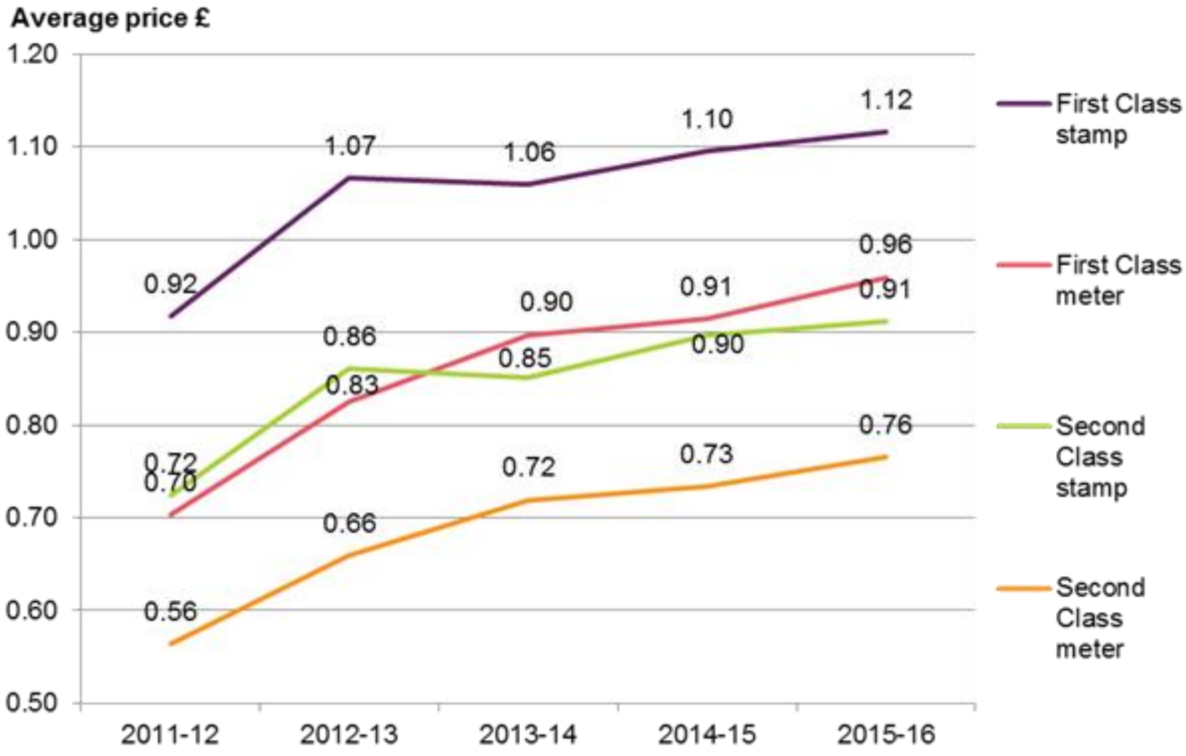
Source: Royal Mail price list

Large letter stamp and meter prices

3.17 There are four weight steps for Large Letters – 0-100g, 101-250g, 251-500g and 501-750g. Figure 3.2 shows the average price for Large Letters in recent years (across the weight steps and taking account of volumes in each weight step).

3.18 Prices rose for Large Letters across all weight steps in 2014-15 compared to the previous year. The average price for large letter stamps increased by c.2% for both First and Second Class. Meter prices increased by 4.9% and 4.3% for First and Second Class respectively.

Figure 3.2 – Average Large Letter First and Second Class stamp and meter prices 2011-12 to 2015-16

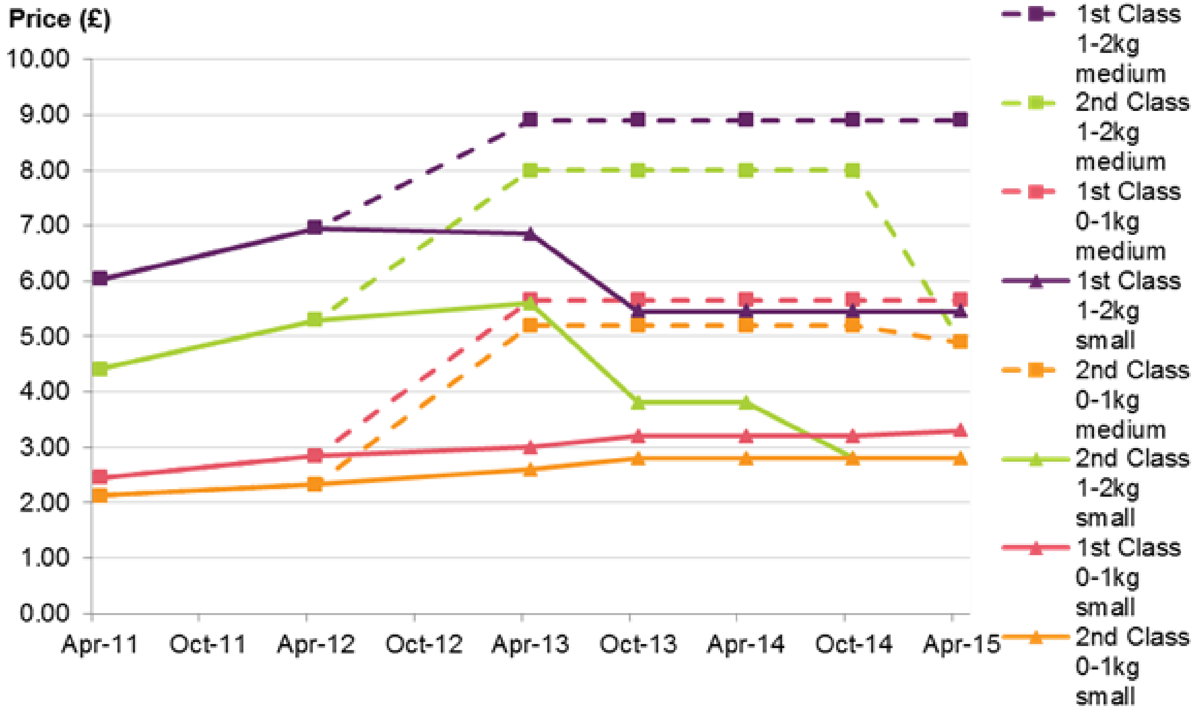


Source: Royal Mail. Ofcom calculation based on volume weighted average by weight step

Parcel prices

3.19 Figure 3.3 shows the trend in parcel stamp prices between 2011-12 and 2015-16, including two size-based price changes that took place during 2013-14. The weight bands shown are the current weight bands Royal Mail uses. Some of these weight bands have changed over the years. However, as we have data on the volumes sold in each year in the different weight steps set out below, we have been able to show a trend in the weighted average prices.

Figure 3.3 – Weighted average price for First and Second Class stamp parcels 2011-12 to 2015-16



Source: Royal Mail, Ofcom calculation based on volume weighted average price

3.20 In April 2013, Royal Mail introduced a change in its parcel formats which affected universal postal service parcel charges – pricing was no longer based solely on weight but on size/dimensions as well as weight. This is because Royal Mail had determined that the cost of delivery is driven more by the size of a parcel than its weight.[29] From 2 April 2013, Royal Mail offered two new parcel formats for its universal service parcel products, 'Small Parcel' and 'Medium Parcel'[30] (as shown in the graph above).[31] This introduction led to significant price increases in medium sized parcels with prices more than doubling in some cases. Based on consumer feedback Royal Mail changed the dimensions of its cube format with a larger 'shoebox' sized format in October 2013[32] resulting in a greater number of parcels

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[29] For example, while small parcels can be delivered at the same time as letters by postmen and women on their standard delivery round, bulkier parcels have to be delivered by van. 'Large parcels' – with maximum dimensions of 1.5m length and 3m length and girth combined up to 30kg – will be carried by Parcelforce Worldwide as that business can carry larger items more efficiently than Royal Mail.

[30] 'Small parcel' is no bigger than: 45cm length x 35cm width x 8cm depth, no heavier than 2kg. 'Medium parcel' is no bigger than 61cm length x 46cm width x 46cm depth, no heavier than 20kg. In addition Royal Mail made an exception to allow small cubes[30] to be sent as a 'Small Parcel' – with maximum dimensions of 16 x 16 x 16cm and no heavier than 2kg.
For more details see: http://www.royalmail.com/parcels-made-easy.

[31] Royal Mail's Standard Parcel service for non-priority items weighing more than 1kg (but less than 20kg) was withdrawn and replaced by an extension of the Second Class parcels product, which previously only went up to 1kg (we have represented this as a Second Class from 1-2kg in Figure 3.3 above).

[32] http://www.royalmailgroup.com/royal-mail-makes-changes-its-small-parcels-range.

qualifying as small parcels. [33] Royal Mail also reduced prices for its First and Second Class small 1-2kg parcels.

3.21 Although size-based pricing led to an increase in Royal Mail's revenues, particularly in the months immediately following its introduction in April 2013, there was a decline in consumer parcel volumes as a result. Royal Mail acknowledged that the introduction of size-based pricing contributed to volume decline in parcels, which resulted in customers switching to alternative postal operators.[34] This was a contributing factor to the overall 1.2% parcel volume decline in 2013-14, which was in contrast to the historic trend of parcel volume growth. This trend along with greater competitive pressures has continued into 2014-15 where parcel volumes declined by 1.1%.

3.22 In response to further customer feedback, Royal Mail made additional amendments to its small parcels dimensions on 20 October 2014.[35] The two dimensions that previously met the small parcel under 2kg criteria were replaced by a single format size – 45cm length x 35cm width x 16cm depth. Prices for small parcels remained unchanged, as did the maximum size for medium parcels.[36] Royal Mail also introduced a pricing promotion whereby the price of Small Parcels weighing 1-2kg would be the same as Small Parcels weighing 0-1kg. This promotional period lasted through the Christmas and New Year period (until 18 January 2015).

3.23 All stamped parcel service prices for 2015-16 with the exception of First Class 0-1kg small parcels fell or remained at 2014-15 levels as a result of the competitive pressures within the parcels market. The increase in First Class 0-1kg small parcels was 10p (3.1%). Royal Mail has reduced Second Class 1-2kg small and medium parcels from 2014-15 with prices falling by 26.3% and 38.9% respectively.

Affordability of universal services

3.24 The PSA 2011 requires universal postal service prices to be affordable. In our March 2012 Statement we committed to an effective and on-going monitoring regime to track Royal Mail's performance on, amongst other things, the affordability of universal postal services.

3.25 We also committed to further consider our approach to assessing whether universal postal services are affordable. We therefore published a report of our findings on the affordability of universal postal services in March 2013,[37] which included consumer research we had undertaken. In summary, the evidence we collected indicated that universal postal services are affordable for both residential consumers (including low income and other vulnerable consumers) and businesses (including small and medium businesses) at both the 2012 and 2013 prices.

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[33] 'Small parcels' can be 'wide': 45cm length x 35cm width x 8cm depth or 'deep': 35cm length, 25cm width, 16cm depth.
[34] Royal Mail 2013-14 audited Statutory Financial Statement.
[35] http://www.royalmailgroup.com/royal-mail-increasing-its-small-parcel-format-and-launching-festive-price-promotion.
[36] 61cm length x 46cm width x 46cm depth.
[37] Ofcom report on the *Affordability of universal postal services* 19 March 2013, http://stakeholders.ofcom.org.uk/binaries/post/affordability.pdf.

3.26 As noted further in this Section, Figure 3.10 shows 58% of residential consumers surveyed are satisfied with the cost of postage. Furthermore, Figure 3.11 shows consumer perceptions on value for money have improved over the past year to 58% and 50% of customers satisfied or very satisfied with value for money of First and Second Class stamps respectively, despite First and Second Class stamp price increases.

3.27 The latest ONS data shows 2014 weekly household expenditure on postal services to be around 0.1% (60p) of total expenditure based on 2013 prices.[38] This is a little less than the current price of a single First Class stamp (63p).

3.28 We will continue to use our quantitative consumer surveys for residential consumers and businesses – which are discussed later in this Section – to monitor the use of postal services, to assess the affordability of services in the universal service and the satisfaction with the value for money of post and postal prices.

Non-price terms of universal services

3.29 In our March 2012 Statement we stated that as part of the monitoring regime we would also consider the impact of non-price changes to the terms of universal services, which involve changes to Royal Mail's Postal Schemes. Postal Schemes set out the terms and conditions for 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. The Postal Schemes are available on Royal Mail's website. Before making changes to the Schemes, Royal Mail has to formally consult customers and stakeholders, including Ofcom, and the consumer advocacy bodies, for example, Citizens Advice, providing at least one month's notice in advance of the date on which Royal Mail proposes to implement the change.

3.30 During 2014-15, Royal Mail made the following changes to non-price terms:

- Prohibited and restricted goods – Royal Mail removed the restriction for water-based paints and included new restrictions on the delivery of human and animal samples in compliance with updated health and safety legislation.
- Small parcels – Customers sending parcels which do not exceed the dimensions 450mm x 350mm x 160mm will be priced at the small parcel rate.
- Royal Mail introduced a large letter format to the Overseas Letter Post Scheme on 30 March 2014. The format directly mirrors the domestic large letter format with dimensions of 353mm x 250mm x 25mm and a maximum weight of 750g.

[38] ONS Family Spending, 2014 Edition, Table A1, published 02 December 2014, http://www.ons.gov.uk/ons/rel/family-spending/family-spending/2014-edition/rft-table-a1.xls.

Quality of Service

Royal Mail met its First Class national target and exceeded its Second Class national target

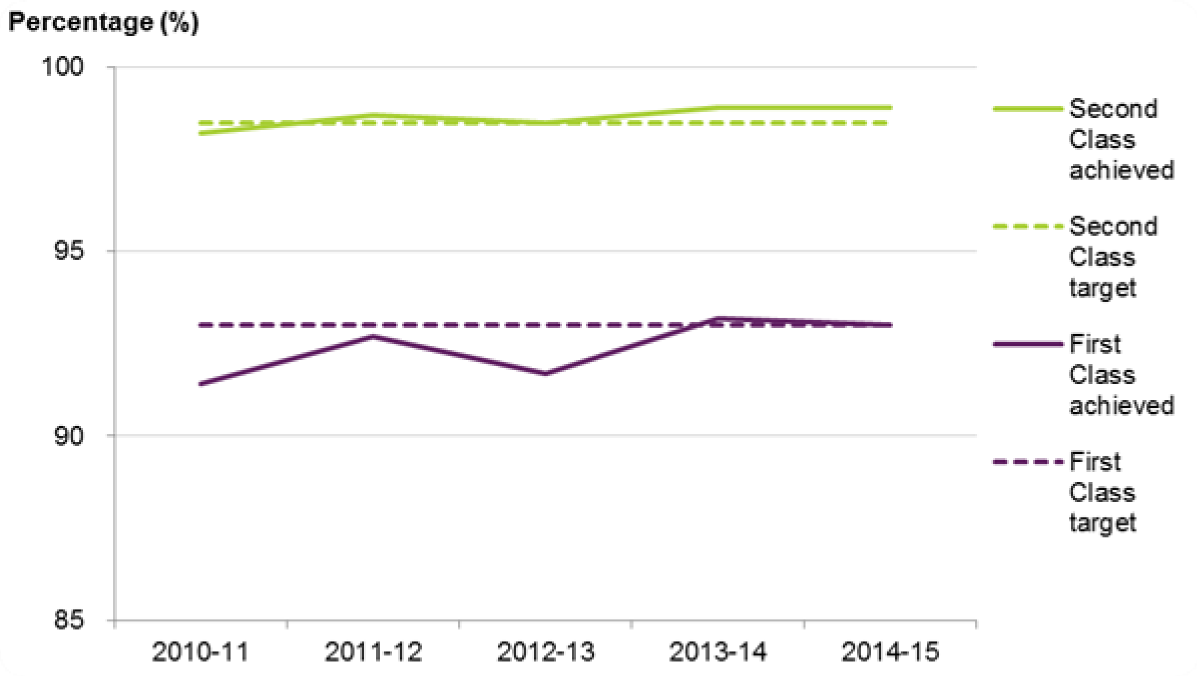
3.31 The EU Directive requires that universal service providers be subject to quality of service targets. Ofcom takes this issue very seriously as customers have a right to know what quality of service they can expect when they purchase universal service products. Royal Mail is therefore subject to several quality of service (QoS) targets. We monitor its performance against these targets as discussed below. The figures cited in this subsection (and shown in Figures 3.4 to 3.7) are taken from Royal Mail's QoS reports and do not reflect any adjustment that Royal Mail makes to account for force majeure events, such as very severe weather.

3.32 Regulatory conditions imposed by Ofcom require Royal Mail to deliver 93% of all First Class retail items (single piece stamp, meter and PPI letters and parcels) on the day after collection, and 98.5% of all Second Class[39] retail items within three days of collection. 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 to aircraft flights due to bad weather or missed network connections due to road traffic delays and breakdowns. If the targets were set at a higher level it would be likely to increase Royal Mail's costs and, potentially, universal service prices. In the case of the 93% first class target this was originally agreed as achievable by Royal Mail and Postcomm in 2001.

3.33 As shown in Figure 3.4 (which also shows historic performance), in 2014-15, Royal Mail met its First Class target, reaching 93%; and exceeded its Second Class target by 0.4% reaching 98.9%.

[39] Until 2 April 2013, consumers could send parcels up to 20kg First Class and up to 1kg Second Class, with a Standard Parcels product for consumers wishing to send items weighing between 1kg to 20kg, but more cheaply than First Class. Standard Parcels were subject to a lower than Second Class QoS target. From 2 April 2013, Royal Mail replaced its Standard Parcel service with Second Class parcels up to 20kg, with performance measured against the Second Class letter quality of service target.

Figure 3.4 – Retail First and Second Class: Performance against delivery targets (items delivered on time)[40]



Source: Royal Mail QoS reports, 2010-2015. Note: 2013-14 and 2014-15 figures are unadjusted for force majeure

3.34 There are 121 Post Code Areas (PCAs) in total. Royal Mail is required to deliver 91.5% of all First Class single piece mail the day after collection to 118 PCAs. This is to ensure Royal Mail provides a good level of service across the UK – not just in more densely populated areas, but also in less densely populated areas and those where addresses may be harder to reach. Three of the PCAs – HS (Hebrides), KW (Kirkwall, Orkney) and ZE (Shetlands) – are excluded from this target, principally because it is not practical logistically 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.

3.35 As shown in Figure 3.5, in 2014-15 Royal Mail achieved the 91.5% target in 109 of its 118 PCAs.[41] The nine PCAs that did not reach 91.5% in 2014-15 were within the margin of error for the independent survey measurement process used to calculate performance. This therefore did not justify intervention or further investigation as due to the estimation methodology it could not be ascertained whether Royal Mail had missed the target or not. However, this represented a fall from 2013-14 when Royal

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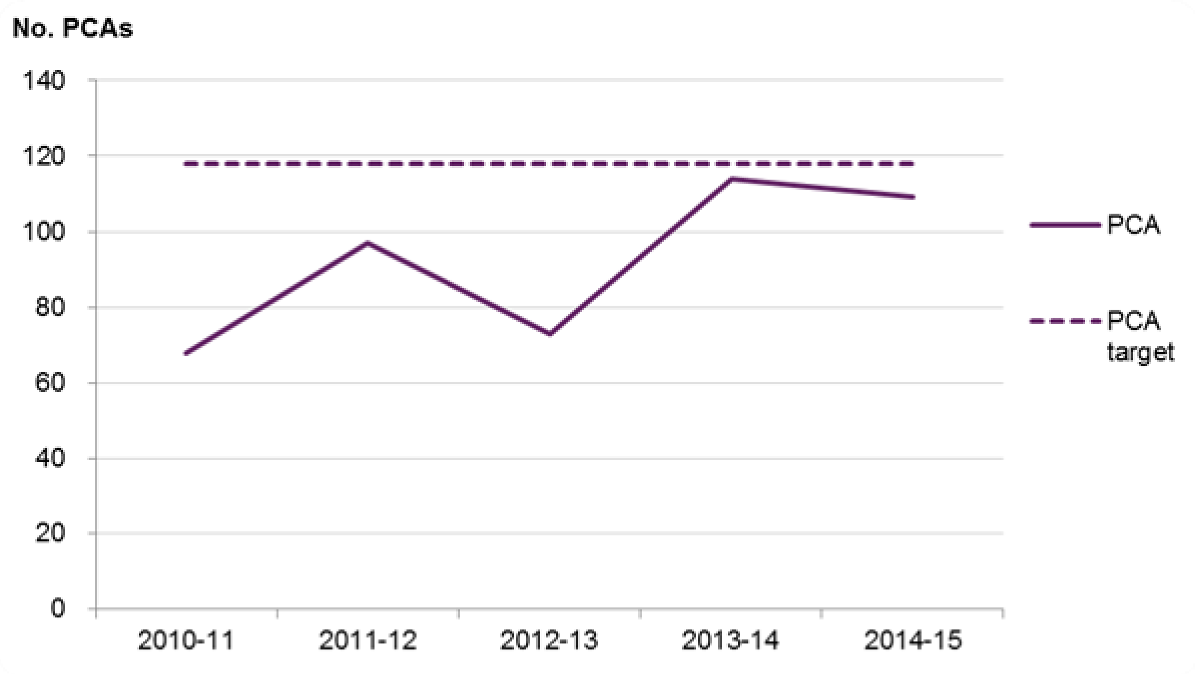
[40] Until 2 April 2013, consumers could send parcels up to 20kg First Class and up to 1kg Second Class (with a Standard Parcels product for consumers wishing to send items weighing between 1kg to 20kg, but more cheaply than First Class) – Standard Parcels were subject to a lower than 2nd class QoS target. From 2 April 2013, Royal Mail replaced its Standard Parcel service with Second Class parcels up to 20kg, with performance measured against the Second Class letter quality of service target hence from 2013-14 onwards these have been included in the overall QoS figures as presented in Figure 3.4.

[41] Royal Mail's Quarterly Quality of Service and Complaints Reports are available online, http://www.royalmailgroup.com/customers/quality-service/quality-service-reports.

Mail hit the target in 114 PCAs. The PCAs which were within the margin of error of the survey in 2014-15 were different PCAs to those that were similarly within the margin of error in 2013-14.

Figure 3.5 – Number of PCAs in which First Class delivery targets were met



Source: Royal Mail QoS reports, 2010-2015. Note: 2013-14 and 2014-15 figures are unadjusted for force majeure

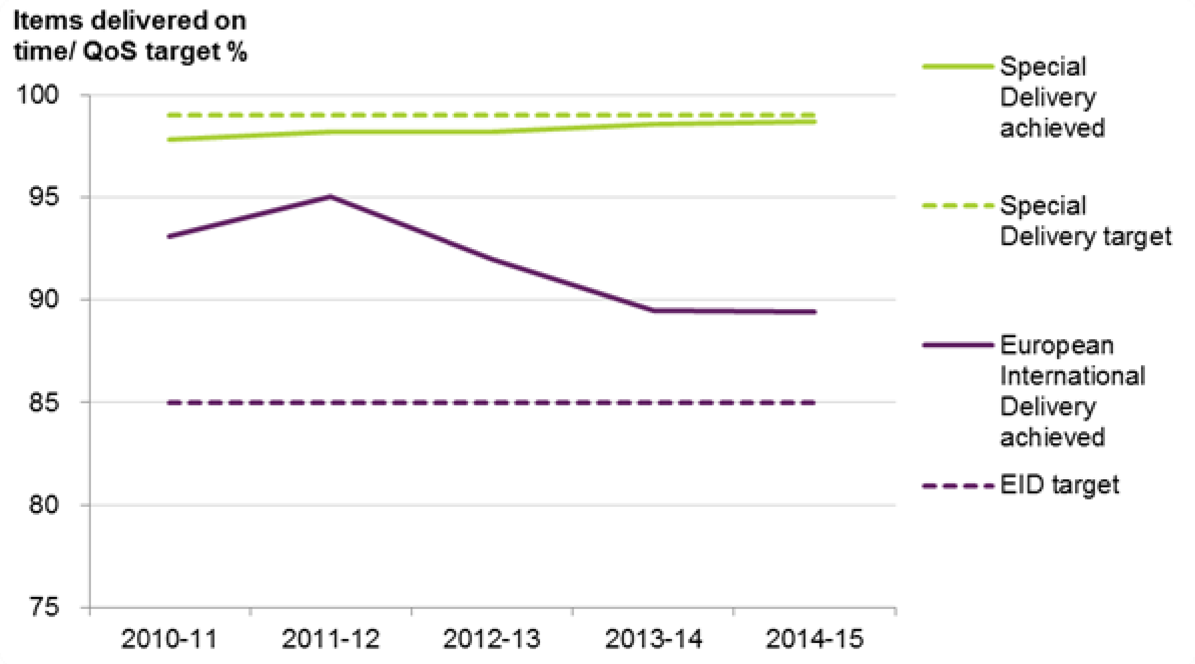
Targets were achieved for European International, collection points served daily and items correctly delivered, but narrowly missed for Special Delivery and for delivery routes completed daily

3.36 Also included within the universal service are European International Delivery and Special Delivery (Next Day) Services.

3.37 As shown in Figure 3.6 below, for the Special Delivery (Next Day by 1pm) product 99% of items are required to be delivered on the next delivery day. As with previous years, in 2014-15 Royal Mail narrowly missed the target for Special Delivery items achieving 98.7% on time delivery.

3.38 In addition, 85% of European International items should be delivered in three days. Royal Mail exceeded its target, achieving 89.4%.

Figure 3.6 – Performance against targets for other universal service products

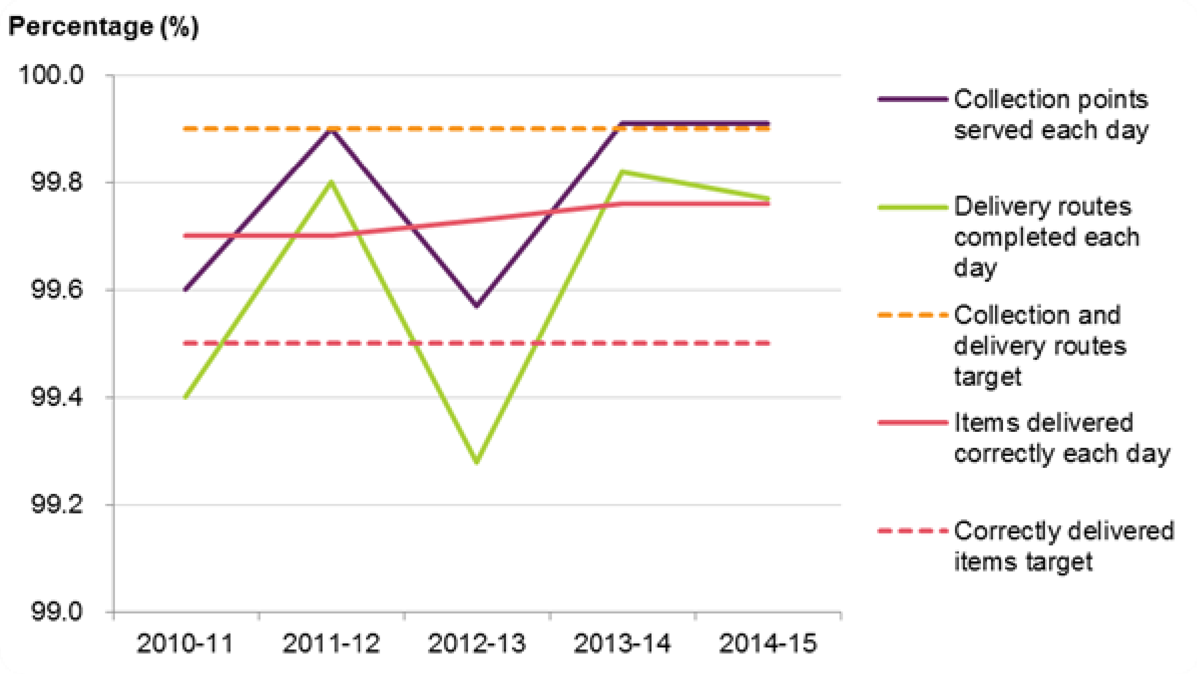


Source: Royal Mail QoS reports, 2010-2015. Note: 2013-14 and 2014-15 figures are unadjusted for force majeure.

3.39 In addition to the above product-related targets, Royal Mail has a number of service-oriented targets. Six days per week Royal Mail is required to: collect from 99.9% of its collection points; complete 99.9% of its delivery routes; and deliver 99.5% of items correctly.

3.40 As shown in Figure 3.7, in 2014-15 Royal Mail exceeded the targets for correctly delivered items and collection points served but just failed to meet its target for delivery routes completed each day (99.7%). In view of the very small margin of failure we do not consider it necessary to investigate further but we will monitor this issue during 2015-16.

Figure 3.7 – Performance against targets for correctly delivered items, collection points served and delivery routes completed



Source: Royal Mail QoS reports, 2010-2015. Note: 2013-14 and 2014-15 figures are unadjusted for force majeure.

We will continue to monitor Royal Mail's QoS closely

3.41 We are pleased that Royal Mail met or exceeded the majority of its quality of service targets in 2014-15 and those products or services which failed did so within a small margin. We will continue to monitor Royal Mail's QoS closely.

Complaints data

3.42 All regulated postal operators including Royal Mail are required to publish annual complaints data. Additionally, Royal Mail is required to publish quarterly reports showing the amount of compensation paid in relation to complaints about most universal services.[42]

3.43 We have observed that over a five year period from 2010-11 total complaints per 100,000 items to Royal Mail have fallen by 15%.[43] Over this time the average cost (per complaint in response to which compensation was paid) has also fallen by 10%. The main reason for this fall was that during 2012-13 Royal Mail changed its

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[42] See Consumer Protection Condition 4.3. See also: http://www.royalmailgroup.com/sites/default/files/annual%20complaints%20report%20for%202014%2015.pdf. Please note that Royal Mail reports on two different complaint figures. First it reports the number of complaints relating to regulated postal services. Secondly, in relation to the compensation paid this relates to the payments made to all customers (consumer and business) in accordance with product terms and conditions, the regulatory compensation scheme for delay, and any goodwill payments made in respect of customer complaints received.

[43] Complaint figures referred to relate to all Royal Mail complaints not just those relating to regulated postal services.

compensation policy, capping the maximum compensation for standard universal service items at £20. This was a significant change as previously the maximum compensation available was 100x the cost of a First Class Stamp (in the year of the change, this was £60.00). This change encouraged senders posting higher value items to use the 'Signed For' service which has a compensation cap of £50 and a lower probability of loss. The substitution effect and lowering of the maximum compensation had the combined effect of decreasing average cost per complaint. It is worth noting that eBay sellers are required to send items using Signed For or tracked services if they wish to sell items via PayPal and benefit from payment protection.

3.44 Royal Mail is required to report the top ten categories of complaint.[44] In 2014-15, the greatest number of complaints was in relation to lost items which accounted for 31% of all complaints. This was the same percentage as 2013-14. In addition to its normal mail integrity procedures, Royal Mail is taking steps to minimise the risk of loss in 2015-16 by introducing a new employee conduct agreement, improving training around security of mail for new starters, deployment of enhanced loss analysis tools along with improved barcoding of parcels. There will also be an increased focus on training to reduce staff leaving items on the doorstep of the addressee with a view to ensuring staff follow procedures such as 'delivery to neighbour' correctly.

3.45 We will continue to examine any complaints data that we receive. This, along with our consumer survey findings, will help to highlight whether there is degradation and/or any areas of concern in postal services used by residential and small business customers.

Residential and business customer surveys

3.46 As part of our on-going monitoring regime, we run a market research programme to ensure we have up-to-date views of consumers on the postal market. The research began in July 2012.

3.47 We run two separate surveys to track use of and attitudes to post, one focused on residential consumers and the other on small and medium enterprise (SME) business customers. This is the third year since the surveys have been introduced and we therefore present the results for the twelve month periods from July 2012 to June 2015 for the residential survey and the twelve month periods from April 2012 to March 2015 for the business survey.

3.48 A broader range of data from these surveys is summarised in our Communications Market Report, and detailed survey results are published alongside it.[45] Below we discuss some of the consumer metrics which we consider to be particularly relevant to our monitoring regime.

3.49 The variation between sample results and the true values (the findings that would have been obtained if everyone had been interviewed) can be predicted from the sample sizes on which the results are based and on the number of times that a particular answer is given. The confidence with which we can make this prediction is

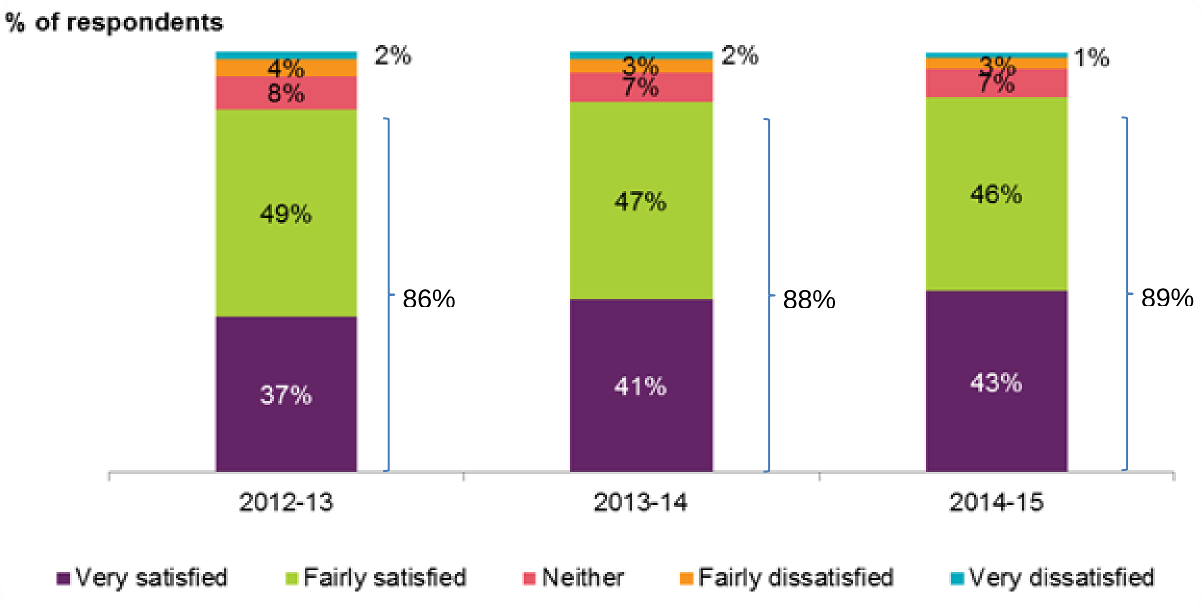
[44] http://www.royalmailgroup.com/sites/default/files/annual%20complaints%20report%20for%202014%2015.pdf .
[45] http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr15/CMR_UK_2015.pdf.

95% that is chances are 95 in 100 that the true values will fall within a specified range. Where movements are not statistically significant we have noted them below.

Our findings suggest the majority of consumers continue to be satisfied with postal services

3.50 Residential consumer satisfaction results showed an improvement on key metrics against the prior year, with a greater percentage of respondents being either very satisfied or fairly satisfied. Three key metrics are discussed below.

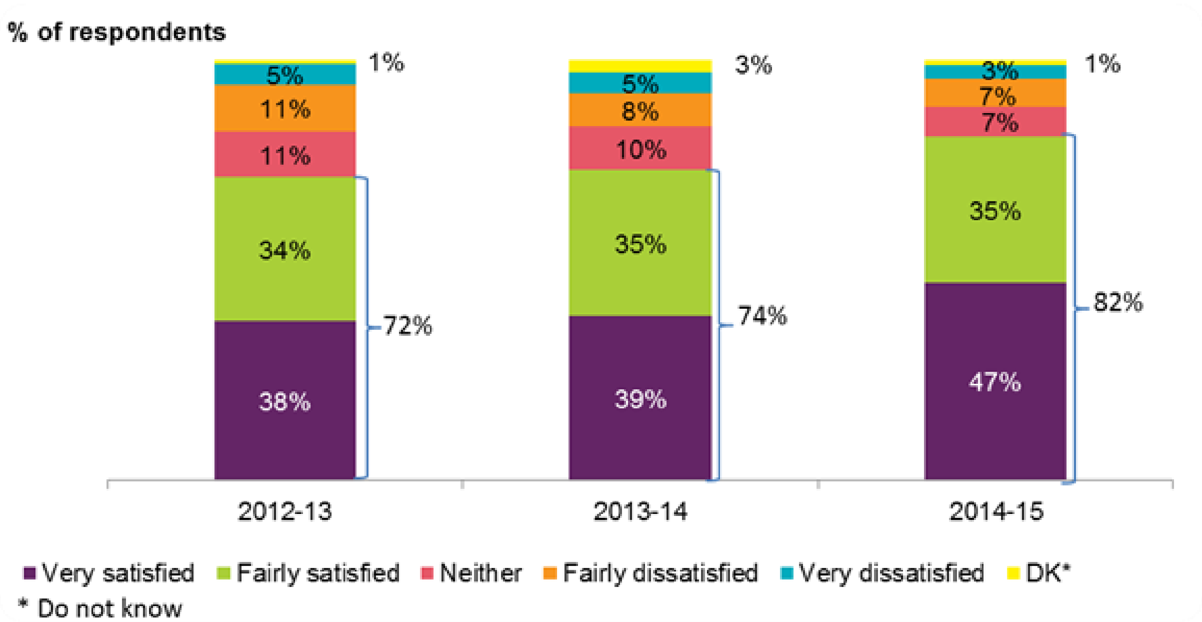
Figure 3.8 – Residential consumers' overall satisfaction with post



Source: Ofcom Residential Postal Tracking survey. Base: All respondents (3,122) July 2014 - June 2015, Annual monitoring update on the postal market: financial years 2012-13 and 2013-14
QE2. SHOWCARD Thinking about your experience of using the postal service to send and receive mail, how would you rate your overall satisfaction with the postal service? (SINGLE CODE).

3.51 As shown in Figure 3.8, the vast majority of residential consumers said that they were satisfied with postal services overall, with 89% of respondents stating they were either very satisfied or fairly satisfied with postal services. This figure improved by 1% from 2013-14. The overall percentage of those satisfied with postal services has improved by 3% from 2012-13. However, please note the increase is within the margin of error so is not statistically significant.

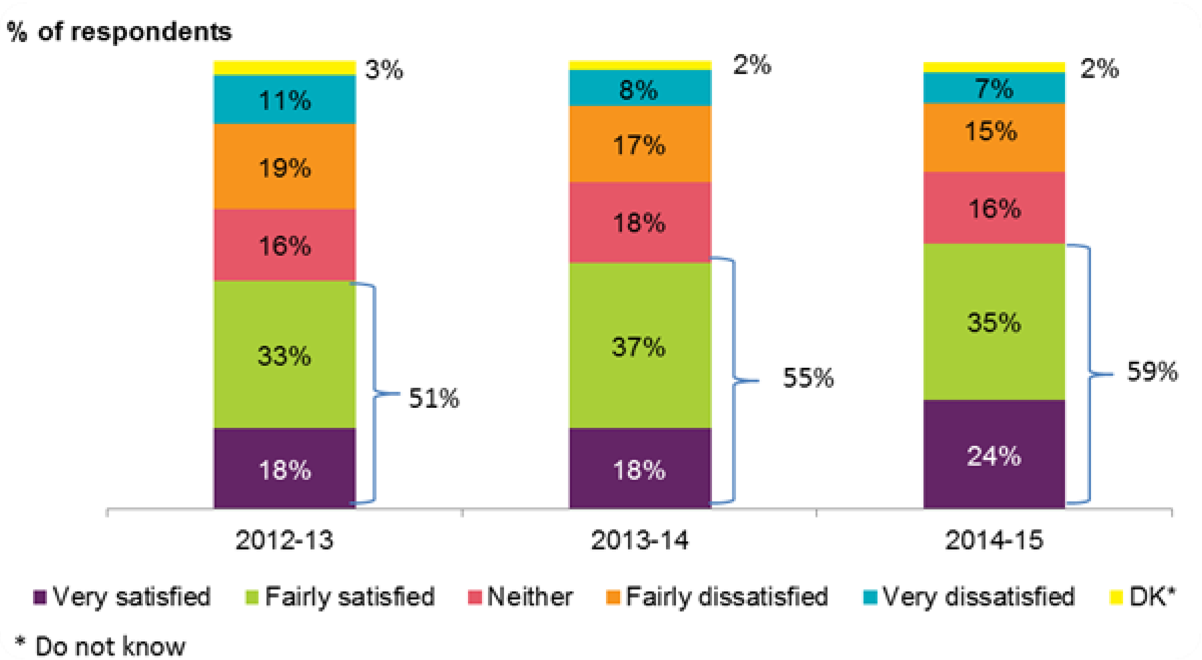
Figure 3.9 – Residential consumers' views on delivery times



Source: Ofcom Residential Postal Tracking survey. Base: All respondents (3122) July 2014 - June 2015, Annual monitoring update on the postal market: financial years 2012-13 and 2013-14
QE3A. SHOWCARD - SATISFACTION WITH ASPECT OF ROYAL MAIL'S SERVICE - The time of day your post is delivered to you (SINGLE CODE).

3.52 Figure 3.9 shows around 82% were either very or fairly satisfied with the time of day post is delivered which was an improvement from 74% in the prior year, indicating consumers are happy with current delivery arrangements. This metric has improved significantly from 2012-13 (10% increase).

Figure 3.10 – Residential consumers' views on cost of postage

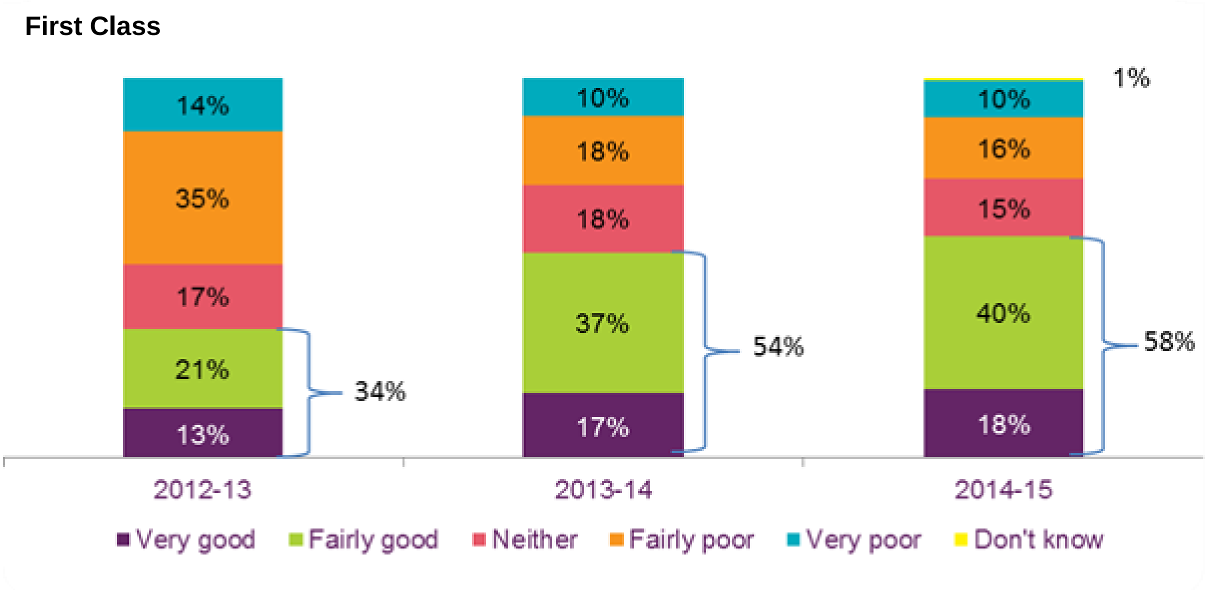


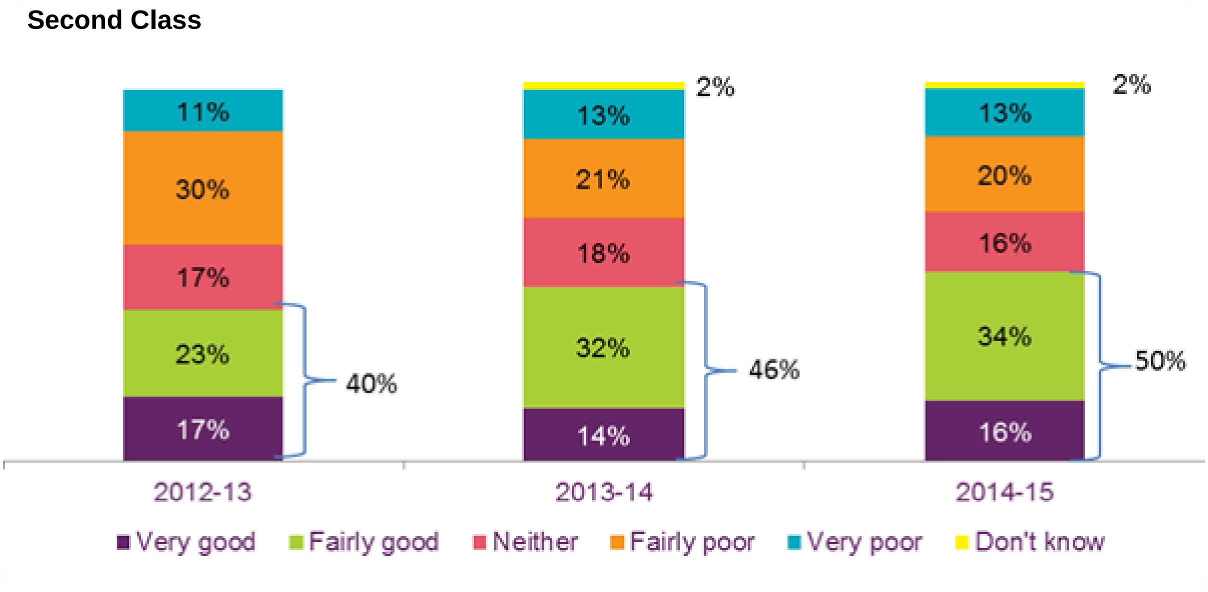
Source: Ofcom Residential Postal Tracking survey. Base: All respondents (2,151) July 2014 - June 2015, Annual monitoring update on the postal market: financial years 2012-13 and 2013-14
QE3F. SHOWCARD - SATISFACTION WITH ASPECT OF ROYAL MAIL'S SERVICE - The cost of postage (SINGLE CODE).

3.53 As shown in Figure 3.10, respondents' satisfaction with the cost of postage continues not to be as high as the other metrics with 59% satisfied, although this was an improvement to the prior year (2013-14: 55%). Since 2012-13 there has been an improvement of 8% in total.

Perceptions about value for money are better for First Class stamps compared to Second Class stamps, and both have increased in perceived value in 2014-15 compared to previous years

Figure 3.11 – Perceived Value for Money of First and Second Class Stamps





Source: Ofcom Residential Postal Tracking survey. Base: All respondents (1,582) July 2014 - December 2014, Annual monitoring update on the postal market: financial years 2012-13 and 2013-14
QF3. SHOWCARD It currently costs 62p to send a standard letter first class within the UK. How would you rate the Royal Mail's first class service in terms of value for money (SINGLE CODE). QF4. SHOWCARD It currently costs 53p to send a standard letter second class within the UK. How would you rate the Royal Mail's second class service in terms of value for money? (SINGLE CODE)

3.54 Our survey also considered consumer perceptions on the value for money of postal services. Once informed of the correct price for First and Second Class stamps, Figure 3.11 shows the extent to which people think they offer good value for money.

3.55 58% of residential consumers considered that First Class stamps offer fairly or very good value for money (2013-14: 54%) compared to 50% (2013-14: 46%) who thought the same of Second Class stamps.[46] Consumer perceptions on value for money have remained improved over the past year, despite First and Second Class stamp price increases. However, these price rises have been lower than previous years. They have improved by a greater percentage from 2012-13 for both First and Second Class. Perceptions in 2012-13 may have been affected by the significant rises Royal Mail made to both First and Second Class prices in 2012.

Misdelivered mail continues to be the largest category of complaint, however due to increasing the number of categories we are unable to compare complaints on a like-for-like basis

3.56 Our survey asked residential consumers about the types of problems they have experienced with postal services. We have increased the number of complaints categories in the current tracker to include ‘card from Royal Mail when someone is in to receive item’, therefore the year-on-year trend is not on a like-for-like basis. This is separate from the complaint statistics reported by Royal Mail (see paragraph 3.44 above).

3.57 When asked specifically about the service received from Royal Mail, 44% of respondents said they had experienced some a problem. When prompted, the main problems experienced with Royal Mail were with mis-delivered or delayed mail, as shown in Figure 3.12. This was the same percentage as the prior year, albeit as noted above, the prior year numbers are not on a like-for-like basis.

[46] These figures are not as strong as those from a previous Postcomm[46] survey (in 2009) in which 82% of adults rated First Class stamps 83% Second Class stamps as good value for money. This may be due to the fact that there have been significant above inflation increases in both First and Second Class stamp prices since 2009. However these comparisons are not on a like for like basis as the methodology and audience were different.

Figure 3.12 – Main postal issues experienced by residential consumers who have reported problems (July 2014 to June 2015)

Source: Ofcom Residential Postal Tracking Survey Base: All respondents who have experienced a problem with their post in the last 12 months (921) July 2014 - June 2015
SUMMARY - EXPERIENCE OF PROBLEMS WITH ROYAL MAIL'S SERVICE IN THE LAST 12 MONTHS

Figure 3.13 – Main postal issues experienced by residential consumers who have reported problems (July 2013 to June 2014)

Source: 2013-14 Annual monitoring update

SME Business satisfaction levels

3.58 As discussed in paragraph 3.47 we also obtain feedback from SMEs about postal services.[47] SMEs are particularly important in the UK postal sector as they account for the majority of all sent mail (around 92%).[48]

3.59 83% use Royal Mail as their only postal operator with the remaining 17% also using another provider in addition to Royal Mail.[49]

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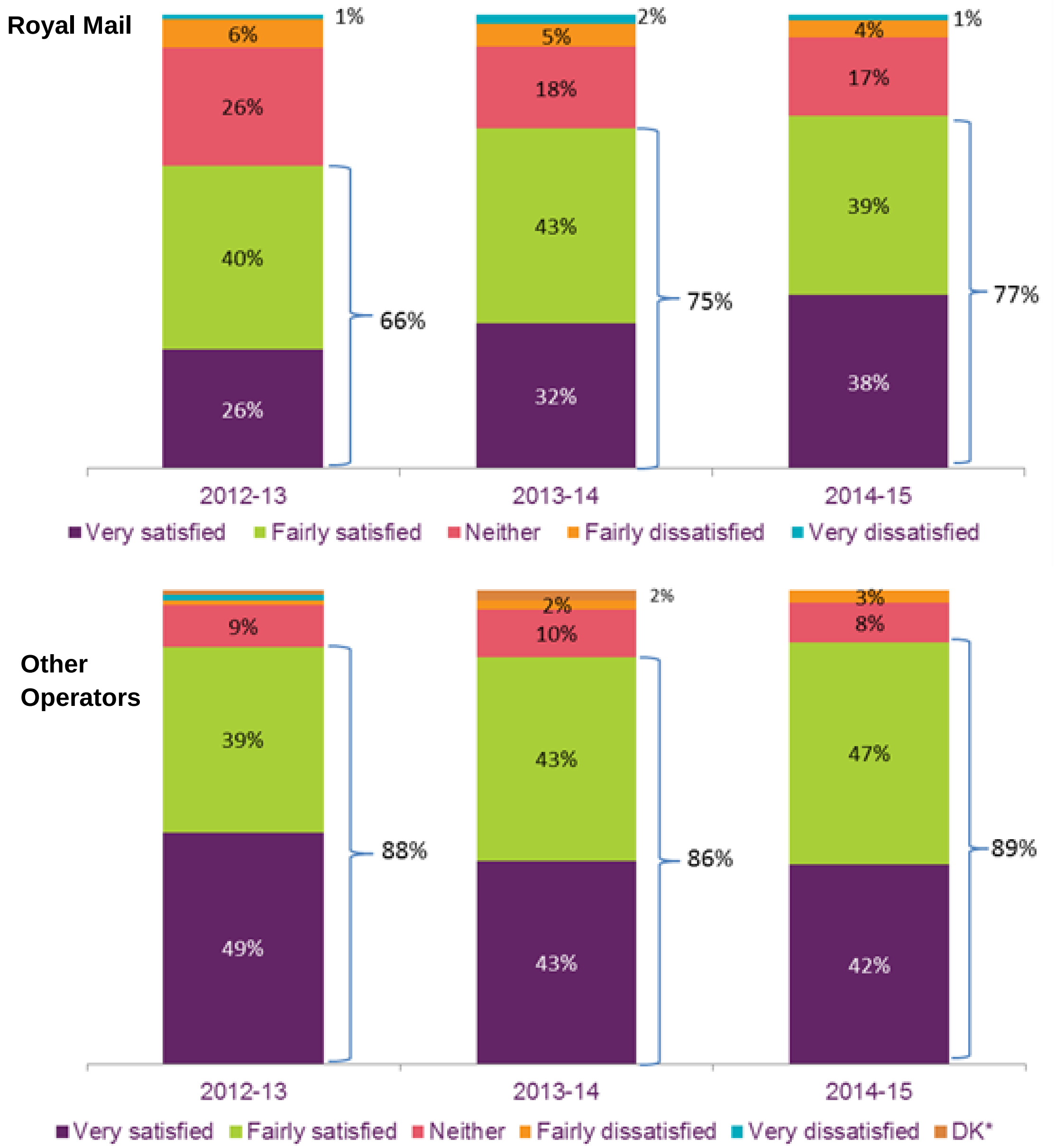
[47] 1,591 SMEs were sampled as part of our Business Postal Tracker, with a further 50 semi-structured interviews conducted with businesses that employ more than 250 employees.
[48] WIK-Consult, Main Developments in the Postal Sector (2010-2013): Country Reports, August 2013.
[49] Business postal tracker Year 3.

Figure 3.14 – Satisfaction levels amongst businesses for Royal Mail and other postal operators



Source: Ofcom Business Postal Tracker. Base: Royal Mail (1,564), Other Providers (276) April 14 to March 15 QRM2. Thinking generally about the service your organisation receives as a whole, how satisfied are you with the overall quality of the services you receive from Royal Mail as a recipient and sender? QOP1a. ALL PROVIDERS OTHER THAN RM. Thinking generally about the service you receive as a whole as a sender and recipient of mail, how would you rate the quality of the services you receive from [QV5C]

3.62 Figure 3.14 shows the satisfaction levels amongst SMEs for Royal Mail and other postal operators. 77% of business consumers are either very or fairly satisfied with postal services. Satisfaction rates are better for other postal operators with 89% being satisfied with services from other operators. The level of satisfaction has increased from the prior year with Royal Mail improving by 2% and other operators

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http://stakeholders.ofcom.org.uk/binaries/research/statistics/2015May/Business_postal_tracker_Year_3_Data_Tables.pdf .

improving by 3%. However, these movements are within the margin of error. Royal Mail has improved its satisfaction levels from 2012-13 with an improvement of 11%.

3.63 It should also be noted that 63% of sampled SMEs stated they had switched mail to other communication methods within the last 12 months. This percentage has increased by 4% from the prior year indicating SMEs are increasing their rate of substitution. 66% of respondents who switched stated the reason for switching was price increases.

We will continue to monitor views on the postal sector through our consumer surveys

3.64 Our business and residential surveys provide us with a useful measurement of the consumer experience of postal services – for example, in terms of general satisfaction with the service, satisfaction with the cost of postage, value for money and the problems encountered. We will continue to provide analysis from both the residential and business surveys in our future annual monitoring updates.

Summary

3.65 The key findings relevant to customers and consumers are below.

- First and Second Class stamps are perceived as being good value for money. Royal Mail is complying with the Second Class safeguard cap we have put in place.

- Royal Mail met or exceeded the majority of its quality of service targets in 2014-15 and those products or services where it failed, it did so within a small margin. We will continue to monitor Royal Mail's QoS closely and if Royal Mail fails to meet its QoS targets in future, we will consider opening a formal investigation.

- Complaints data published by Royal Mail showed the number of complaints has continued to fall since 2010-11 with the most complained about issue being lost items. Royal Mail has stated it is always striving to reduce complaints and recent data suggests this is the case with complaints per 100,000 items reducing over the last five years. Royal Mail is implementing a number of new initiatives in addition to its normal mail integrity procedures with a view to reducing complaints and claims related to loss. We will monitor complaints closely throughout the year to identify if these measures have the intended effect.

- Our market research indicates that the vast majority of residential consumers and the majority of business customers are satisfied with their postal services, though 77% of Royal Mail's SME customers say they are satisfied compared to 89% of other operators' SME customers.

Section 4

Bulk mail services

4.1 As set out in the March 2012 Statement, competition in the postal market has a number of potential benefits for customers. This includes providing choice for customers and incentives for Royal Mail to become more efficient and to innovate, thereby improving the future sustainability of the universal service. However, we also recognised that competition has the potential to threaten the future sustainability of the universal service if it results in an acceleration of Royal Mail's volume and revenue decline.

4.2 This Section outlines trends in the UK letters sector then discusses the different types of competition and market trends for alternative types of mail volumes. We then discuss Royal Mail's price increases for its retail bulk mail products and the price changes for access products effective from April 2014 and January 2015. We then discuss trends and new developments in both access and end-to-end competition in the UK.

Trends in the UK letters sector

4.3 The total UK letter volumes have continued to decline since 2005.

4.4 The factors set out in a 2013 PwC report commissioned by Royal Mail on UK mail volumes continue to be relevant:

- E-substitution – electronic forms of communication, such as e-mail, replace mail volumes;
- Low GDP growth – it is likely that the recession experienced in the UK over the last few years reduced or slowed the growth (or increased the rate of decline) of some mail volumes more than would otherwise have been the case;[50] and
- Price rises – particularly those that were above inflation, were also likely to have impacted the consumption of mail products.

4.5 We consider it likely that these factors have been influencing the decline in UK letter volumes in recent years to some degree, although their individual effects are difficult to determine in any precise way.[51]

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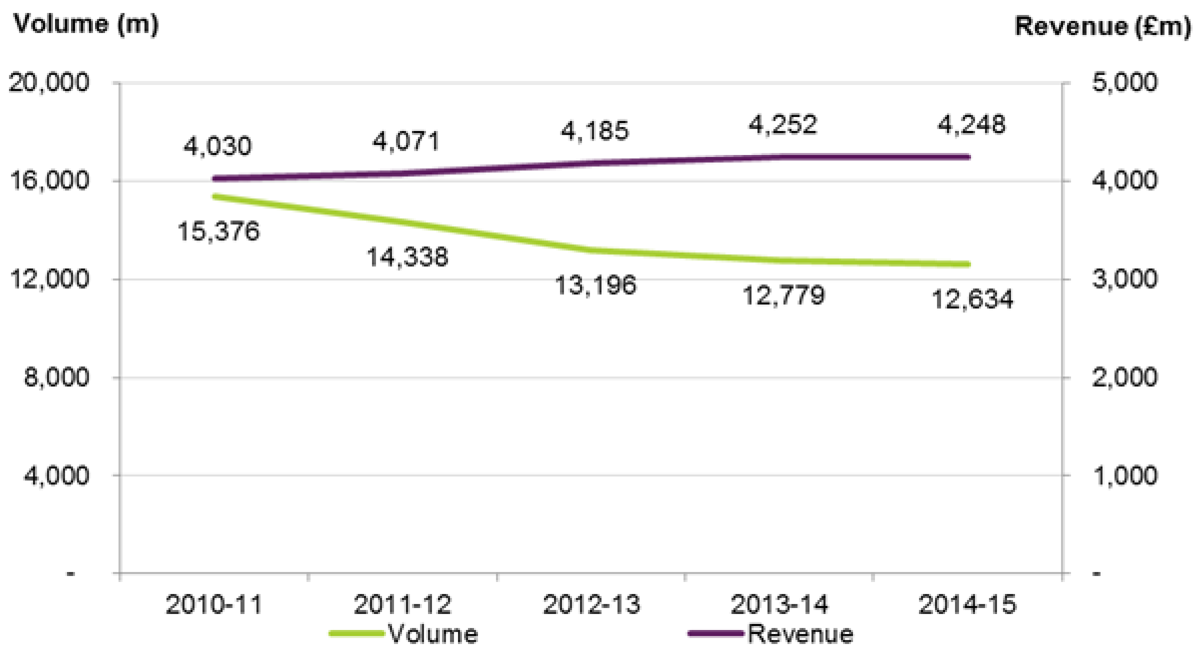
[50] For example, see the PwC report *The outlook for UK mail volumes to 2023* at http://www.royalmailgroup.com/sites/default/files/The%20outlook%20for%20UK%20mail%20volumes%20to%202023.pdf slides 9, 26 and 33. The rate of mail volume declines seem to have been more pronounced since 2008 indicating there has been a macroeconomic impact. In particular, the recession seems to have been a key contributor to the rapid decline of direct mail volumes in recent years (see slide 40).

[51] Mail volumes have been falling in other countries as well, to varying degrees. The PwC report shows that volumes appear to have fallen more sharply in some countries particularly those which have been more focused on digitising mail, such as in Denmark where the Government is seeking to make all government interactions paperless within a few years, and less so in countries like Germany

4.6 Figure 4.1 shows that total letter volumes have declined since 2010-11. Total addressed letters volumes continued to fall in 2014-15, declining by 1.1% to 12.6bn items. Although the rate of decline has been slowing in the past couple of years, and the decline in the past year is a slower rate of decline than the previous year (which was 3.2%), it still represents an 18% decline since 2010-11. The slower rate of decline has been attributed to the improvement in UK economic conditions[52].

4.7 Despite the fall in volumes, total letters revenue remained broadly flat (0.1% decline) at £4.2bn. As discussed later in this Section, the principal reason for this was price rises from Royal Mail.

Figure 4.1 – Total UK letter volumes and revenue



Source: Royal Mail Regulatory Financial Statements, Royal Mail Wholesale, operator returns to Ofcom, Ofcom estimates. Note: Royal Mail figures relate to the Letters and Large Letters[53] in the Reported Business.UK Letter volumes and revenues include a small element of access parcels volumes and revenues. Addressed mail only

Types of competition

4.8 Within the postal sector, there are two main forms of competition: access and end-to-end.

4.9 Access competition is where the operator 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. Royal Mail is subject to a regulatory condition requiring it to

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where the public sector has given comparatively low priority to the digitisation of mail and there is a lower acceptance of 'digital signatures'.

[52] Royal Mail Annual Report and Financial Statements 2015, page 21.

[53] Standard Letters or Letters means any item up to length 240mm, width 165mm, thickness 5mm and weighing no more than 100g. Large Letters means any item larger than a Letter and up to length 353mm, width 250mm, thickness 25mm and weighing no more than 750g.

offer access at its Inward Mail Centres to other postal operators and customers for letters and large letters. This enables other operators to offer postal services to larger business customers for these formats without setting up a delivery network. Access has been the predominant form of letters competition in the UK since the first access contract was signed in 2004.

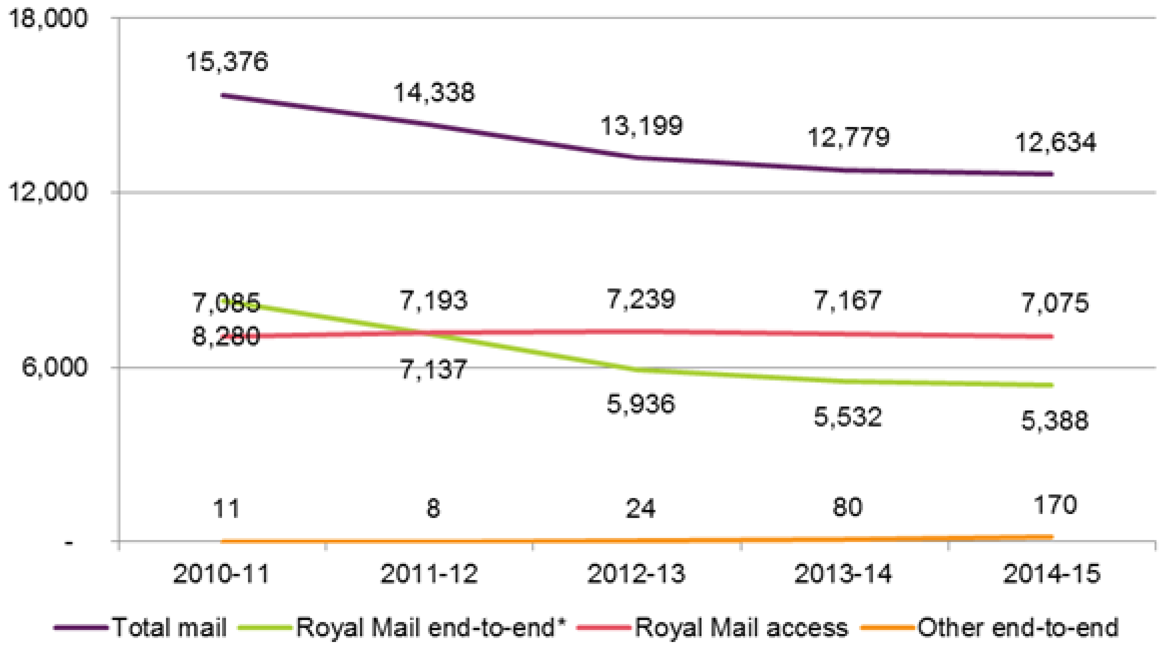
4.10 End-to-end competition is where an operator other than Royal Mail undertakes the entire process of collecting, sorting and delivering mail to the intended recipients.

Letters competition

4.11 Together the total bulk letters and large letters mail sector consists of three parts: mail collected and delivered by Royal Mail (Royal Mail end-to-end); mail collected by other operators and delivered by Royal Mail (Royal Mail access); and mail collected and delivered by other operators (Other operators' end-to-end).

4.12 Royal Mail access revenue is the revenue paid to Royal Mail by other operators for the delivery of access mail; other operator's access revenue is that paid to other operators by customers for the delivery of their mail, minus the portion of that revenue paid to Royal Mail for delivery (i.e. the Royal Mail access revenue).

Figure 4.2– Total addressed letters volume by type of operator



Source: Royal Mail Regulatory Financial Statements, operator returns to Ofcom, Ofcom estimates.[54]

4.13 Figure 4.2 shows that total letter volumes have fallen since 2010-11. Total letters volumes continued to fall in 2014-15, declining by 1.1% to 12.6bn items. Although

[54] Total Royal Mail letter volumes (access and end-to-end) are consistent with the volumes split by format in Figure 6.6. Royal Mail access volumes are as per its Regulatory Financial Statements and include a small amount of parcels. The effect of this is that Royal Mail's access volumes are overstated and its end-to-end volumes are understated.

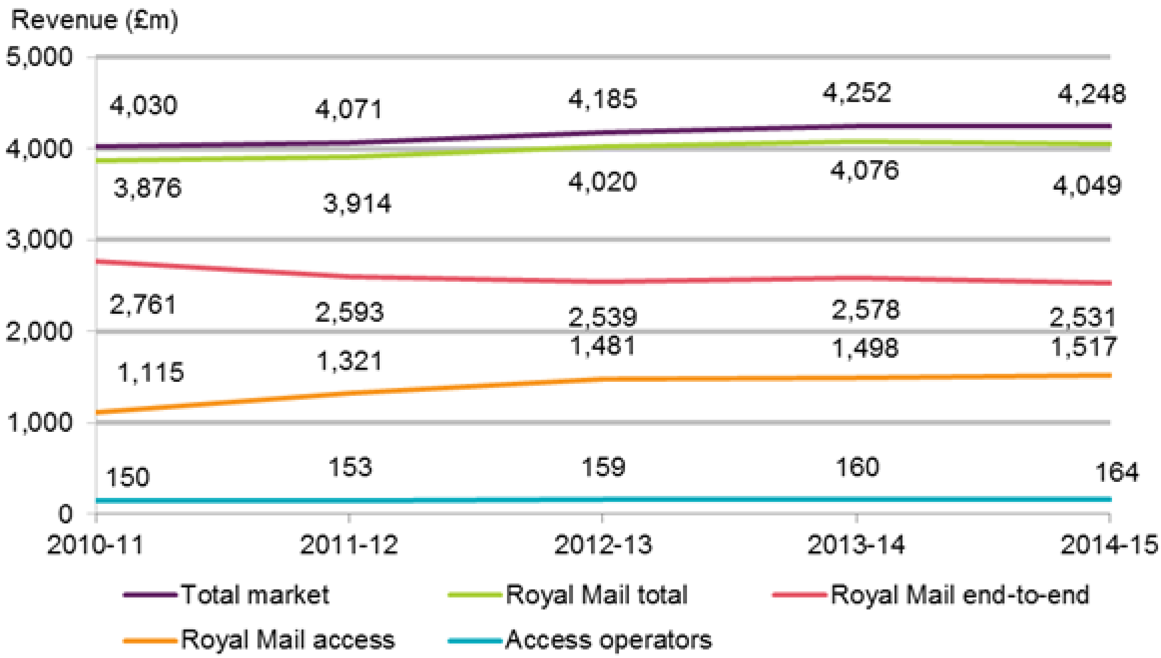
this is a slower rate of decline than the previous year, which was 3.2%, it still represents an 18% decline since 2010-11.

4.14 For the second consecutive year, access volumes have declined, falling by 1.3% year-on-year to 7.1bn items in 2014-15. As the rate of decline for access volumes is similar to the decline in total letters volumes, the proportion of access in total letters volumes has remained the same year-on-year. Access now accounts for approximately 56% of total letters market volume.

4.15 The 1.3% decline in access volume in 2014-15 is faster than the 1.0% decline for the previous year. The greater rate of decline in access volumes in 2014-15 is partly due to Whistl's end-to-end operations. The majority of Whistl's delivered volumes came from converting its access customers to end-to-end products in the areas in which it was delivering, so as its end-to-end volumes grew, the volumes being carried through access agreements fell.

4.16 Royal Mail's end-to-end volumes fell by 2.6% as there was continued decline in its First and Second Class single piece and retail bulk mail volumes, as it lost additional upstream bulk mail volumes to competitors, as noted in this Section.

Figure 4.3 – Total letters revenue by type of operator



Source: Royal Mail Regulatory Financial Statements, Royal Mail Wholesale, operator returns to Ofcom, Ofcom estimates.[55]

4.17 As shown in Figure 4.3, total letters revenue was broadly stable year on year, falling by 0.1% to £4.2bn.

[55] Total Royal Mail letter revenue (access and end-to-end) are consistent with the revenues split by format in Figure 6.7. Royal Mail access revenues are as per its Regulatory Financial Statements and include a small amount of parcels. The effect of this is that Royal Mail's access revenues are slightly overstated and its end-to-end revenues are slightly understated.

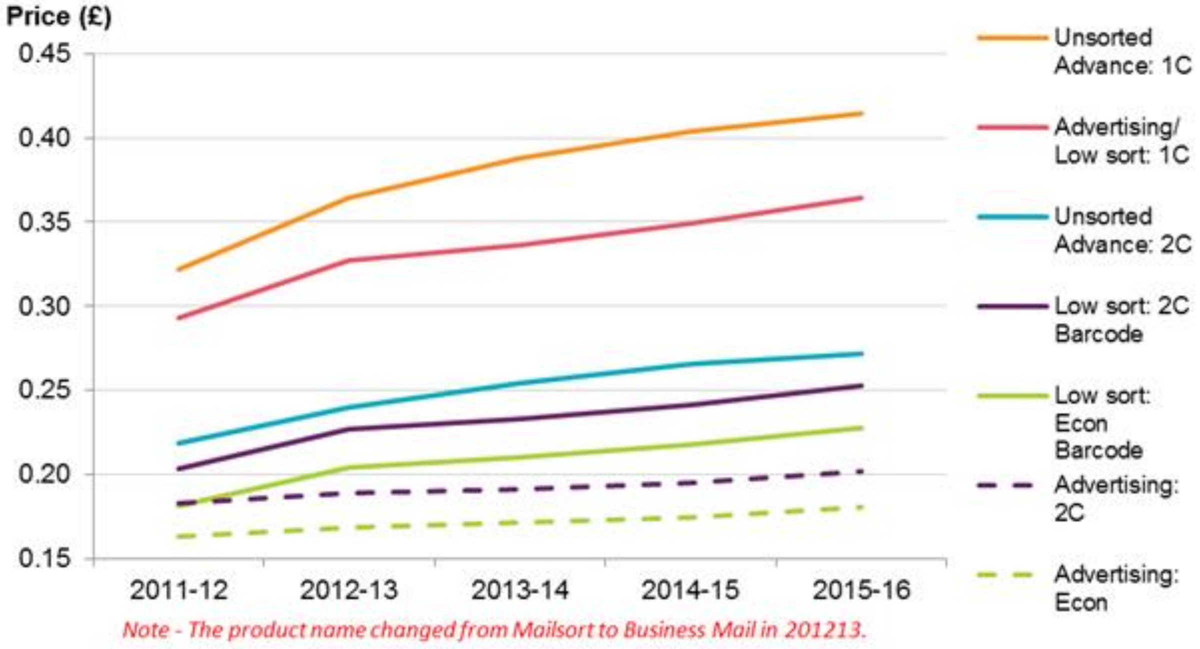
4.18 Revenue from access operations increased both for Royal Mail and for the access operators. Price rises for these products meant that Royal Mail grew its access revenues by 1.3% to £1.5bn. Access operators also increased their revenues by 2.2% to £163m, despite the 1.3% decline in access volumes. This is likely to be due to access operators gaining unsorted volumes which have a higher unit price and cost.

Price trends for retail bulk mail and access customers

Retail bulk mail prices

4.19 Royal Mail and other operators also offer a number of products and services to business customers who send larger volumes of mail, which are not within the universal service. These include letter, large letter and parcel products that are subject to discounts for factors, such as, the volume of mail sent, the way the mail has been presented (for example, using fonts to make it easier for the machine to read the address), applying machine barcodes, the level of sortation, and/or the purchase of any other conveyance of the same or any other postal packet.

Figure 4.4 - Royal Mail Business Mail prices – 2011-12 to 2015-16[56]



Source: Royal Mail, Ofcom calculation based on maximum discounted prices i.e. 120k+ volume discounts and low sort barcode discount

4.20 Figure 4.4 shows the trend in the maximum discount prices of several of Royal Mail's main retail pre-sorted bulk mail products in recent years. Royal Mail has continued to increase the price of these products into 2015-16. Royal Mail offers larger discounts on its retail advertising mail products than transactional products (introduced in 2010-11). The differential between Second Class advertising and Second Class Low

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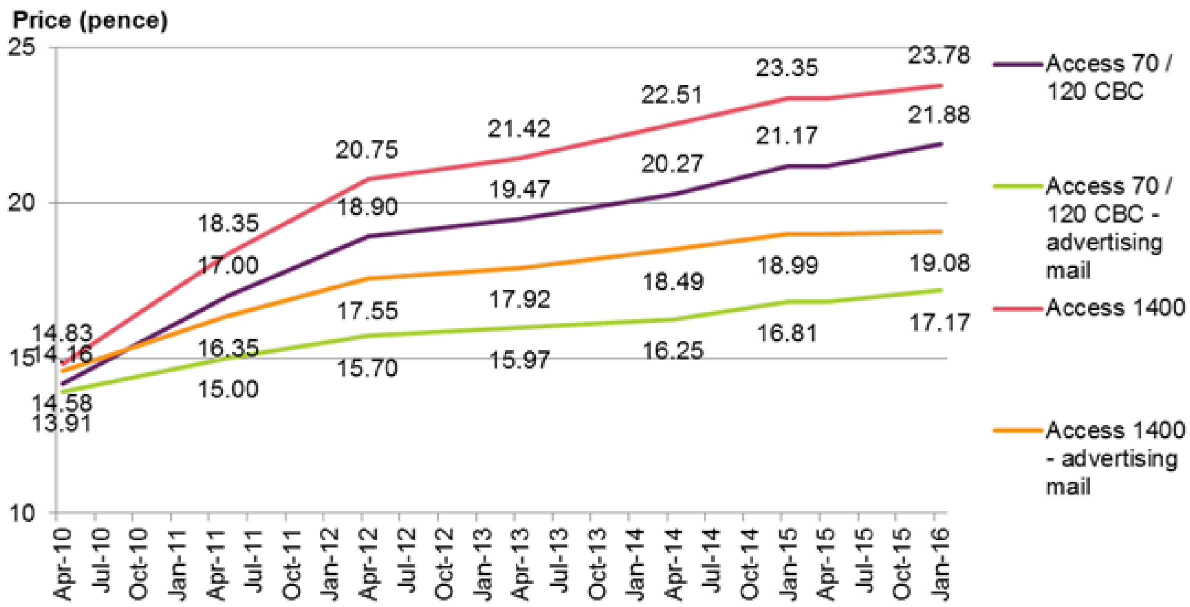
[56] Low sort Barcode was previously called Mailsort 70 CBC (prior to 2011-12 Mailsort 120 CBC), Economy was previously Mailsort 3 and Unsorted Advance was previously called Cleanmail Advance. Advertising Mail was introduced in 2011-12 and the relevant Mailsort price has been used prior to this date.

Sort barcode mail increased in 2015-16 as the price of Second Class Low Sort barcode mail increased by 4.5% and the price for Second Class advertising barcode mail increased by 3.5%.

Access prices

Figure 4.5 – National access prices: April 2010 – Jan 2016



Source: Royal Mail, based on National access prices, weighing 0-100g
April 2014 prices restated to reflect NPP1 prices

4.21 As set out in Figure 4.5, Royal Mail has been increasing its access prices since 2010, particularly in 2011 and 2012 (where the overall price increase for some services was around 20% across both years). As with its retail business mail prices, the access price increases have been lower for advertising mail compared to transactional mail. However, prices for National Price Plan 1 (NPP1) remained unchanged in Royal Mail's access price changes in March 2015.

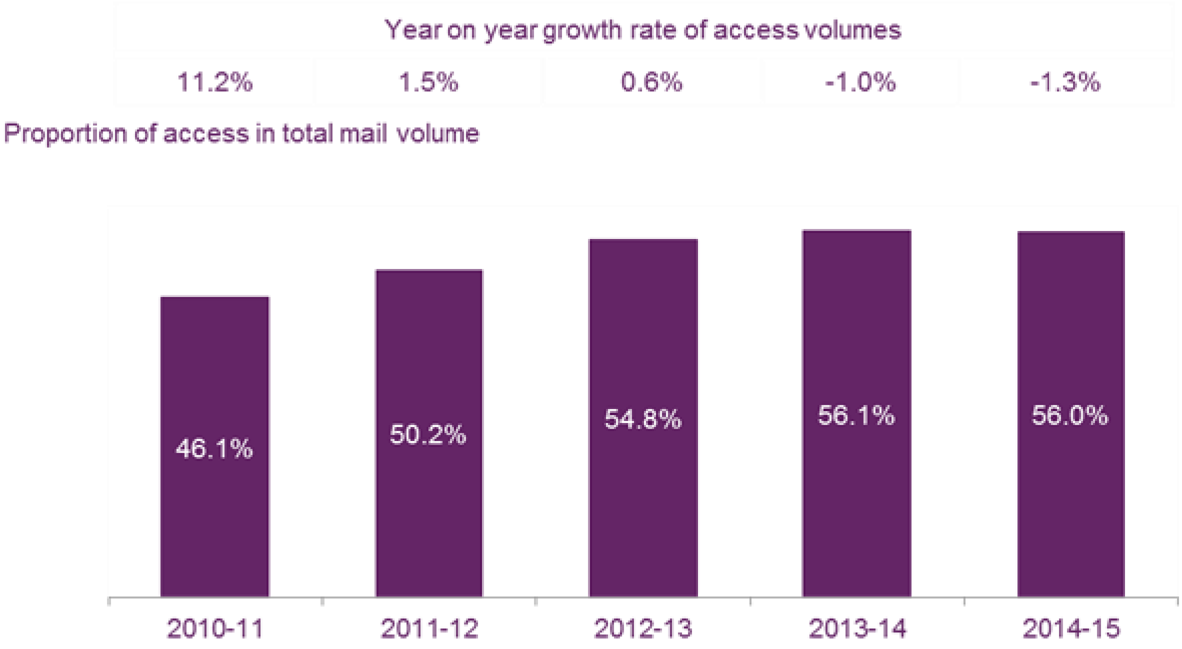
4.22 Royal Mail recently announced price changes to its access products which will take affect from 4 January 2016. In the above subset of products prices increased between 0.5% and 3.3%.

4.23 In early 2015 Royal Mail introduced a provision to the terms of its contract with access operators that it increased its flexibility to offer incentive schemes and promotions in Access in order to stimulate mail volume growth. These discounts are not included in Figure 4.5.

Access competition

4.24 Access represents a large portion of the letters market by volume (over 50% of all delivered mail), though the proportion of revenue retained by other operators from access is much smaller at 3.9% (£163m out of a total market revenue of £4.2bn).

Figure 4.6 – Growth of UK access mail



Source: Royal Mail Regulatory Financial Statements

4.25 Figure 4.6 shows that access has maintained its share of total mail volumes, despite volumes falling for the second time this year. Access grew from 46% of the market by volume in 2011-12, to account for 56% of the market by volume in 2013-14 and 2014-15.

4.26 Although there are a number of operators handling access mail, the bulk of volumes are handled by two companies – Whistl and UK Mail. Whistl's parent company Post NL has stated in its 2014 annual report that Whistl has a 56% share of downstream access volumes in the UK,[57] and UK Mail stated last year that it carries almost 3 billion items through downstream access each year.[58]

4.27 Royal Mail is subject to a margin squeeze control on its retail prices for D+2 Letter and Large Letter bulk mail. The control seeks to ensure that the upstream element of the revenues of these bulk mail services is sufficient to cover the costs of the relevant upstream activities carried out by Royal Mail to provide the services. The objective of the control is to ensure Royal Mail does not compete unfairly with the access operators that purchase wholesale access services from Royal Mail to provide bulk mail services in the market. We note that in accordance with the requirements in our USP Access Condition, we have received quarterly compliance reports from Royal Mail which set out details of the prices, volumes, revenues, costs and the contract information needed to demonstrate compliance with the control.

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[57] Post NL, *Annual Report 2014*, February 2015, http://www.postnl.nl/Images/2014-postnl-annual-report_tcm10-22091.pdf. (Post NL's financial year runs from 1 January to 31 December) .
[58] UK Mail, *Written Evidence from UK Mail Group plc (USO 27)*, October 2014, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/competition-in-the-uk-postal-sector-and-the-universal-service-obligation/written/14766.pdf.

4.28 The cost standard used in the control is fully allocated cost (FAC). However, in our March 2012 Statement,[59] we stated that in principle we consider that in the long-term any margin squeeze test should use long run incremental cost (LRIC) (a minimum of LRIC margin to be maintained between the wholesale access price and the equivalent retail price). We also said that we would endeavour to review the margin squeeze control in around 18-24 months but recognised that (i) a key condition for such a review would be the availability of robust LRIC data from Royal Mail, and (ii) LRIC is complex and we will need to consider various issues in ensuring it that any LRIC figures are fit for purpose. At this point in time we still think the FAC cost standard is the most appropriate to use in ex-ante margin squeeze regulation.

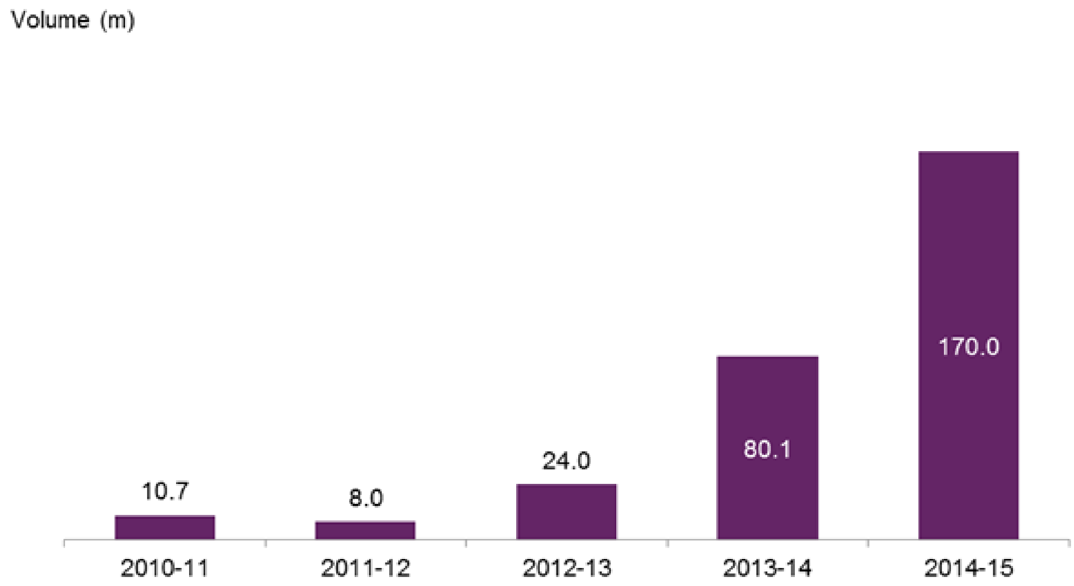
End-to-end competition

4.29 There is little end-to-end competition in the UK letters market, unlike some other European countries where end-to-end competition is the main form of competition. Despite the entry of Whistl (previously TNT Post UK) into the delivery market in 2012, alternative operators to Royal Mail only delivered 170m letters in 2014-15 – which equated to around 1.3% of the addressed letter mail market. This was the first time that operators other than Royal Mail had a greater than 1% share by volume of delivered addressed letter mail.

4.30 The majority of the increase in delivered volumes, as in the previous year, was due to Whistl. It began delivering letters end-to-end in West London in April 2012 and then rolled out services more widely, extending its network to deliver to 2 million addresses in London, Manchester and Liverpool by March 2014.[60] As well as carrying out end-to-end delivery, Whistl is also an access operator. It had been converting its access customers to its delivery products, using its end-to-end network to deliver in the areas where it had rolled this out, and, where it had not, using access products to provide a UK-wide service.

[59] Paragraph 10.150 to 10.151.
[60] Equivalent to 7.4% of UK households. Post NL, *Annual Report 2014*, February 2015, http://www.postnl.nl/en/Images/2014-postnl-annual-report_tcm9-22091.pdf.

Figure 4.7 – Other operators' end-to-end delivered volumes



Source: Operators' returns, based on former licensed area delivered volumes

4.31 As we noted in the 2013-14 Annual monitoring update, in January 2014 Royal Mail notified new access prices that it planned to implement in April 2014.[61] These included the introduction of a price differential between the two national price plans – NPP1 and National Price Plan 2 (NPP2) and a change to zonal prices (the zonal tilt). Following a complaint from Whistl, Ofcom opened an investigation under the Competition Act 1998. Under the terms of Royal Mail's contract with access operators, these proposed prices were suspended pending the outcome of Ofcom's investigation.

4.32 At the same time, Ofcom launched a review of the pricing requirements of the USP Access condition, which led to the publication on 2 December 2014 of a consultation entitled *Royal Mail Access Pricing Review, Proposed amendments to the regulatory framework*.[62] In this consultation, to retain the benefits of end-to-end competition, and in particular incentives for efficiency improvements, we proposed new regulatory obligations that would prevent Royal Mail from setting charges in a way that could undermine entry into letter delivery.

4.33 On 10 June 2015, following a decision on 11 May 2015 to suspend Whistl's end-to-end postal operation in the UK, Whistl and its parent PostNL announced that there was no viable way to ensure a sustainable future for the service and it therefore would not continue.

4.34 Given that Whistl was by far the largest end-to-end competitor to Royal Mail, its withdrawal from the provision of end-to-end letter delivery services resulted in Royal Mail no longer facing the prospect of significant end-to-end competition in bulk letters

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[61] Royal Mail Group, *Ofcom investigation into Access contract changes*, 9 April 2014, http://www.royalmailgroup.com/ofcom-investigation-access-contract-changes
[62] https://www.royalmailwholesale.com/mint-project/uploads/125713808.pdf.

mail, raising concerns that Royal Mail may have weakened incentives to deliver efficiency improvements and an increased ability to charge excessive prices.

4.35 In July 2015, we therefore suspended our review of Royal Mail's access pricing in the form it had taken up until then. However, the concerns we provisionally identified in relation to competition and efficiency remain, and we will address these issues as part of our on-going broader review of the regulation of Royal Mail.

Summary of trends in bulk mail services

4.36 The key findings relevant to business customers and competition are:

- The decline in business letters mail volumes was broadly similar to the overall market reduction, falling 3.4% while total volumes fell by 3.2%.

- Access letters volumes declined for the second year since the introduction of access in 2004, falling by 1.3%. However, the proportion of total volumes it accounts for remained stable and 56% of total mail volumes are now handled by other postal operators. However, other operators only retain about 4% of total addressed letter mail revenue.

- End-to-end letters competition increased in 2014-15 (112%) and for the first time represented over 1% of total delivered addressed letter mail by volume. However, the withdrawal of Whistl from end-to-end operations will lead to a significant reduction in end-to-end competition.

Section 5

Parcels

5.1 As noted in Section 2 above, on 16 June 2015 we announced a review of the regulation of Royal Mail to ensure regulation remains appropriate and sufficient to secure the efficient and financially sustainable provision of the universal postal service. The review incorporates work that we had already begun looking at Royal Mail's position in the parcels sector.

Collecting information on parcels

5.2 As part of that work, we have collected quarterly volume and revenue information from parcel operators, and are aiming for this to become a regular part of our monitoring. The information presented below includes the information we have collected.

5.3 For the purposes of the information presented in this chapter, we have defined a parcel as an addressed postal item that is delivered end-to-end and is:

- larger than a Large Letter (i.e. an item up to length 353mm, width 250mm, thickness 25mm, and weighs no more than 750g);
- weighs no more than 31.5kg; and
- can be lifted by a single average individual without mechanical aids.

5.4 We have attempted to collect information from all parcel operators providing UK-wide services. These companies are: The Alternative Parcels Company Limited, Citipost AMP Limited, DHL International (UK) Limited, DPD Group UK Limited[63], DX (Group) plc, FedEx UK Limited, Hermes Parcelnet Limited, Royal Mail Group Limited including Parcelforce Worldwide, TNT UK Limited, Tuffnells Parcels Express Limited, UK Mail Limited, UPS Limited and Yodel Delivery Network Limited. One company (DHL) has sought judicial review of our information request.

5.5 We have not collected information from operators who offer only same-day delivery services.[64] We have also not collected information from organisations who deliver their own parcels, such as Amazon Logistics delivering Amazon parcels or other retailers carrying out their own deliveries.

5.6 It is our view that the information we have collected represents the significant majority of all UK parcel volumes and revenues and – with the exception of DHL's volumes – all parcel volumes and revenues carried by national operators. We recognise, however, that the range of operators we have collected information from

[63] DPD Group UK Limited was formerly known as Geopost UK Limited.

[64] We aimed to collect information on services akin to those offered by Royal Mail (i.e. delivery over a network involving sortation – same-day deliveries typically involve collection and delivery of a single item, from one point to another). We note that Royal Mail does offer a same-day service, and that we may need to reconsider our approach for any future data collection if same-day delivery becomes a more prominent feature of the parcels sector.

may differ from other market sizing exercises and may, therefore, not be directly comparable.

5.7 For any future requests, we will keep the list of those from whom we request this information under review and will add or remove organisations according to developments in the sector.

5.8 Where we state proportions of total volumes and revenues below, the figures presented are (unless otherwise stated) shares of the data collected.

Parcels volumes and revenues

5.9 Based on the information collected so far, both total measured national parcel volumes and revenues have increased over the past two years. Total measured national volumes increased in 2014-15 by 7% to 1.9bn items and revenues grew by 6% to £7.4bn.[65] See Figure 5.1 below.

5.10 This growth reflects both an increase in UK GDP and, in particular, the continued growth of online shopping: in the calendar year 2014, the Interactive Media in Retail Group (IMRG) estimated the value of e-commerce sales in the UK at £104bn, an increase of 14% on 2013 and more than double the value in 2009.[66][67]

5.11 The parcels sector has, however, faced a number of challenges since we published the 2013-4 Annual monitoring update on the postal market. Indeed, one operator, City Link, went into administration on 24 December 2014 following "*substantial losses over several years*", which were attributed to "*a combination of intense competition in the sector, changing customer and parcel recipient preferences, and difficulties for the Company in reducing its cost base*".[68] Other operators have also faced financial pressures, as well as pressure on capacity in the run up to Christmas and following record online sales on Black Friday, which occurred on 28 November 2014.[69]

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[65] This includes international parcels sent from and delivered within the UK. These numbers are based on information collected from parcel carriers that we understand to be the larger operators in the sector (but not including volumes carried by DHL). This excludes volumes delivered over retailers' own logistics' networks such as Amazon Logistics.

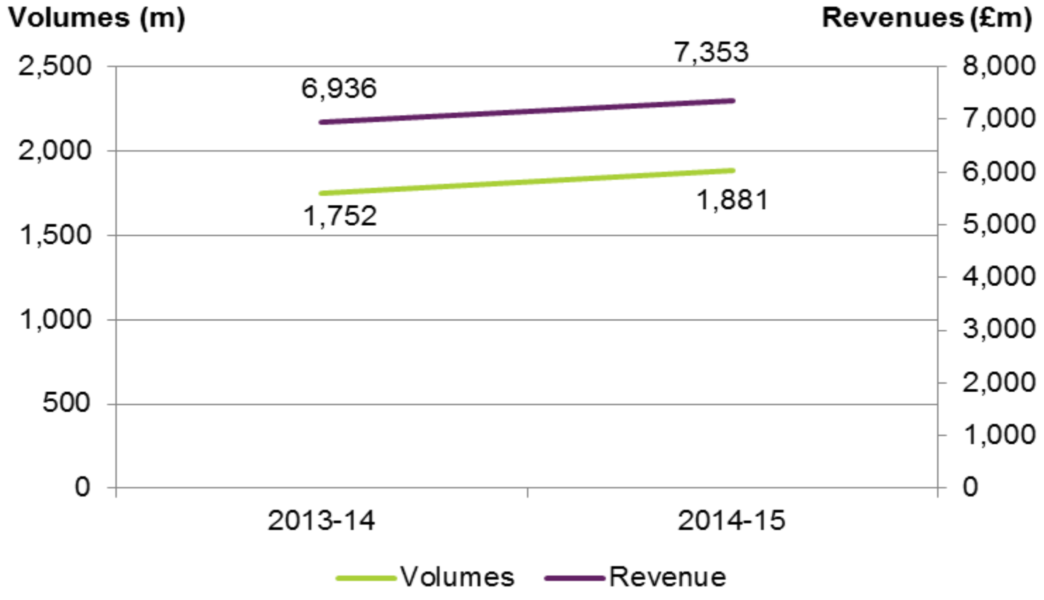
[66] https://www.uk.capgemini.com/news/uk-news/uk-online-sales-exceed-ps100-billion-in-2014 - we understand that this includes groceries and travel expenditure.

[67] Note that not all increase in sales will necessarily result in increased parcel volumes. Online sales may be of items that are fulfilled electronically (e.g. music downloads), or through in-store 'Click and Collect' services, where online purchases are collected from retailers' high street stores.

[68] http://postandparcel.info/63672/news/companies/city-link-calls-in-administrators-after-failing-to-stem-substantial-losses/.

[69] http://internetretailing.net/2015/01/online-sales-grew-by-14-to-104bn-in-2014-and-will-grow-by-12-to-116bn-in-2015-imrg/#.

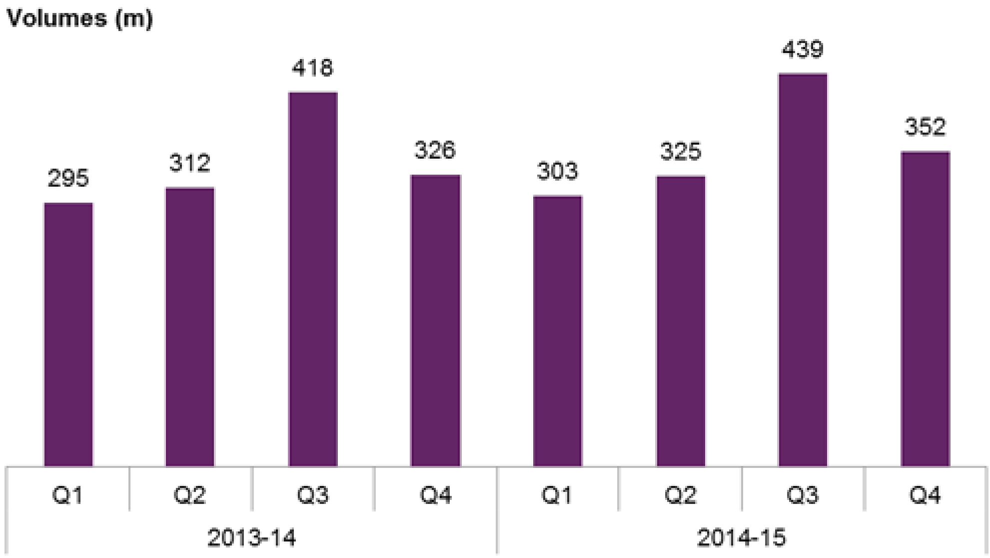
Figure 5.1 – Total measured national parcels volumes and revenues (including international)



Source: Operator returns to Ofcom

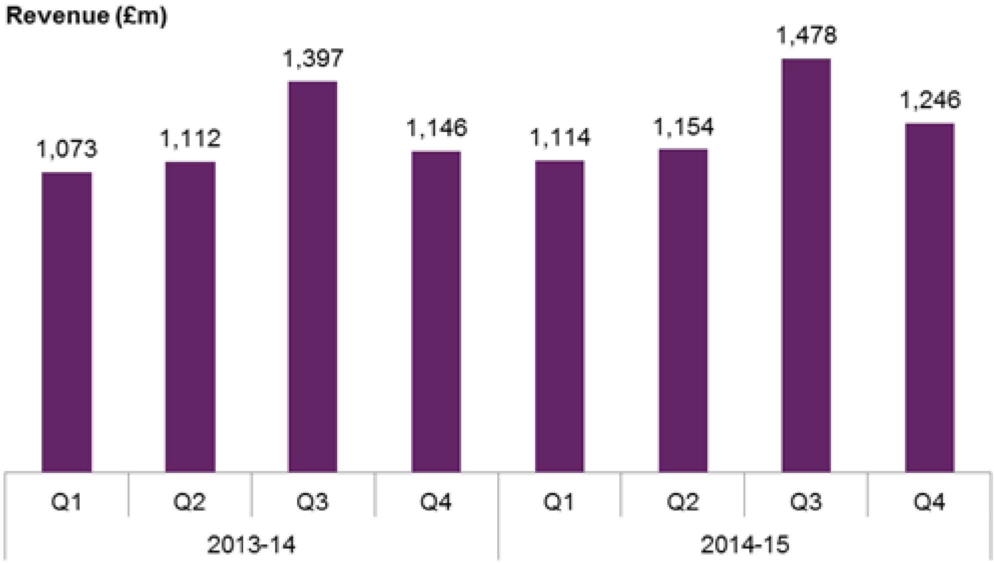
5.12 Figures 5.2 and 5.3 show measured national volumes and revenues on a quarterly basis which illustrate the seasonal nature of parcel volumes (with particular additional volume in the run up to and over the Christmas period). They also show growth in each quarter when comparing information from 2013-14 and 2014-15.

Figure 5.2 – Quarterly measured volumes for domestic parcels



Source: Operator returns to Ofcom (does not include Access volumes)

Figure 5.3 – Quarterly measured revenues for domestic parcels

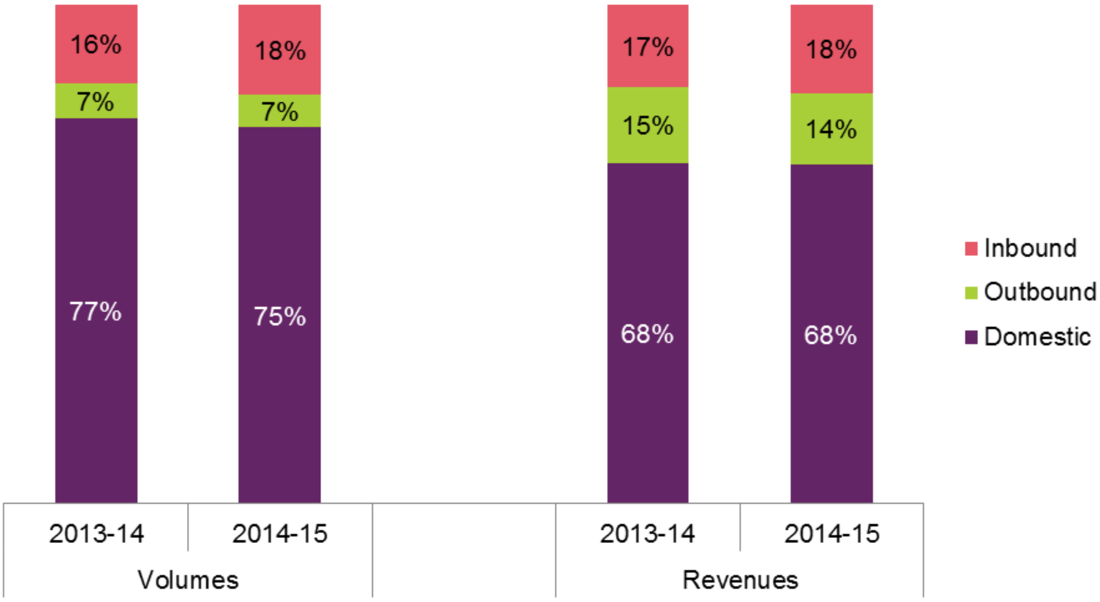


Source: Operator returns to Ofcom (does not include Access volumes)

5.13 In 2014-15 measured national domestic parcel[70] volumes increased 5%, to 1.4bn items (75% of total volumes), and measured national domestic revenues increased 6%, to £5bn (68% of total revenues). International inbound parcels[71] made up 18% of measured volumes and 18% of measured revenues, and outbound parcels[72] made up 7% of volumes and 14% of revenues. Figure 5.4 sets out the proportion of measured national volumes and revenues comprised by domestic parcels, and international inbound and outbound parcels. As can be seen from Figure 5.4, the majority of volumes and revenues derive from domestic parcels. However, domestic parcels constitute a much larger proportion of total volumes than of total revenues. International outbound parcels comprise 7% of total volumes, but 14% of total revenue. This is reflected in average unit revenues: in 2014-15 the average unit revenue for domestic parcels was £3.52, whereas the average unit revenue for international outbound parcels was £8.62.

[70] Where the parcel is both sent and delivered in the UK.
[71] Where the parcel is sent from outside the UK and delivered in the UK.
[72] Where the parcel is sent from within the UK and delivered outside the UK.

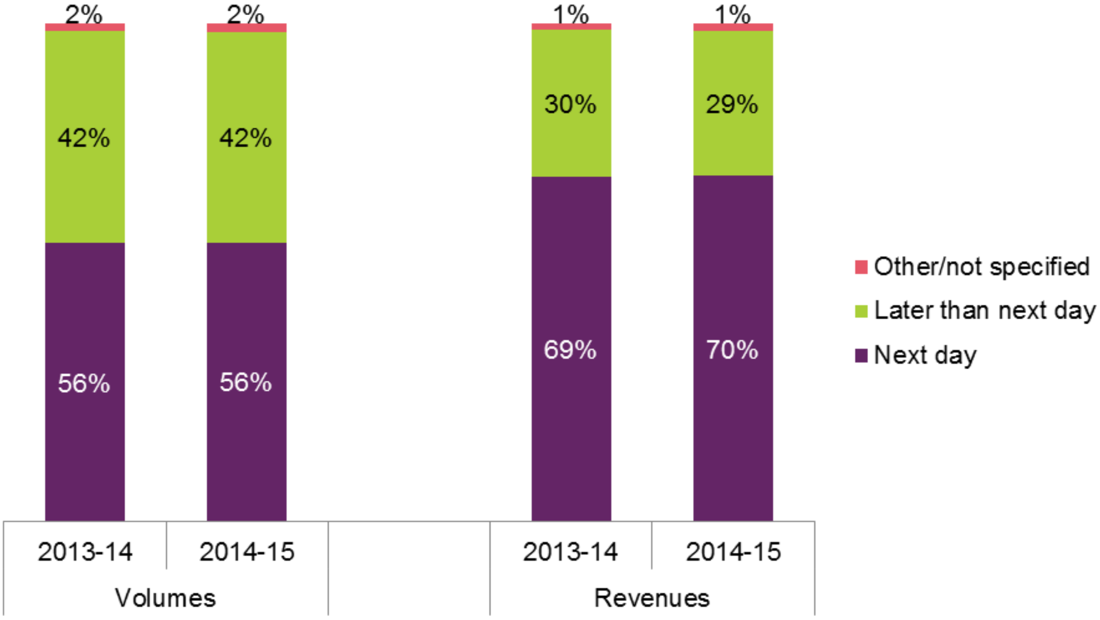
Figure 5.4 – Volumes and revenues for measured parcels by delivery type (international and domestic)



Source: Operator returns to Ofcom

5.14 As shown in Figure 5.5, of measured national volumes, Next Day parcel services were the most commonly used, accounting for 56% of all domestic volumes in both 2013-14 and 2014-15. Next Day services accounted for an even larger proportion of total domestic revenues (69% in 2013-14 and 70% in 2014-15). This is clear evidence that, unsurprisingly, there is a price premium for express services. This can be seen further in the fact that, while delivery services slower than Next Day accounted for 42% of domestic volumes in 2014-15 (and in 2013-14), these services only accounted for 29% of domestic revenues (down from 30% in 2013-14). Again, this is reflected in average unit revenue, which was £4.36 in 2014-15 for Next Day parcels, but only £2.41 for later than next day. For our category of other/not specified, the average unit revenue was £3.04.

Figure 5.5 – Domestic measured volumes and revenues by speed of delivery



Source: Operator returns to Ofcom

5.15 Reflecting the continued growth of the sector, operators are continuing to increase the volume of parcels that they can process and deliver, with UK Mail, DPD, Parcelforce, Yodel, and Hermes all investing in new hubs and depots over the past two years. In addition, the online retailer Amazon has created its own delivery network (Amazon Logistics) in certain areas of the UK. The creation of this additional capacity has contributed to prices remaining relatively low; despite the growth in volumes and revenues, the average price per parcel has remained low, and indeed decreased by 1% in 2014-15.[73]

Developments in the parcels sector

5.16 We understand from conversations with stakeholders that prices have also been kept low by the level of competition in the sector. Unlike in the letters sector where Royal Mail delivers c.99% of letters, and has a share of c.95% of revenue, the parcels sector is much more competitive. Using its own methodology (which differs to Ofcom's), Royal Mail estimate that Royal Mail and Parcelforce combined has a 52% share of domestic parcel volumes, and estimates that its share of domestic parcel revenues is 38%, which it understands to be the largest share of any operator.[74]

5.17 Royal Mail considers that competition in the parcels sector is shifting, with operators that historically focused on delivering parcels to business customers beginning to deliver parcels to and from consumers, moving into what are typically called the business-to-consumer (B2C) and consumer-to-anyone (C2X) segments.[75] Apex

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[73] The change in average revenue per parcel differs, however, between domestic (1%), international inbound (-7%), and international outbound (0%).
[74] Royal Mail plc, *Full Year 2014-15 Annual Results*, 21 May 2015, slide 4
[75] Royal Mail, *Annual Report and Financial Statements 2014-15*, p.12

Insight's 2014 *UK Parcels Market Insight Report* supports this view,[76] as does the European Commission.[77] Growth in the business-to-business (B2B) segment is typically understood to follow GDP, whereas growth in B2C is currently being driven by the growth in online retail. Royal Mail estimates total parcel volume growth at approximately 4%, with the B2C and C2X parcel segments estimated to be growing between 4.5% and 5.5%.[78] There is, therefore, a clear incentive for B2B operators to move into the B2C segment, and this would suggest that the parcels sector is becoming more competitive, with more operators competing for the same traffic.[79]

5.18 Competition in the sector combined with the expectations of consumers is helping to drive innovation. Royal Mail has stated that innovation is a key feature of the UK parcels sector,[80] and considers that competing operators are "*improving their service performance, with more delivery options, increased geographic coverage and leading edge technology*".[81] Indeed, in January 2015, DPD launched 'Last Mile Labs', a programme designed to help start-ups develop innovations that improve the delivery business.[82] We have also heard from some stakeholders that individuals and companies outside of the parcels sector are developing technology solutions to sell to parcel operators, which is contributing to innovation. Other stakeholders have suggested that consumer demands are driving innovation.

5.19 In our 2014 statement on end-to-end competition[83] we stated some of Royal Mail's competitors were more advanced with technological and service innovations for parcels. For instance, the majority of other parcel operators of significant size offer tracking as standard. DPD's Predict service (launched in 2010), gives parcel recipients advanced notification of a one-hour delivery slot. It also provides the recipient with a range of 'in-flight' options, including an alternative delivery date or delivery to a neighbour.

5.20 In response to the competitive environment, Royal Mail has sought to become more flexible and invest in its technology. This includes:

- having extended the number of days that large customers can access the core network;
- investing in barcoding more parcels to ensure it can track more parcels[84];
- rolling out automated parcel sortation at around 20 of its busiest Mail Centres;

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[76] Apex Insight, *UK Parcels Market Insight Report 2014*, p.10.
[77] European Commission, A Digital Single Market Strategy for Europe - Analysis and Evidence, p.19 – http://ec.europa.eu/priorities/digital-single-market/docs/dsm-swd_en.pdf .
[78] Ofcom, *Communications Market Report 2015*, p.382.
[79] We have not presented data split by B2B, B2C, and C2X as a number of operators reported that they would be unable to provide information that would enable this split.
[80] Royal Mail's June 2014 Submission (non-confidential version), p.17.
[81] Royal Mail, Royal Mail, *Annual Report and Financial Statements 2014-15*, p.12.
[82] http://postandparcel.info/63741/news/it/dpd-launches-innovation-accelerator-programme-in-uk/
[83] Ofcom, *Review of end-to-end competition in the postal sector,* paragraph 3.87 - http://stakeholders.ofcom.org.uk/binaries/post/end-to-end-statement/end-to-end.pdf .
[84] Royal Mail, *Annual Report and Financial Statements 2014-15*, p.12 – in its 2015 *Delivery* Matters report (see p.15), Royal Mail notes that 77% of online shoppers say that tracking would make them feel more confident about online shopping, and 60% of online shoppers would track every item that they ordered.

- reclaunched its click and collect offering (Local Collect) in 2013-14 which is available in around 10,500 post office branches and 1,222 delivery offices[85]; and

- expanding the IT solutions that it offers to customers, for example, launching a new portal in March 2015 to enable online retailers to manage returns.

5.21 Consistent with consumers' desire for convenience and flexibility, click and collect services[86] continue to grow in popularity, with IMRG claiming that 73% of online consumers have now used click and collect services.[87] Apex Insight suggests that click and collect is now worth £2bn,[88] and market reports suggest that click and collect will grow substantially. Royal Mail also considers that both in-store click and collect and delivery to intermediary locations are growing quickly.[89]

5.22 Royal Mail suggests that in-store click and collect tends to still replace purchases that would otherwise have been made on the high street, rather than replacing delivery traffic. However, it does believe that demand for intermediary collection points, while currently still small, will likely increase as consumers look for greater convenience and flexibility.[90] Certainly, 42% of respondents to the eCustomerServiceIndex conducted in January 2015 stated that collecting in store is more convenient than collecting from their local post office or collection centre.[91] Further investment in parcel shop networks and pick-up points continues. For example, DPD announced in January 2015 that it was developing its own network of parcel shops,[92] Doddle opened its 35th store in June and has plans to have 100 open by the end of 2015,[93] and CollectPlus has increased its network to over 5,800 sites.[94]

5.23 However, Royal Mail's research suggests that most consumers have used a click and collect service because it is free, and 74% of online shoppers would prefer a free home delivery service.[95] Our own research found that home delivery is the preferred delivery method for 68% of adults.[96] As we noted in the 2015 Communications Market Report, 56% of adults said that free delivery was an important factor when choosing a retailer and 55% of those who had not completed an order did so

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[85] http://postandparcel.info/68734/news/royal-mail-extends-local-collect-network/
[86] There are, broadly, two forms of click and collect service: where consumers collect online orders from a retailer's store; or from an intermediary location such as a dedicated parcel shop (such as those operated by Doddle), parcel locker (such as those operated by Amazon), or a drop-off or collection-point in a retail store (such as with CollectPlus's network).
[87] http://www.imrg.org/shoppers-rate-click-and-collect-services-high-as-use-of-in-store-collections-continues-to-rise – in order to access this link, please paste it into your browser.
[88] https://www.apex-insight.com/product/uk-e-fulfilment-market-insight-report-2015-2/#
[89] Royal Mail, *Annual Report and Financial Statements 2014-15*, p.12.
[90] *Ibid.*, p.12.
[91] http://www.imrg.org/shoppers-rate-click-and-collect-services-high-as-use-of-in-store-collections-continues-to-rise – in order to access this link, please paste it into your browser.
[92] http://postandparcel.info/63821/news/companies/dpd-developing-parcel-shop-network-in-uk/
[93] http://postandparcel.info/65439/news/markets/britains-station-based-parcel-shop-network-doddle-opens-35th-store/.
[94] http://www.collectplus.co.uk/about-us .
[95] Royal Mail, *Delivery Matters – Understanding the needs of the UK's online shoppers in 2015*, p.13 - 62% of respondents to the eCustomerSeviceIndex also reported that they used a click and collect service because it offered free delivery.
[96] Ofcom, *Communications Market Report 2015*, p.385.

because the cost of delivery was too high.[97] This further adds to the pressure on prices in the parcels sector.

5.24 Royal Mail estimates that total volumes of parcel deliveries in the UK will grow at approximately 4% per annum in the medium term, and that the fastest growing areas of growth will be clothing and footwear, and toys and sports equipment.[98] This is in contrast to the items that Royal Mail has traditionally carried, such as DVDs, CDs, and books, which are increasingly not being purchased as physical items.

5.25 While it considers that the parcels sector will grow at approximately 4% per annum, Royal Mail has said that the impact of Amazon delivering an increasing number of parcels using its own delivery network will reduce the annual rate of growth in the addressable market to around 1-2% in the short term.[99] It believes this will lead to further competition between other operators. Royal Mail also considers that overcapacity will continue to create pricing pressures.[100]

Summary of parcels

5.26 The key findings relevant to parcels were that measured national parcel volumes increased in 2014-15 by 7%. While measured national revenues also increased, they increased at a slower rate (6%) than volumes, which is consistent with the level of competition in the sector.

[97] Ofcom, *Communications Market Report 2015*, pp.383 and 388. There are similar findings in Royal Mail's 2015 *Delivery Matters* report.
[98] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 5.
[99] *Ibid.*, page 5.
[100] *Ibid.*, page 5.

Section 6

Royal Mail's financial performance

6.1 As set out in Section 2, we must have regard to the need for the provision of a universal postal service to be both financially sustainable and to become efficient before the end of a reasonable period and remain so. The PSA 2011 does not exhaustively define the concept of 'financial sustainability'. However, it states that it includes the need for a reasonable commercial rate of return for any universal service provider on any expenditure incurred by it for the purpose of, or in connection with, the provision by it of a universal postal service.[101]

6.2 As set out in paragraphs 2.14 - 2.15, Royal Mail is the universal service provider and, more specifically, the fully regulated part is known as the 'Reported Business'. This Section therefore summarises the financial performance of the Reported Business, unless otherwise stated. We present the financial performance over the last year, and where relevant, a five year trend.

6.3 We discuss in sequence:

- Profit margins and cash flow – we need to monitor Royal Mail's progress on these because, as outlined in paragraph 2.1, the PSA 2011 requires us to have regard to the need for the provision of a universal postal service to be financially sustainable, including the need for a reasonable commercial rate of return for any universal service provider.

- Changes in the volumes at a total sector level – looking at both letter and parcel volumes and the contributory factors affecting the overall trends for each format;

- Changes in overall volumes and revenues for the Reported Business – and then by product groups, formats and universal service products, to help us understand what is driving overall revenue and volume changes of the universal service provider; and

- Changes in the costs of the Reported Business – to understand what progress has been made in relation to cost reduction. This information is also an important input when considering the efficiency of the universal postal service, which is discussed further in Section 7.

Reported Business profit margin

6.4 In considering the financial sustainability of the universal postal service, we are required to take into account the need for the universal service provider to be able to earn a reasonable commercial rate of return in connection with its provision of the universal service. In the March 2012 Statement, we considered that an indicative earnings before interest and tax (EBIT) margin range of 5-10% was consistent with this need.

[101] Section 29(4).

6.5 Royal Mail reports the EBIT margin figure 'after transformation costs', which includes, amongst other costs, the recurring restructuring and redundancy costs related to modernisation. We consider Royal Mail's EBIT margin after transformation costs to be broadly in line with our approach outlined in the March 2012 Statement.[102] However, the pension cost used within Royal Mail's EBIT margin calculation is in accordance with the relevant accounting standards (the accounting pension rate).[103] This differs from the amount Royal Mail pays into its pension scheme each year (the cash pension rate).[104] For example, in 2014-15, the accounting pension rate was 23.6%[105] whilst the cash pension rate was 17.1%.[106]

6.6 We explained in the March 2012 Statement[107] that we considered the EBIT operating margin to be an appropriate proxy for operating cash generation, as the operating cash flow and EBIT were projected to become broadly comparable towards the end of Royal Mail's plan. Since the March 2012 Statement the accounting rate and cash rates have diverged and will likely continue to move further apart until the end of the current agreement in 2018[108]. In our view, this means that the accounting rate for pensions is not a good measure of the impact of pensions on Royal Mail's cash flow. We have therefore adjusted Royal Mail's reported EBIT after transformation costs to reflect the pension cash cost, as shown in Figure 6.1 below.

6.7 We refer to the cash pension rate adjusted EBIT margin after transformation costs as the 'financeability EBIT margin'. It is the financeability EBIT margin that we measure against the indicative 5-10% range which we considered in March 2012 was consistent with a commercial rate of return, and therefore use to assess the financial sustainability of the universal service.

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[102] We set out in the March 2012 Statement that the EBIT margin would be calculated on a pre-exceptional basis. We noted that we would not expect recurring costs, such as restructuring or redundancy costs that are likely to be incurred year on year, to be included in exceptional items. We also noted that we would determine the exceptional nature of items on a case by case basis. Footnote 69 of the March 2012 statement: http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf.

[103] International Accounting Standards 19, which states pension costs, must be based on market yields.

[104] The actual cash pension cost (which is based on an actuarial valuation) is determined by the agreement with the Pension Trustees.

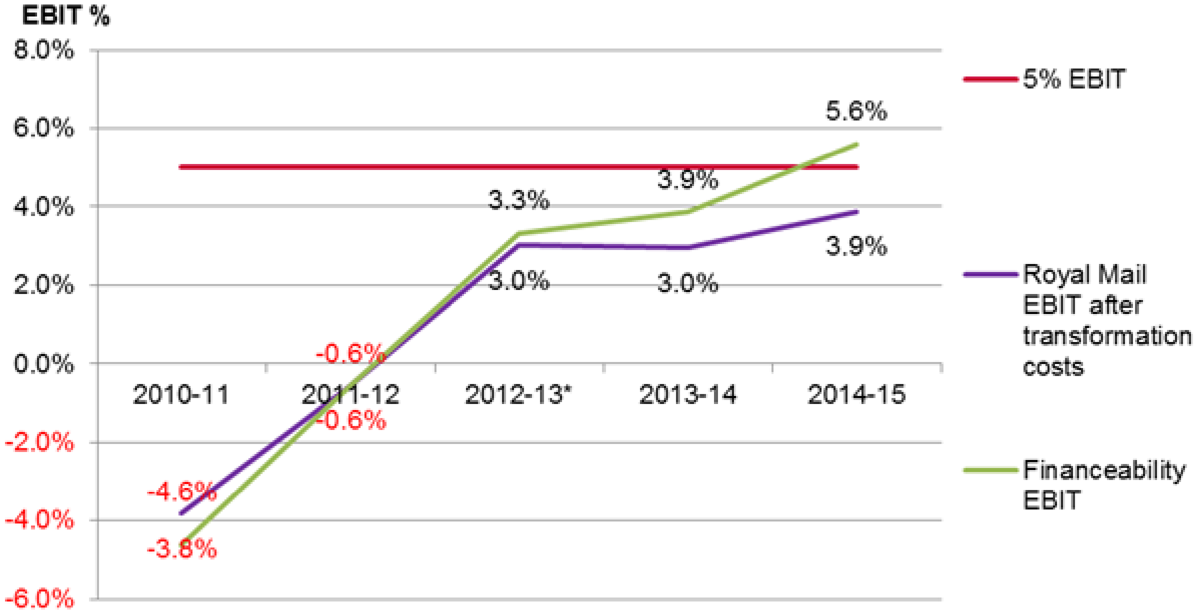
[105] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 102.

[106] As part of the pension's reform that took effect on 1 April 2014 and as agreed with the Communications Workers Union, Royal Mail's pensionable pay increases were reduced from RPI +1% to RPI. The Trustee of the Royal Mail Pension Plan (the Trustee) also agreed to reduce Royal Mail's cash contributions to 17.1% of pensionable pay. This was in return for Royal Mail transferring its surplus pension assets over a number of years to the Trustee, which would have been used to fund the additional 1% pensionable pay increases.

[107] Paragraph 3.25.

[108] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 28.

Figure 6.1 – Reported Business EBIT margin



Source: Royal Mail audited regulatory accounts and unpublished submissions from Royal Mail
** 2012-13 EBIT margin is based on 53 weeks*

6.8 Figure 6.1 shows that both Royal Mail's reported EBIT margin after transformation costs and the financeability EBIT margin increased in 2014-15. The difference between the two margins is that the financeability EBIT margin adjusts people costs for the impact of using the cash pension rate rather than the accounting pension rate.

6.9 This reporting is consistent with Royal Mail's segment reporting in its Annual Report and Financial Statements, where UKPIL adjusted operating profit after transformation is reported on a cash pensions basis.[109]

6.10 The increase in financeability EBIT margin from 3.9% in 2013-14 to 5.6% in 2014-15 is largely due to reductions in non-people and transformation costs which were offset somewhat by reduced revenues and an increase in people costs.

6.11 The financeability EBIT margin shows continual improvement over the past five years and for the first time in that period is now within the indicative 5-10% range we considered in March 2012 to be consistent with a reasonable commercial rate of return for a financially sustainable universal service in the longer term.

6.12 In the five year period from 2009-10, Royal Mail has incurred management reorganisation costs in two years – £51m in 2010-11 and £104m in 2013-14. We note that the management reorganisation costs are large in size and have been incurred every three years since 2007-08. Royal Mail has stated that the annual cost savings in 2014-15 related to the management reorganisation was £42m with ongoing savings from 2015-16 expected to be £80m per annum.[110]

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[109] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 25.
[110] *Ibid.*, page 4.

Royal Mail Group's cash flow

Figure 6.2 – Relevant Group free cash flow*

Source: Royal Mail Statutory Accounts
** 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 non-GAAP figure*
**** Relates to a one-off disposal of a property in the London property portfolio, separately stated in Royal Mail's 2014-15 statutory accounts*

6.13 Cash flow is also an important component in ensuring the financeability of the universal service. The cash flow of the Relevant Group[111] was negative in 2007-08 and remained so until 2010-11. As Figure 6.2 illustrates, free cash flow improved and turned positive in 2011-12. Royal Mail Group saw continued further improvement in its cash flow in 2014-15[112] where it reached £0.45bn, which represents a 13.8% increase on the previous year. However, it should be noted that circa £100m[113] of the 2014-15 free cash flow related to the disposal of the Paddington site. Disposals relating to the London property portfolio are considered non business as usual disposals. Adjusting for this disposal, free cash flow was around £50m less than the prior year. This is mainly due to increased investment and one-off benefits to working capital in the prior year.[114]

6.14 The main reasons for this overall improvement over the five year period were Royal Mail's improved trading performance and a lower level of cash paid out regarding

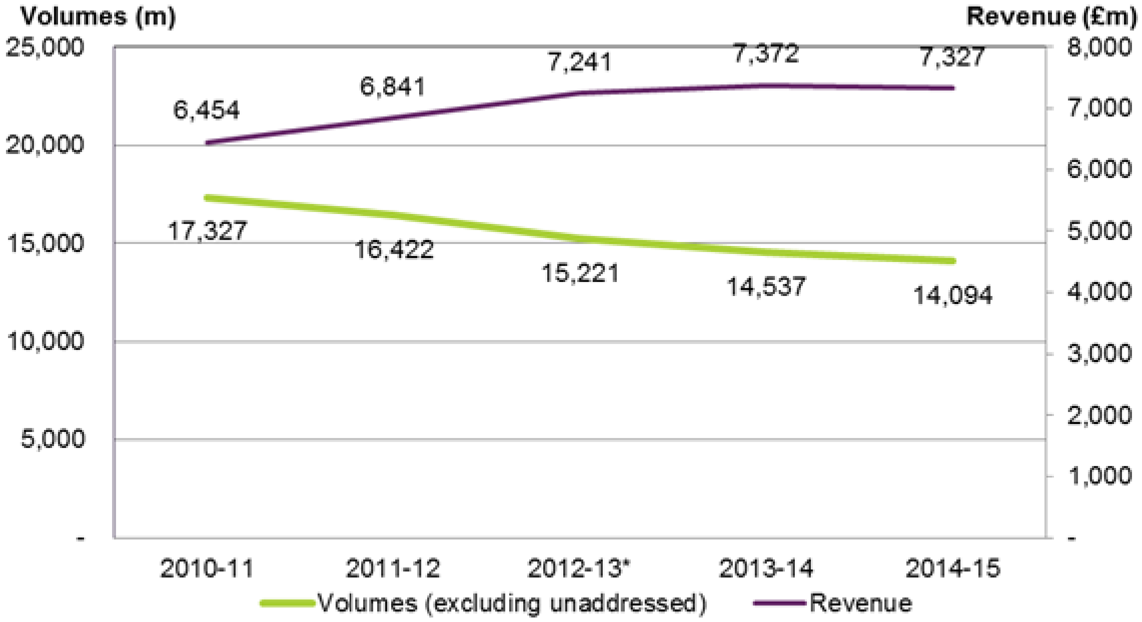
[111] The Relevant Group comprises the Companies owned by Royal Mail Plc (Royal Mail Group Limited, Royal Mail Estates Limited, Royal Mail Investments Limited, General Logistics Systems B.V and Romec Limited (51% ownership)).
[112] Free cash flow includes profit on disposal of properties.
[113] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 92.
[114] *Ibid.*, page 19.

pensions due to the removal of the pension deficit payment in 2011-12[115]. This removed approximately £300m per annum pension deficit payments.

6.15 Royal Mail states in its financial statements that it has £1.05bn in undrawn banking facilities as of 29 March 2015. This cash can be drawn upon depending on business needs.[116]

In 2014-15, Reported Business total mail volumes continued to fall and revenues decreased for the first time since implementation of the revised regulatory framework

Figure 6.3 – Reported Business total mail revenue and volumes (excluding unaddressed)



Source: Royal Mail Regulatory Financial Statements.
** adjusted 52 weeks*

6.16 Reported Business total volumes of (addressed and unaddressed) mail continued to fall in 2014-15, by 1.7% to 17.4bn. This was due to fewer addressed mail items handled by Royal Mail, which fell by 3.0% to 14.1bn (as illustrated in Figure 6.3).

6.17 Although in 2014-15 total Reported Business volumes continued to follow the downward trend seen in recent years and being reflective of the UK postal sector trend, the rate of decline in 2014-15 was less than in 2013-14 when total volumes fell by 4.3% The improved UK economic conditions in 2015 may have contributed to the lower rate of volume decline in 2014-15.

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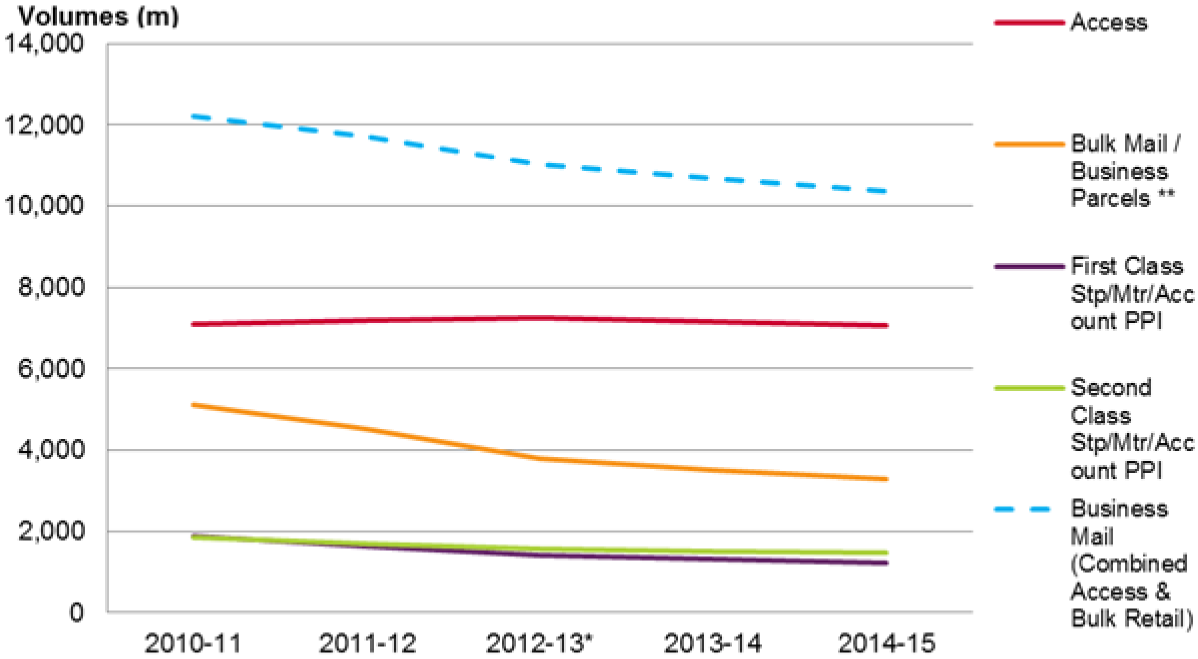
[115] Following its approval by the European Commission in March 2012 (http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:279:0040:0068:EN:PDF) the UK Government transferred Royal Mail's historic pension deficit assets and liabilities to the Treasury in the first half of 2012. In addition, Royal Mail stated in its prospectus that it also received £124 million in restructuring aid. Royal Mail still needs to provide for the ongoing pension costs accrued for its staff.
[116] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 83.

6.18 Total revenue for the Reported Business fell for the first time since implementation of the revised regulatory framework, by 0.6% to £7.3bn. This indicates that Royal Mail was not able to offset the effect of volume decline by raising prices as it had done in previous years. The level of price rises has fallen from previous years. See Section 3 for more information on prices. These trends are illustrated in Figure 6.3.

Changes in Reported Business volumes and revenue by product group[117]

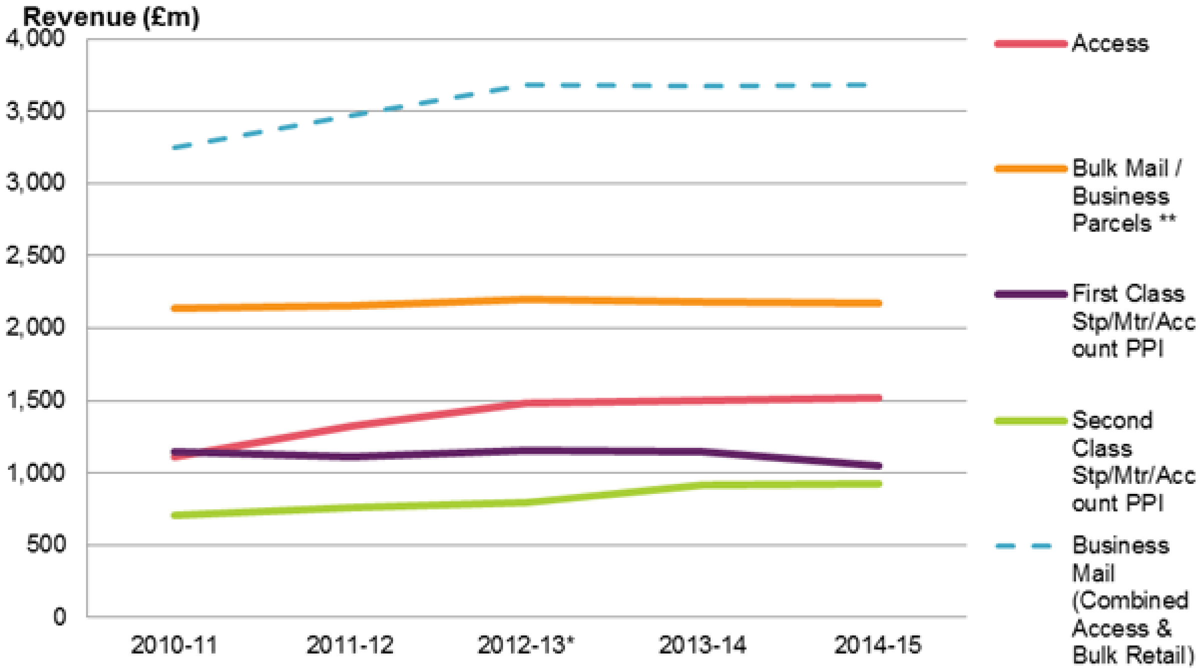
Figure 6.4 – Reported Business volumes split by product group - First and Second Class, access, bulk



Source: Royal Mail - Revenue-derived volumes
** Royal Mail have provided us with adjusted 52 week figures, therefore the 2012-13 figures have been restated to reflect this*
*** includes all Special Delivery items*

[117] In 2012-13, some reclassifications were made to these categories as part of the changes Royal Mail made to its business mail products;
i) PPI mail was reclassified from the '*First class Stp (Stamp)/Mtr (Meter)* and '*Second class Stp/Mtr*' product groupings to the '*Bulk mail'* grouping. PPI (Printed postage impressions) mail is an indication on the envelope that the postage has been paid and can be used by customers with an account with Royal Mail. It offers a pre-printed alternative to stamps and franking machines. Meter is a way of paying postage in advance, and items have a franking impression made by a franking machine licensed by Royal Mail; and
ii) a single-piece PPI product was introduced, which we have classified within the '*First Class single piece'* and '*Second Class single piece'* groupings. We have reclassified the '*First class Stp/Mtr'* and '*Second class Stp/Mtr'* categories, to '*First Class single piece*' and '*Second Class single piece*' respectively.

Figure 6.5 – Reported Business revenue split by product group - First and Second Class, access, bulk



Source: Royal Mail - Revenue-derived volumes
** Royal Mail have provided us with adjusted 52 week figures, therefore the 2012-13 figures have been restated to reflect this*
*** includes all Special Delivery items*

6.19 Figures 6.4 and 6.5[118] show the development of volumes and revenues of First Class, Second Class, access[119] and retail bulk mail[120] products. This analysis by product group enables us to gauge the impact each has on the overall Reported Business volume and revenue trend.[121]

[118] Figures reflect Royal Mail's groupings and therefore the reclassification of PPI to the Bulk Mail grouping effective from 2012-13. Where relevant, we have provided figures below the historical PPI volumes to reflect the impact of this change in classification, thus enabling a like-for-like comparison. We have done this by categorising First Class PPI and Second Class PPI (in 2011-12 and preceding years) as Bulk Mail. It should be noted that the First Class (and Second Class) single piece figures from 2012-13 include stamp, meter and account (the single piece PPI product introduced in 2012-13).
[119] Access means allowing other companies to use a postal operator's facilities for the partial provision of a postal service. In the UK this involves Royal Mail accepting mail collected and processed by third parties at its inward mail centres under wholesale contracts. Access mail is therefore the mail which is partially handled by users of these wholesale services.
[120] Bulk mail means mail for which the price per postal item is subject to discounts related to (i) the number of postal packets sent; (ii) the positioning or formatting of text on the postal packet; (iii) the requirement to apply markings which facilitate the use of machines to sort postal packets; (iv) pre-sortation into geographical areas for delivery; or (v) the purchase of any other conveyance of the same or any other postal packet.
[121] We were provided with adjusted unaudited 52 week comparative results for the 2012-13 volume and revenue split by product groups (Figures 6.4 and 6.5, respectively) from Royal Mail. We have therefore restated the 2012-13 results to reflect the 52 weeks in order to perform a like-for-like year-on-year comparison. As these figures exclude non-revenue generating volumes, they do not reconcile to the figures published in Royal Mail's annual Statutory and Regulatory accounts.

First Class revenues and volumes

6.20 First Class single piece letter and parcel volumes fell by 7.2% in 2014-15.This was partly driven by: the continuing structural decline in letter volumes and switching to Second Class; the adverse effect that the introduction of size-based parcel pricing in April 2013 had on single piece parcel volumes which continued to be felt in 2014-15; and Amazon's further roll out of its own parcel network. The trend of declining First Class single piece letter and parcel volumes continued in 2014-15, and was greater than in the previous year (5.4% decline in 2013-14).

6.21 First Class single piece letter and parcel revenues fell by 8.4%, compared to a 0.9% decrease in 2013-14. The decrease in revenue was partly attributable to lower levels of price increases than in previous years not offsetting the structural decline in letters volumes.

Second Class revenues and volumes

6.22 The decline in Second Class single piece letter and parcel volumes was similar to that in 2013-14, falling by 3.0% (compared to 2.9% in the previous year). However, Reported Business revenues increased 1.6% (compared to a 15.2% increase in the previous year). The slow down in the rate of revenue increase has been led by price increases not being at the same levels as those in previous years due to Royal Mail responding to competition in the market i.e. Royal Mail has decided not to increase Second Class parcel prices, and for some parcel formats prices have declined compared to the previous year.

6.23 For the third year in a row, the fall in Second Class volumes continued to be less than the fall in First Class volumes. Furthermore, Second Class revenue continued to increase whilst First Class revenue fell. We consider that the reasons for this are similar to those in previous years. Consumers of Second Class products may have been less sensitive to price increases compared to consumers of First Class products. The proportion of business mail in Second Class single piece products continues to be higher than the comparative First Class products (as consumers tend to send more First Class than Second Class mail). It is also still possible that some customers may have been choosing cheaper Second Class products, perhaps as a result of the price rises and, potentially, a greater desire to economise due to wider macroeconomic factors.

Bulk revenues and volumes

6.24 For the retail bulk mail (including bulk PPI[122]) and business parcels, volumes declined by 6.4% and revenues decreased by 0.3%[123].

- Reported Business access volumes declined by 1.3% to 7.1bn items. This decline was greater then the prior year (decline of 1.0%). However, due to price rises, access revenues increased by 1.3% to £1.5bn over the same period. Access and end-to-end competition is discussed in Section 4.

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[122] Printed postage impressions. These can be used instead of stamps or franking machines and printed directly onto labels or envelopes.

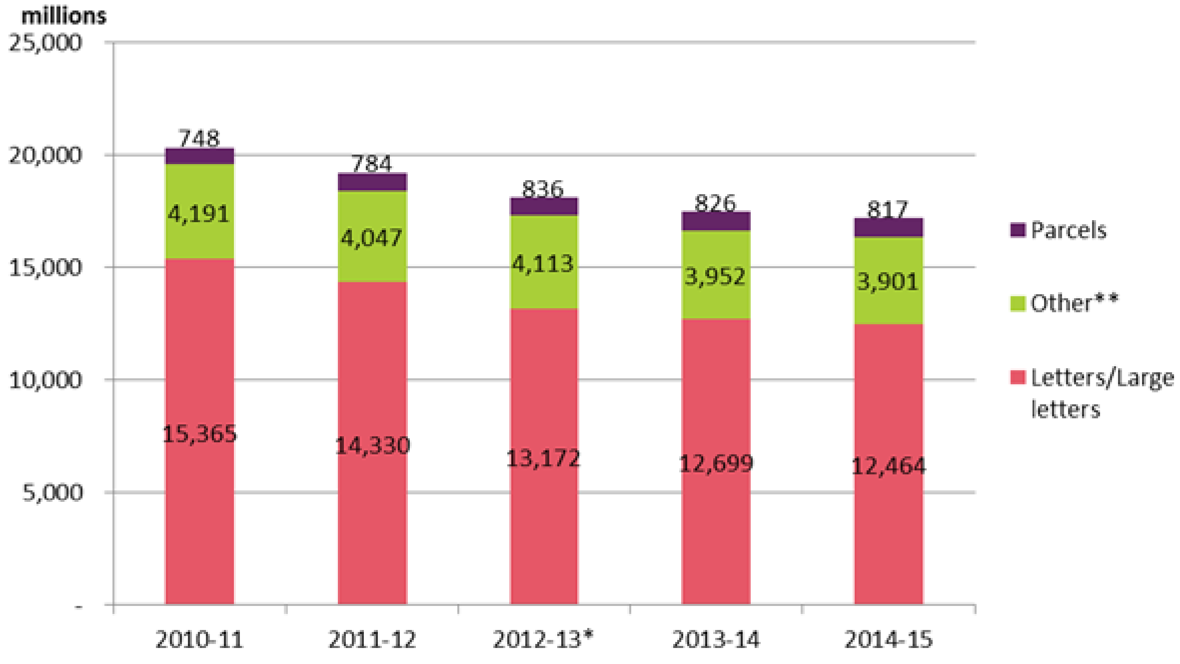
[123] These figures include all Special Delivery items (i.e. they include universal service Special Delivery items as well as contract Special Delivery).

- Combined access and retail bulk volumes declined by 3.0% and revenues increased by 0.3% in 2014-15. This volume decline was the same as the overall addressed mail volume decline of 3.0%. In previous years the decline was less than the overall decline. It therefore suggests that business mail volumes (which include transactional mail) are now affected by the same factors (such as e-substitution) as other addressed mail. The 0.3% increase in revenue was driven by price rises in access mail. See Section 4 for more information on access pricing.

6.25 Letter and parcel price trends over the last five years are discussed further in Section 3.

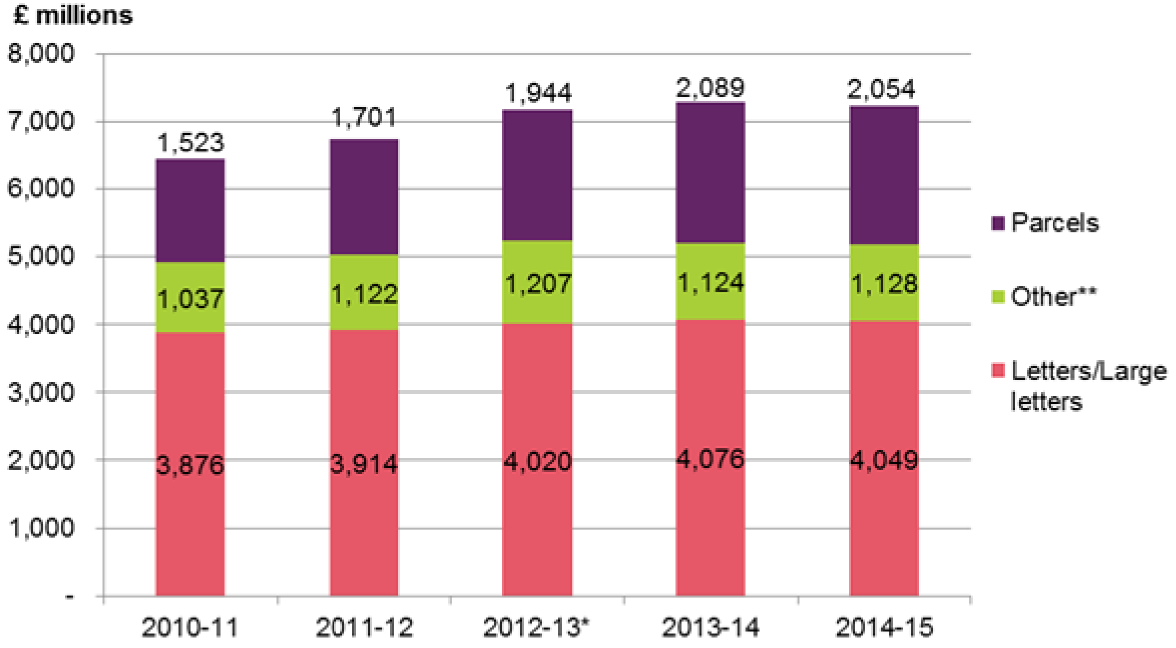
Changes in Reported Business volumes and revenue by format

Figure 6.6 – Reported Business volumes split by format – Letters/Large Letters, Parcels and Other items



Source: unpublished submission provided to Ofcom. Volumes shown are UKPIL excluding Parcelforce
** Adjusted 52 weeks*
*** Other includes unaddressed and international mail*

Figure 6.7 – Reported Business revenue split by format – Letters/Large Letters, Parcels and Other items



Source: unpublished submission provided to Ofcom. Revenues shown are UKPIL excluding Parcelforce
** adjusted 52 weeks*
*** Other includes unaddressed and international mail*

6.26 We have considered changes in the volumes and revenues of different product groups over the past five years to ascertain whether and, if so, how they have contributed to the overall decline in volumes and increase in revenues for the Reported Business. Figures 6.6 and 6.7 plot the trends for Letters/Large Letters (including retail and access), Other items (including unaddressed and international mail) and Parcels (both retail and access).[124]

6.27 As illustrated in Figure 6.6, Letters/Large Letters volumes reduced by 1.9%, which was a slower decline than the prior year decline of 3.6%. Figure 6.7 shows Letters/Large Letters revenues decreased by 0.7% (in the previous year they increased by 1.4%). In prior years Royal Mail has responded to volume decline by increasing prices. However, since the April 2012 price rises relative price increases have been smaller. The presence of access and end-to-end letters competition is relevant to Royal Mail's pricing decisions given the proportion of its volumes and revenues accounted for by access and retail bulk mail products. For further information on pricing refer to Section 3.

6.28 In 2014-15 Whistl did not roll out to further locations but increased its market share to around 1.3% of addressed letter market volumes somewhat in part to the roll out to West London in February 2014 and Liverpool in March 2014 which did not impact 2013-14 volumes but did in 2014-15. We discuss Whistl and end-to-end competition further in Section 4. It should be noted that Whistl confirmed its decision to stop its

[124] Figures are from unaudited and unpublished submissions provided to Ofcom. Parcel volumes are based on Royal Mail's definition of parcels and include some fulfilment letters and large letters and are therefore not directly comparable to the parcel market volumes collected by Ofcom and reported in Section 5. Ofcom's definition of what constitutes a parcel is set out in paragraph 5.3.

end-to-end letters delivery operations in June 2015. Going forward there will not be a significant competitor in the end-to-end delivery market.

6.29 Figure 6.6 shows total Reported Business parcel volumes fell by 1.1% in 2014-15. This is the second year volumes have decreased albeit the rate of decline has slowed from 2013-14 (decline of 1.2%). It is also in contrast to the overall parcel market growth as noted earlier in the previous Section, and although measured national volumes (as outlined in Section 5) are prepared on a different basis and are not directly comparable with Royal Mail's reported volumnes, it suggests the Reported Business parcel share of supply declined further in 2014-15. The decrease in volumes was mainly attributable to intensified competition in the parcels market with some switching between the Reported Business and Parcelforce Worldwide. Amazon's roll out of its own network continues to impact Royal Mail with them estimating a 1-2% short term decrease in UKPIL's addressable market. [125]

6.30 As we described in our 2013-14 Annual monitoring update, the introduction in April 2013 of size-based pricing led to price increases for medium sized parcels, resulting in prices more than doubling in some cases. It led to a year-on-year decline in consumer parcel volumes,[126] which in turn contributed to the total parcel volume decline of 1.2% in 2013-14. Royal Mail made changes in October 2013 to increase the dimensions of its small parcel, leading to previously medium sized parcels being classified as cheaper small parcels.

6.31 The revised small parcel dimensions had been in place for over a year by the end of 2014-15. Lower average unit revenues due to the reclassification, coupled with volume decline (paragraph 6.29) meant that year-on-year parcel revenues fell for the first time since the introduction of the revised regulatory regime (decline of 1.7%).

6.32 Figure 6.6 shows Other volumes (which consist of unaddressed letters and international mail) decreased by 1.3% (compared to a 3.9% decrease in the previous year). This slowdown in the decrease was due to an increase in unaddressed volumes, with international volumes (parcels and letters) declining at a faster rate.

6.33 Other revenues increased by 0.4%, compared to a 6.9% decrease in the previous year (see Figure 6.7). This reversal was due to an increase in unaddressed advertising mail volumes compared to the prior year.

6.34 We have undertaken some high level analysis to ascertain how much of the overall increase in total Reported Business revenue in 2014-15 was due to mix and how much was attributable to price rises.

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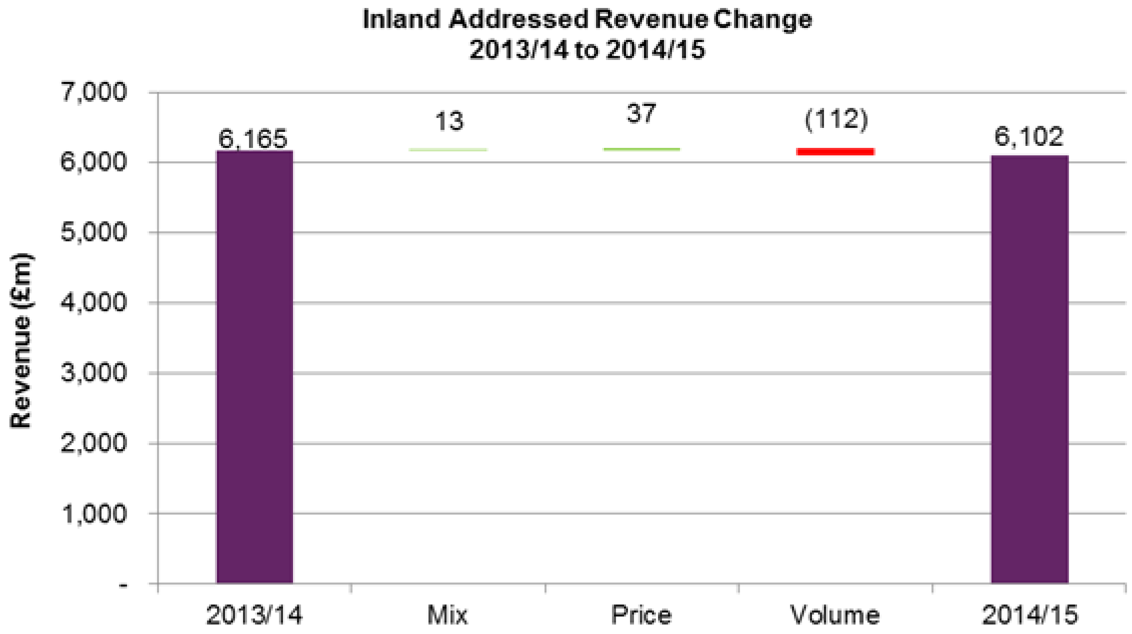
[125] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 8 .
[126] Combined First and Second class parcel volumes i.e. First and Second class Single, Meter, PPI and non-revenue generating parcel volumes. Figures are based on unaudited and unpublished submissions to Ofcom.

Figure 6.8 – Contributions of mix, price and volumes to inland addressed revenue change



6.35 Our analysis[127] – set out in Figure 6.8 – shows the relative contributions of price increases, overall volume decline and the change in volume mix (i.e. higher proportion of parcels) towards the decrease in revenue for inland addressed mail. This analysis suggests that price increases were not able to offset volume decline in addressed mail. This is contrary to the prior year, where price increases drove an increase in revenue, due to the introduction of size-based parcel pricing in April 2013 and the fact that price rises were comparatively higher in 2013-14.

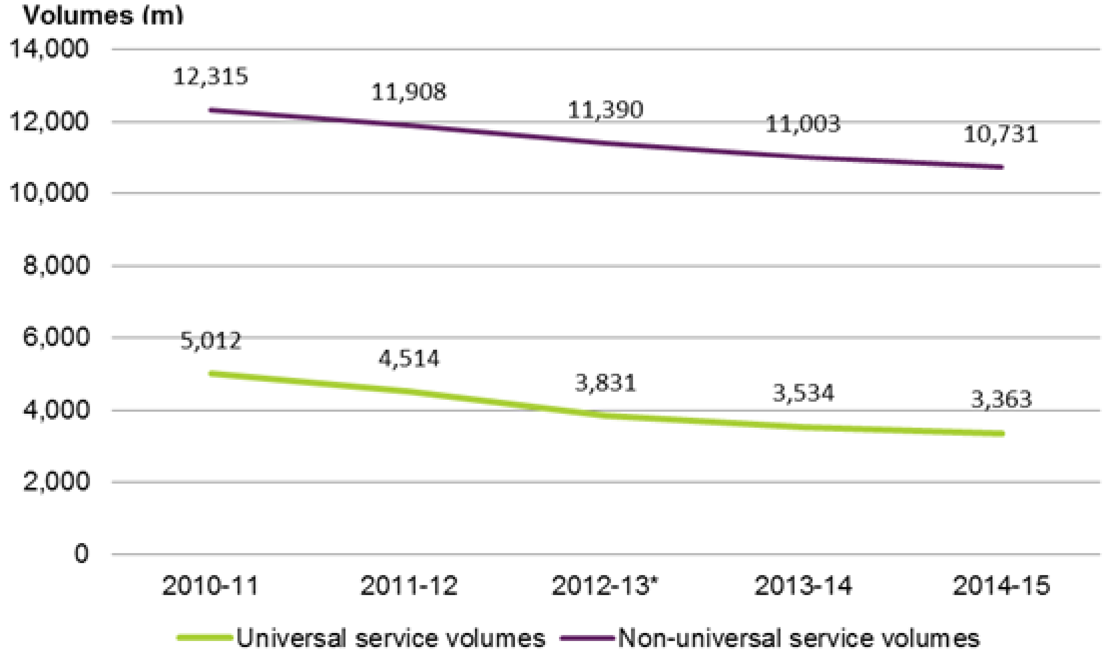
6.36 In 2014-15, the change in mix represented 11% of the volume impact, which was less than in 2013-14 (18%).

Universal service and non-universal service volumes and revenues

6.37 As set out in Section 2, the Reported Business includes all universal service products, as well as other products which use the universal service network (for example, retail bulk mail and access products).

[127] The analysis looks at the drivers behind the change in addressed mail revenue between 2013-14 and 2014-15. This is calculated with reference to the overall change in revenue for letters/large letters (combined) versus parcels. The calculation is undertaken in three steps: a) to estimate the impact of changes in mix, the 2013-14 total volumes and average prices were used alongside the 2014-15 change in mix (i.e. the proportion of letters/large letters compared to parcels); b) to estimate the impact of the change in prices, 2014-15 average prices and mix were used alongside the 2013-14 total volumes; and c) to estimate the impact of the volume decline, total volume was scaled to reflect 2014-15 total volumes along with the 2014-15 prices and mix.

Figure 6.9– Volumes split by universal service and non-universal service products



Source: Royal Mail Regulatory Accounts, addressed volumes
** Adjusted 52 weeks*

6.38 Figure 6.9 shows the Reported Business volumes, broken down into universal service and non-universal service products. Note these are the same volumes as those shown in Figures 6.6 and 6.7 in this Section, only categorised in a different manner.

6.39 The volume of universal service products continues to decline. In 2014-15, universal service volumes declined by 4.8% and since 2010-11, they have fallen by 32.9%.[128] As part of Postcomm's August 2011 review,[129] some products were removed from the scope of the universal service, which consequently reduced universal service volumes. The volume of non-universal service products also continues to fall but less so, with a 2.5% reduction in 2014-15 (and 12.9% reduction since 2010-11).[130] This was mainly due to the growth of access volumes, which results in other operators taking upstream volume from Royal Mail. However, as shown above, 2014-15 saw further reduction in Royal Mail's access volumes. This is likely to be due to a combination of increased end-to-end competition and the access market potentially nearing maturing, i.e. subject to the same pressures as the rest of the mail market, resulting in structural decline.

6.40 As discussed in paragraph 6.24, combined access and retail bulk volumes declined by 3.0% in 2014-15. Historically, this decline in bulk business mail volumes has been

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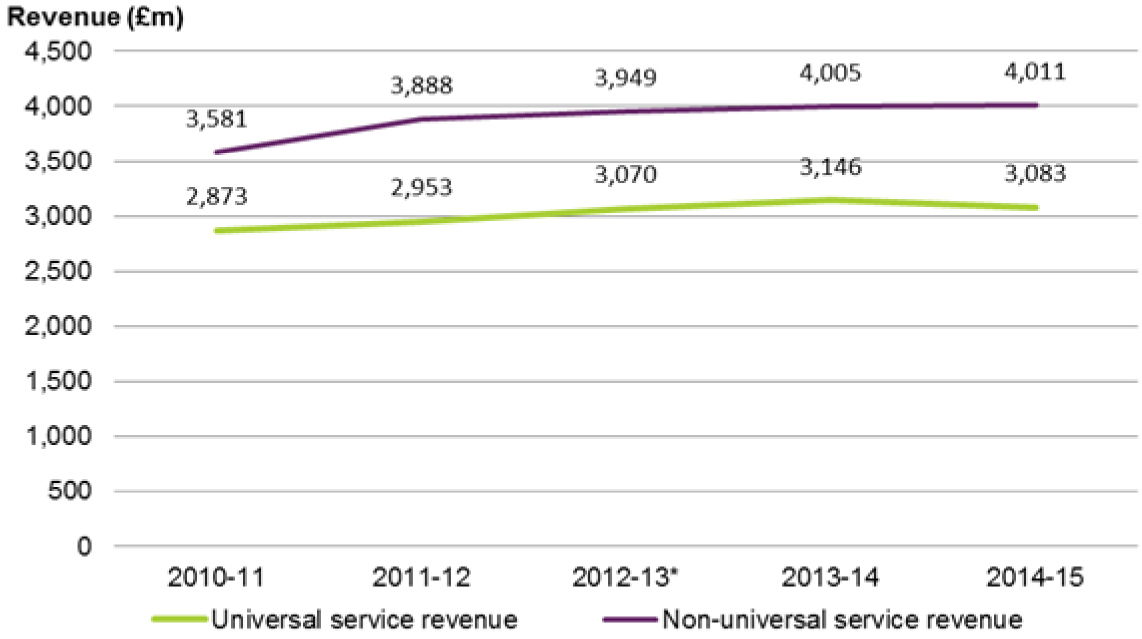
[128] Based on the 2012-13 universal service product scope where Mailsort 1400 and Cleanmail were redesignated to non-USO services, like-for-like volumes fell by 24.7% since 2010-11.
[129] See Postcomm *Removing bulk products from the universal service and clarifying the status of other universal service products – a decision document.* http://stakeholders.ofcom.org.uk/binaries/post/2005.pdf
[130] Based on the 2012-13 universal service product scope where Mailsort 1400 and Cleanmail were redesignated to non-USO services, like-for-like volumes fell by 16.6% since 2010-11.

slower than the decline in volume of universal services predominantly used by consumers and small businesses, as shown in Figure 6.9. However the gap between the two has started to decrease as outlined in paragraph 6.24.

Figure 6.10 – Revenue split by universal service and non-universal service products



Source: Royal Mail Regulatory Accounts, addressed revenues
** Adjusted 52 weeks*

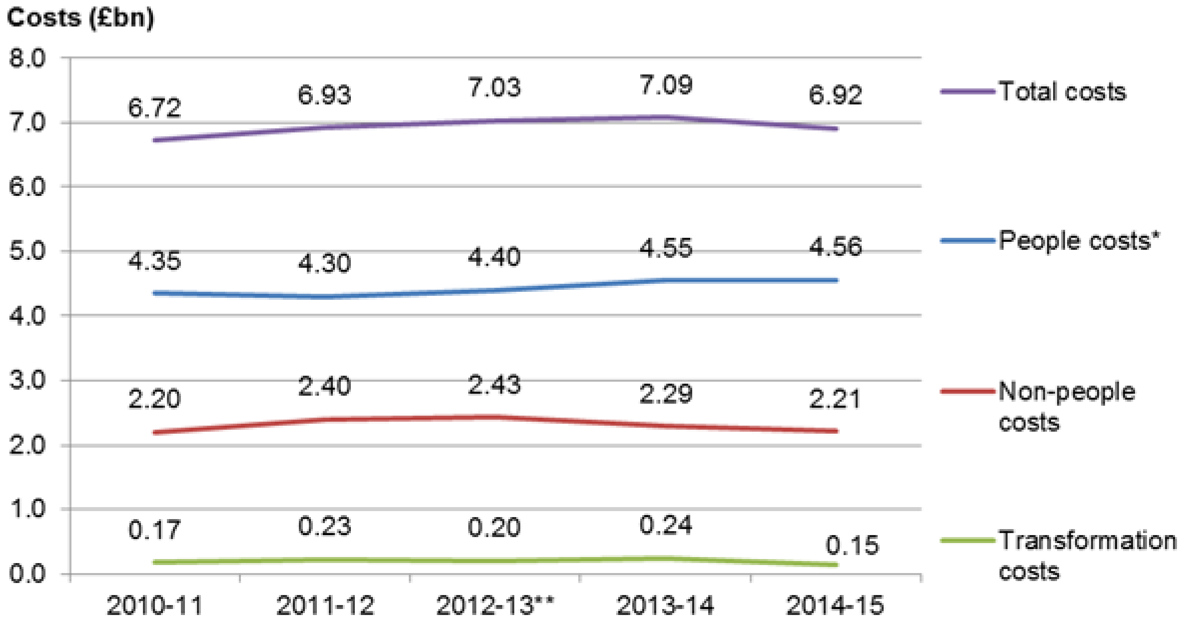
6.41 Figure 6.10 sets out the corresponding revenue for the Reported Business split between universal and non-universal service products. Despite the volume decline discussed above, revenues from universal service products have increased over the last five years, largely due to price rises.[131] However, in 2014-15 revenues declined by 2.0% as the price rises no longer countered the decrease in volumes.

6.42 Non-universal service products include discounts for presentation, sorting of the mail and/or volume which reduces the cost of processing these items for Royal Mail. They therefore have lower unit revenue than universal services. This explains why the gap between universal service and non-universal service volumes is larger than the gap between their respective revenues.

[131] Based on adjusted 52 week 2012-13 period.

Reported Business costs

Figure 6.11 – Reported Business costs



Source: Royal Mail audited regulatory accounts and unpublished submissions from Royal Mail
** Adjusted for cash pensions charge*
*** Adjusted unaudited 52 weeks*

6.43 Costs including transformation costs for the Reported Business fell in 2014-15 to £6.92bn. These costs can be broken down into people costs, non-people costs and transformation costs. The breakdown of costs to these categories is shown in Figure 6.11 and we note that:

- *People costs*[132] – were broadly flat, increasing by 0.2% to £4.56bn, despite a lower headcount with the associated reduction in gross hours. The increase was largely due to the 3% pay deal[133] and additional hours worked by frontline staff to deliver election mail.

- *Non-people costs* – fell by 3.6% to £2.21bn, partially due to distribution and conveyance costs falling due to lower fuel prices, improved fleet management and lower terminal dues costs; reduced property spend following the end of the agreement to manage POL's estate; offset by £25m of additional VAT credits which were received in 2013-14.

- *Transformation costs* – transformation costs were £0.15bn in 2014-15, representing a 40.1% decrease compared with 2013-14. This is largely due to the £104m management reorganisation cost that was incurred in 2013-14. Underlying transformation costs increased by 5.1% as Royal Mail continues to reduce headcount through voluntary redundancy and modernise the business.

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[132] Adjusted to reflect the cash cost of the defined benefit pension scheme rather than the accounting charge.
[133] Agreed with the CWU in December 2013.

6.44 As volumes handled by Royal Mail continue to fall, particularly parcel volumes which declined again in 2014-15 for the second year in a row, the ability to offset the lower letter revenue impact by parcel revenues is constrained.

Summary of financial performance

6.45 We have reviewed a broad set of financial performance data in this Section. In summary, the key trends for the 2014-15 financial year were:

- The financeability EBIT margin increased from 3.9% to 5.6% in 2014-15, which was due to the reduction in non-people and transformation costs, partially offset by worsening trading performance and higher people costs. Royal Mail's financeability EBIT was therefore within the indicative 5-10% range we identified as consistent with a reasonable commercial rate of return for a financially sustainable universal service;

- Free cash flow continued to be positive in 2014-15 where it reached £0.45bn, which represents a 13.8% increase on the previous year, albeit this was primarily due to property disposals in the financial year, without which it would have reduced by c.£50m. Royal Mail also has access to a further (c. £1bn) of funds from its undrawn banking facilities.

- On an overall sector level, letter volumes fell (this year, primarily due to e-substitution) whilst parcels grew (primarily as a result of the growth in e-commerce). This continues the trend of falling letter volumes and rising parcels volumes that has been the case for a number of financial periods;

- Reported Business letter volumes continued to decline, albeit at a lower rate than previous years due to the improvement in UK economic conditions. Parcel volumes continued to decline, reflecting a shrinking of Royal Mail's share of supply as the UK parcels sector grew. The decline in the Reported Business parcels volumes was caused by the adverse impact of size-based pricing and intensified parcel competition, for example, Amazon rolling out its own delivery service and other providers competing on price and service offering;

- Reported Business revenues decreased for the first time since implementation of the revised regulatory framework due to parcel volumes declining alongside predicted letter volume declines;

- Reported Business costs reduced by 2.4% year-on-year. The main reason for this was that higher people costs driven by the 3% pay deal were offset somewhat by headcount and gross hours reduction and a decrease in non-people and transformation costs.

Section 7

Royal Mail's efficiency

7.1 In this Section we discuss efficiency, covering:

- Why it is an important aspect of our monitoring regime;
- The further work we are doing to better understand Royal Mail's efficiency; and
- What Royal Mail has been doing to improve its efficiency.

7.2 We then estimate Royal Mail's efficiency for 2014-15 using a range of metrics in line with those adopted in the 2013-14 Annual monitoring update.

Efficiency is an important element of our monitoring regime

7.3 In discharging our duties in relation to post, the PSA 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 of time and then remain efficient at all subsequent times.

7.4 In the March 2012 Statement, we noted that we expected Royal Mail to improve its efficiency levels and to sustain such improvements thereafter. This was to avoid Royal Mail relying solely on price increases with the associated risk of exacerbating volume decline. However, we did not set specific efficiency targets.

7.5 Therefore, efficiency is one of the key areas we assess as part of the monitoring regime. As part of this, it is important to understand what Royal Mail's actual rate of efficiency improvement is. This is discussed in this Section.

We are continuing our work to understand the efficiency of the universal service better

7.6 In our 2013-14 Annual monitoring update, we explained that we were reviewing the metrics adopted in that report and were also considering what other measures might be appropriate to understand and monitor Royal Mail's efficiency.

7.7 Our work on efficiency metrics now forms part of the on-going review of Royal Mail regulation. This includes consideration of the efficiency metrics adopted here and in the 2013-14 Annual monitoring update, as well as the parameters included in the metrics' calculations such as inflation, marginality and workload. Marginality refers to the extent to which Royal Mail's costs change as a result of volume changes. Workload is a volume measure devised by Royal Mail (volumes are weighted by the theoretical different amounts of time it should take to process and deliver letters, large letters and parcels). Workload is more reflective of the amount of work undertaken by Royal Mail than a simple volume count as it accounts for changes in mix. Change in workload provides an estimate of marginality as it reflects the theoretical change in hours due to change in volume. Royal Mail's workload has to date been based only on processing and delivery activities. It therefore represents a partial measure as it excludes all other parts of Royal Mail's business. However, delivery and processing people costs account for a significant proportion of Royal

Mail's regulated business costs. We understand Royal Mail is continuing to work towards expanding its workload calculation across other parts of its pipeline.

7.8 This review is expected to use efficiency metrics to inform our review of the extent to which Royal Mail's underlying cost base provides an opportunity for efficiency improvement. It will also consider the extent to which its business plan demonstrates initiatives and ambitions to realise those efficiencies while continuing to meet its existing universal service obligations. We expect to publish the outcome of the work alongside the findings of the review in early 2016.

7.9 Prior to the conclusion of the review, this Annual monitoring update adopts the same metrics as were used last year.

Royal Mail's transformation programme

7.10 Since 2008, Royal Mail has been implementing a large-scale transformation programme across the main elements of its operation, including delivery, logistics, processing and overheads. The key structural and operational elements of this programme moved closer to completion in 2014-15.

7.11 In delivery, Royal Mail neared the conclusion of its modernisation of programme of c.1400 Delivery Offices. Indoor working method revisions, new delivery methods, automated walk sequencing and route optimisation have now been implemented in all but a minority of Delivery Offices (less than 100).

7.12 In processing, Royal Mail continued to increase automation during 2014-15. It states that it has increased letter sequence sort rates from 34% in 2010-11 to 82% by end of 2014-15. A further mail centre was closed in 2014-15, following the closure of eight mail centres in 2013-14. Royal Mail now has 39 mail centres in operation, compared to 69 in 2007-08.

7.13 Royal Mail is now entering a new phase in its transformation programme following the structural changes that are largely complete. To achieve this Royal Mail has implemented a number of initiatives intended to reduce costs, optimise networks, and streamline processes. These include parcels tracking, collections on delivery, more delivery revisions, a focus on high impact units and reorganising management structures.[134]

7.14 Royal Mail incurred management reorganisation costs of £104m in 2013-14. Royal Mail stated that the annual cost savings in 2014-15 related to the management reorganisation were £42m with on-going savings from 2015-16 expected to be £80m per annum.[135] This indicates a payback period of two years.

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[134] *Royal Mail Plc, Response to Ofcom's July 2015 Discussion paper: Review of the regulation of Royal Mail,18th September 2015.* http://stakeholders.ofcom.org.uk/binaries/consultations/royal-mail-regulation-review/responses/Royal_Mail.pdf.

[135] Royal Mail Plc Annual Report and Financial Statements 2014-15, page 4.

Provisional indicators of Royal Mail's efficiency improvements

7.15 For the purpose of this report, we consider the efficiency of Royal Mail's reported business excluding the costs incurred in transforming the business. Transformation costs can vary significantly year-on-year, dependent on the timing and scale of business initiatives. We have presented some of our metrics both including and excluding transformation costs as we are concerned with changes in the underlying efficiency of the universal service which we are seeking to monitor but recognise there is an associated cost with achieving efficiency.

7.16 We adopt a variety of metrics to monitor efficiency. These include overall efficiency metrics calculated adopting the PVEO[136] methodology and Real Unit Cost analysis. Both methods seek to isolate the cost movements due to efficiency from those due to volume and inflation. This year we have included an estimate of underlying efficiency excluding transformation costs in addition to including an estimate after transformation costs. This is a change from the prior year and we have restated prior year comparatives to reflect this change.

7.17 PVEO does this by building a cost bridge between years and allocating cost movements to "Price" i.e. inflation, "Volume", "Efficiency" and "Other" considered to be one-off costs. Cost movements are identified at a more granular level than total costs.

7.18 Real Unit Cost analysis calculates the ratio of costs to output or volume, Ideally, the volume measure should take into account both mix (the level to which different products / types of outputs cause different levels of costs i.e. at a more granular level) and economies of scale. However, the calculation is done at a total level.

7.19 We also consider People Cost per FTE and Revenue per FTE and productivity - a non-financial efficiency measure used by Royal Mail to assess operational activity (for example items processed per hour or per employee).

Price, Volume, Efficiency and Other Analysis

7.20 We have disaggregated movements in total costs[137] between 2013/14 and 2014/15 in terms of price (i.e. inflation) changes, volume effects, efficiencies achieved and other one-off costs.

7.21 Our analysis assumes an inflation index of CPI. Cost movements due to volume are accounted for on a subset of the total cost base. These correspond to the frontline costs of delivery and processing, payments to Post Office Limited (POL) and international terminal dues. The remainder of cost movements, once one off items have been accounted for, are assumed to relate to efficiency.

7.22 Figure 7.1 shows an underlying efficiency improvement (excluding transformation costs) of c.2.6% 2014-15 (2013-14 restated: c.0.7%). The improvement was largely driven by a decrease in non-people costs as discussed in paragraph 6.43.

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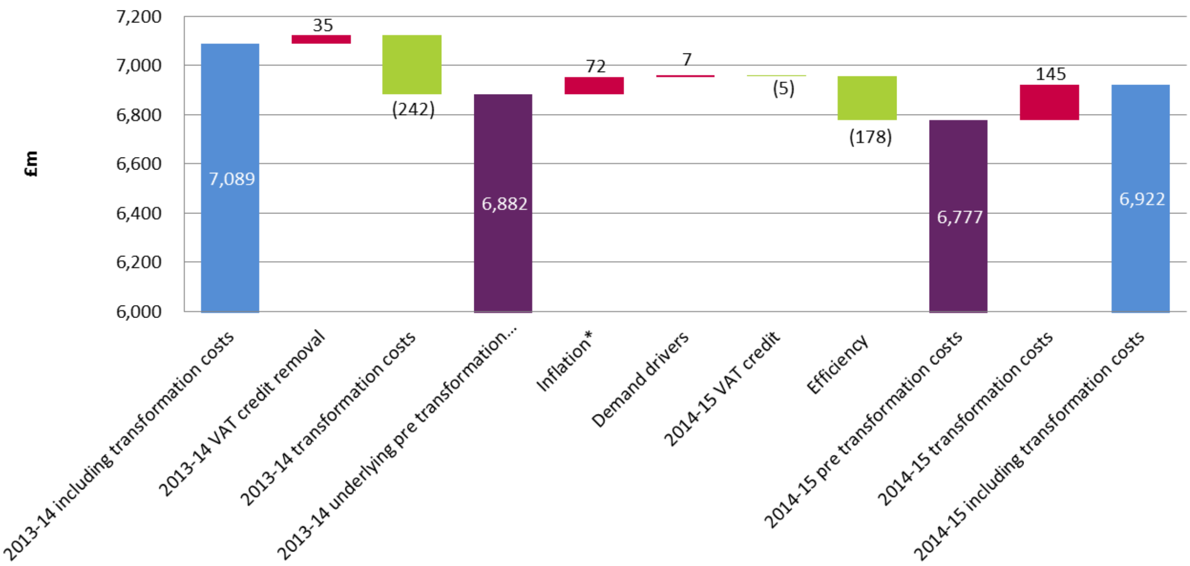
[136] Price, Volume, Efficiency and Other.
[137] Reported Business people, non-people (including depreciation) adjusted for cash pension rate.

7.23 Transformation costs in 2014-15 were around £100m (in real terms) less than those incurred in 2013-14.[138] If we were to calculate efficiency on total costs, including transformation costs, this step change in cost incurred in achieving efficiencies would impact the efficiency calculation, implying a 2014-15 figure of 3.9% (0.2% in 2013-14).

Figure 7.1 – PVEO bridge 2013-14 to 2014-15



Source: Royal Mail Reported Business (figures constructed for regulatory purposes and are unaudited)
**ONS 12 month average CPI figures (April to March)*

Real Unit Cost

7.24 Real unit cost analysis is a high level way of assessing efficiency; it takes the ratio of costs to output (volume). For this report we have adopted Royal Mail's volume measure of workload rather than taking unweighted volumes.

7.25 We wish to exclude the impact of mix and volume from our efficiency estimate. Royal Mail's workload measure weights together different mail formats and so may account for the impact of product mix (i.e. the fact that different product types affect costs at different rates). The measure may also account for the increased proportion of fixed costs as volumes decline as the weights adopted by Royal Mail change over time accounting for a fixed element. We have therefore used workload in our calculation.

7.26 Using workload as the volumetric, underlying real unit costs (excluding transformation costs) decreased by c.2.2% (2013-14 restated: c.0.4%). Efficiency calculated on costs including transformation costs showed a decrease of 3.5% for the same reason as discussed in paragraph 7.22. This was an improvement on the prior year where the analysis showed c.0.2% inefficiency.

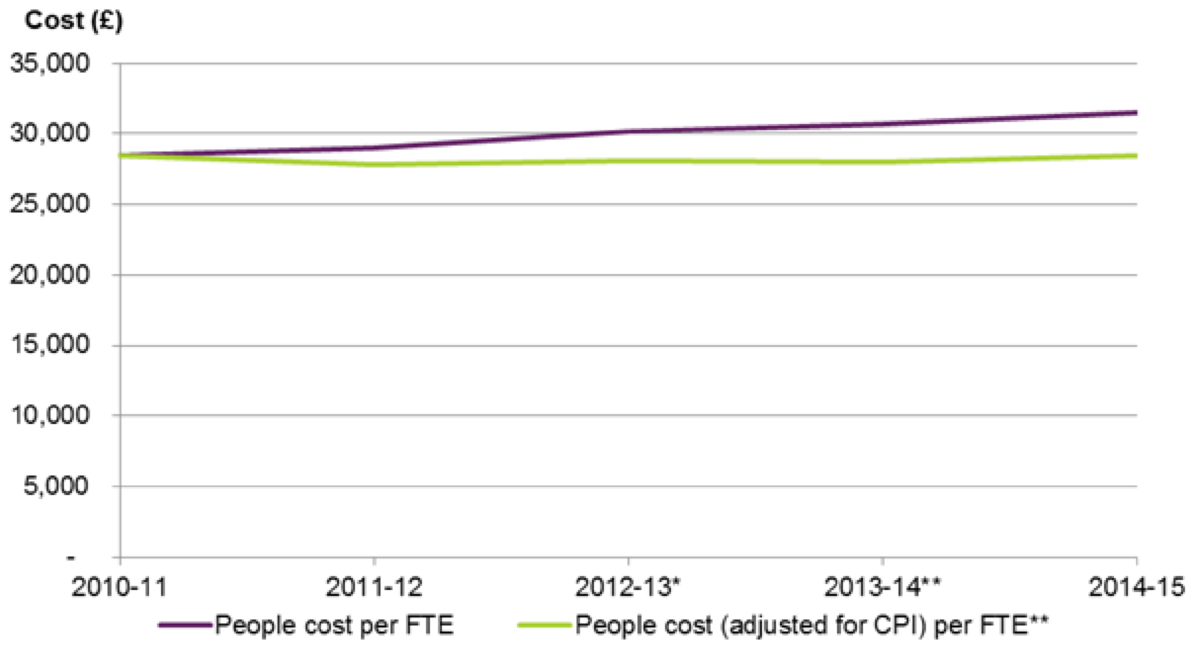
[138] 2013-14 transformation costs included a £104m related to management re-organisation.

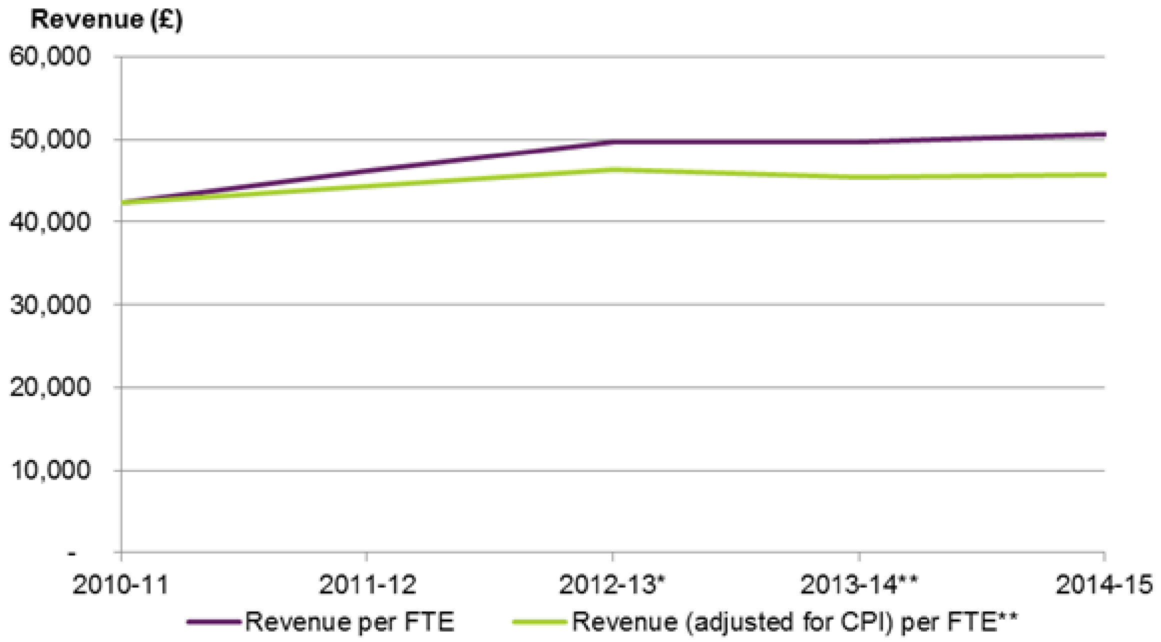
Other Metrics

7.27 Comparing People Cost per FTE and Revenue per FTE also provides an indication of efficiency. For example, if Revenue per FTE increases at a greater rate than People Cost per FTE, it may suggest that each FTE is generating greater revenues than their relative expense. However, there may be other contributory factors, such as price changes, which could influence Revenue per FTE, thereby lessening the direct relationship with People Cost per FTE.

7.28 People costs represent a significant proportion of Royal Mail's costs. However, it may not provide a reliable indicator on its own as a company may have a high cost per employee but a low cost per customer dependent on the company's operations. Nevertheless, it is useful in highlighting a trend.

Figure 7.2 – Reported Business people cost and revenue per FTE





Source: Royal Mail Reported Business (figures constructed for regulatory purposes and are unaudited)
FTE data (including agency staff) provided by Royal Mail.
** 53 week data used in calculation*
*** 2013-14 Restated onto 39 hour working week to bring in line with 2014-15*
**** ONS 12 month average CPI figures (April to March)*

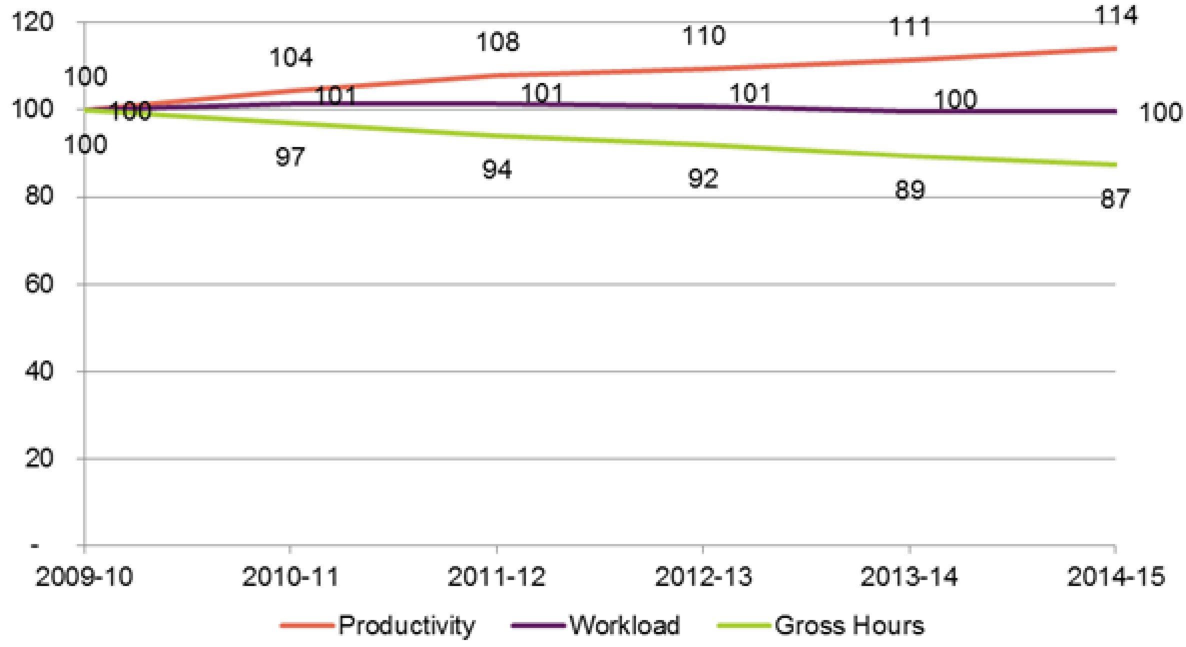
7.29 We see in Figure 7.2 that People Costs per FTE have broadly increased on a real and nominal basis since 2011-12 (with the exception 2013-14). Year-on-year people costs were flat from 2013-14 to 2014-15; however, a reduction in FTE saw the average cost rise. It also shows Revenue per FTE adjusted for CPI, has generally been increasing since 2010-11. Over the past five years, Revenue per FTE adjusted for CPI has increased by 8.2%, whereas People costs per FTE adjusted for CPI has stayed static (note, there have been movements between financial years as indicated by Figure 7.2). The main driver in revenue per FTE adjusted for CPI increasing over this period were the price rises in 2011-12 and 2012-13. People cost per FTE adjusted for CPI has remained static as gross hours reduction and the pay deal have broadly equated to CPI.

Productivity Metrics

7.30 In contrast to the financial efficiency metrics analysed above, productivity provides a non-financial measure of efficiency. Productivity can be considered to be the efficiency of the operational activity, for example, how many items are worked in a given amount of time or by an employee.

7.31 In this report we consider Royal Mail's own productivity metric defined as items worked or workload (processed and delivered) per unit of time (shown below as gross hours139). As discussed previously, Royal Mail's workload calculation accounts for changes in volume and product mix over time but currently only covers delivery and processing activities. It currently excludes parts of Royal Mail's pipeline (although delivery and processing people costs account for a significant proportion of Royal Mail's regulated business costs). We understand that Royal Mail is working to expand the range of activities covered by this measure. It should be noted that the measure is not a financial measure as it does not cover the costs involved in achieving that rate of work i.e. how much people are being paid.

Figure 7.3 – Productivity in Delivery and Processing



Source: Provided as part of unaudited Royal Mail submissions

[139] Gross hours represent the number of hours taken to process and deliver the aggregate annual volume of letters and parcels through the Core Network (based on frontline collections, delivery, processing and logistics hours only).

7.32 Royal Mail's estimate of productivity improvement, employing this approach, is shown in Figure 7.3. This shows an improvement in productivity as the time taken to work the items has decreased relative to the change in workload.[140]

7.33 Overall Royal Mail estimates that its total productivity for both mail centres and delivery offices improved by 2.5% in 2014-15. This productivity improvement was achieved by 2.3% reduction in gross hours despite a slight increase in workload (0.1%).

Summary of efficiency metrics and rate of improvement

7.34 We have worked with Royal Mail to develop and understand appropriate metrics to measure change in efficiency levels over time. We have explored a range of metrics – both financial and non-financial – to show the changes in Royal Mail's efficiency as detailed in this Section. In summary, the key efficiency trends for the 2014-15 financial year were:

- The PVEO analysis indicates an underlying efficiency improvement (excluding transformation costs) of c.2.6% against c.0.7% in the prior year. This has been led primarily by reduction in non-people costs.

- Cost per unit workload adjusted for CPI shows a year-on-year decrease of c.2.2% excluding transformation costs against a year-on-year decrease of 0.4% in the prior year.

- Royal Mail's own measure of productivity improvement for 2014-15 was 2.5%, which was within Royal Mail's target of 2-3**%.**

- Assessing the degree to which Royal Mail's plans represent a reasonable rate of efficiency improvement forms a key part of the review of Royal Mail regulation. Within this, as noted above, we are finalising our work to refine and determine which efficiency metrics we will use as part of our on-going monitoring programme. We expect to conclude on this during 2016.

[140] In 2014-15 Royal Mail expanded its workload definition to include election mail not previously included.

Annex 1

Current information collected as part of the monitoring programme

Information for financial monitoring	Frequency
Relevant Group consolidated income statement, balance sheet and cash flow statement	Annually
Royal Mail Strategic Business Plan and Annual Bridge	Annually
Reported Business income statement, product profitability statements, capital employed statement and cash flow statement (including accounting separation)	Annually
Royal Mail data on compliance with the safeguard cap	Annually
Relevant Group consolidated cash flow projections	Quarterly
Reported Business income statement, product profitability statements, capital employed statement and cash flow statement (including accounting separation)	Quarterly
Royal Mail Costing Manual (including zonal costing) and Accounting Methodology Manual	Quarterly
Other Operators' volume and revenue data split by product	Quarterly
Reported Business revenues and volumes report	Monthly
Relevant Group monthly management and KPI performance pack	Monthly

Information for monitoring impact on customers and consumers	Frequency
Royal Mail Quality of Service Reporting	Annually assessed but reported quarterly
Royal Mail integrity reporting	Annually assessed but reported quarterly
Royal Mail changes to latest delivery and collection times	Three months before change
Royal Mail request to change terms and conditions for USO products	One month before proposed change
Royal Mail request to change prices for USO products	One month before proposed change
Royal Mail notification of changes to terms and conditions for USO products	One month before change
Royal Mail notification of changes to prices for non-USO products	One month before change
Royal Mail change to compensation policies	One month before change