

Intellect submission to Ofcom

Securing the Universal Postal Service: the future framework for economic regulation.

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**This response represents the views
of Intellect members in the meter
manufacturer industry**

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Introduction

Intellect is the UK trade association for the technology industry. Our mission is to use our expertise and knowledge to provide the highest quality of service and intelligence to our 750 plus members across the information and communications technologies (ICT), electronics manufacturing and design, and consumer electronics (CE) sectors. This enables them to make the right business decisions to deliver commercial solutions and achieve growth and profitability. We do this by fostering improved business performance, encouraging thought leadership, and making the shaping of markets and influencing of policy possible.

We are constantly striving to provide work environments where our members can meet their potential and thrive in an atmosphere of excellence through working closely with the government, regulatory bodies, policy makers and businesses.

Intellect Postal Services Group

Intellect's Postal Services Focus Group comprises the key industry stakeholders and has an established programme of engagement with all sections of the market to collate and articulate the concerns and visions of the postal technologies sector.

Our objective is to represent the industry to highlight the importance of technology to the UK postal industry now and in the future. We do not advocate specific company technologies and therefore Ofcom should regard this response as an expression of the specific industry view.

In recent years our group regularly engaged with Postcomm to input the concerns of the technology industry and receive updates from the regulator, and we believe Postcomm found Intellect a useful forum for engaging with key industry stakeholders. We were delighted to recently host our first workshop with Ofcom and to attend Ofcom stakeholder briefings, and this response was formulated based on these and from multiple roundtable workshops of Intellect members.

Intellect response on behalf of the meters industry

Background

In this response Intellect would like to introduce the meter manufacturers sector and provide collated thoughts in response to the consultation issued by Ofcom concerning the future framework for economic regulation.

This response is solely from a specific section of our varied membership – our meter manufacturers. It comprises the collated concerns of the meter manufacturers' sector specifically within the Intellect focus group, in particular:

- **Pitney Bowes Ltd**
- **Neopost Ltd**

These members are keen to convey their thoughts as an industry, and Intellect provides a neutral forum for our members to collectively provide the thoughts of the sector for the benefit of industry and regulator.

Please note references below to '*Intellect members*' refer solely to the views of our members named above and views of Intellect's wider membership may follow separately if appropriate.

The response includes the following sections:

1. An Executive Summary
2. An overview of why customers choose the meters channel

3. Response to the appropriate consultation questions
4. Ongoing dialogue and next steps

Executive Summary

In this response, feedback is limited to Ofcom's consultation on the key issues that affect Intellect members in the meter manufacturer industry.

In the UK today the meters industry provide access to Royal Mail services to over 200,000 of their customers. Customers using this equipment include major financial institutions, public sector bodies and the vitally important SME sector. Working with and through this industry sector the Royal Mail efficiently collects approximately £900m per annum of its revenue.

The meters industry prides itself in the relationship it has built over many years with its principal business partner in the UK, Royal Mail. Since the advent of postal market de-regulation, it has also taken time to understand the regulatory environment that surrounds the industry and to develop relationships with organisations that play a key role in defining this area.

Like stamps and payment through an account, the meter is an important payment channel for Royal Mail services and this document is a response to the current Ofcom consultation. The industry believes it is vital to respond in order to ensure the needs of this important group of postal customers are represented and protected. However, it must be noted that the meter industry provides a range of other services and products to its customers, over and above those that provide access to Royal Mail services, and that the range of services provided by the industry is evolving fast.

As Ofcom assumes full regulatory responsibility for postal services, Intellect would like to take the opportunity to highlight the key issues and concerns affecting our members with regard to the economic regulatory framework, as well as to provide an introduction to the meters sector for reference purposes going forward. Intellect will also be responding to the forthcoming Ofcom consultations and would encourage Ofcom to refer to the background provided below.

The key themes of this response are that:

- The USO, the protection of which is Ofcom's primary priority, is potentially threatened if Ofcom does not fully consider the potential implications of its proposals. Intellect is keen to assist in this with the considerable experience of our members.
- Intellect members do not consider that only controlling second class stamp items would provide sufficient safeguards to SME users from large increases in mail prices as Royal Mail would still be able to substantially increase the price of First and Second class meter and PPI (standard tariff) . Royal Mail still retains virtually monopoly market power in the small to medium size mailer segment and the majority of users would have no option to use other providers of postal services and therefore would be obliged to pay the higher prices or revert back to the loss making, and from a customer perspective, expensive and inefficient stamps channel.
- While our meter manufacturer members understand the need to provide Royal Mail with commercial flexibility, there is significant concern that the proposals to only price cap second class stamps could lead to excessive first class rises which would have serious and lasting detrimental effects on small business users and, therefore, the USO. The research conducted by Postcomm/Consumer Focus in our view concentrated on domestic consumers and therefore does not take into account the needs of business consumers, especially the vitally important SME market, (6.108 – 6.110 Scope of safeguard cap).

- The ability to accurately monitor Royal Mail's performance is fundamental to the profitability of the USO and Royal Mail's financial reporting data must be published to stakeholders at a granular level. (See attached example of Regulatory Financial Statement 2009-10 [page 8, USO Performance]).
- Additionally we make reference to the Ofcom consultation of The Review of Regulatory Conditions where the proposed change to the price notification for products within the USO is at variance with the 3 month notice period between Royal Mail and the meter manufacturers in the UK.

An overview of why customers choose the meters channel

Intellect members from the meters sector have highlighted the following factors which make the meters channel attractive and which it is important for Ofcom to be aware of as part of this work:

1. Business customers can gain easy access to the majority of the Royal Mail's products and services through the franking machine.
2. For customers, franking offers an efficient and accurate way to weigh measure and pay for unsorted business mail.
3. There is no minimum threshold as regards the volume of mail sent. Franking machine users can process their mail in batches or single piece by single piece. It is therefore a very flexible system that can be configured individually to any mailroom, mailhouse or office environment.
4. For SMEs the other channel options would be to go to the Post Office which is an ideal retail channel but inconvenient for many small businesses, or to use stamps which is likely to be the method of posting they used before acquiring a franking machine.
5. SMEs can be assured that they will enjoy the same quality of service from the Royal Mail as larger posters even though they do not spend at the levels of those organisations.
6. The price of an entry level franking machines is attractive to SMEs who are looking for convenience.
7. The channel continues to work closely with the Royal Mail to develop new services for customers and to expand the choice available to customers. For example the use of 2D barcodes would give customers the ability to track mail items in the Royal Mail network and have access to service reports. This technology would also allow Royal Mail to innovate and deliver new value add services for customers.
8. The Royal Mail are offering new services in the market place for all customers, the meters channel are keen to offer their customers the full range of services including the range of Tracked services.

It is also worth noting that the vast majority of Royal Mail products in the meters channel are, currently, price controlled. Price control reflects the fact that Royal Mail has traditionally been seen as a dominant player in this part of the market and therefore attempts to ensure that unfair or anticompetitive practices are not a feature.

As Ofcom are aware Royal Mail is currently required to notify any price changes in advance and Postcomm had the power, within certain parameters, to prevent these price changes from going ahead. Royal Mail also has individual, specific contracts with the meters industry to provide 12 weeks notice of price changes. This notice period is clearly at variance with the 1 month notification proposals for USO products being consulted on by Ofcom in its consultation on The Review of Regulatory Conditions for Postal Regulation.

Customers themselves are not especially concerned about what products and services are in or out of the price control; they require a high quality service at a reasonable price, priced on a uniform basis which they expect the Royal Mail to deliver.

For their part, Royal Mail receives mail with a securely evidenced postmark and can access customer usage data for business planning purposes. The meters industry has the capability and expertise to develop and support Royal Mail with its major automation and efficiency program currently taking place across its network. The industry is working very closely and proactively with Royal Mail to support these activities and believe they will ultimately result in improved quality of service levels, improved resource productivity for Royal Mail and increased customer satisfaction for meter industry customers.

Intellect Response

Intellect would like to address the key themes of the consultation, with a focus on the question of whether deregulation and price-capped second class is the right course for small and medium business customers.

Threat of increased switching from First to Second class

The fact that Royal Mail would benefit from greater commercial freedom is not in question, however our members have raised concerns that the implications of the current proposals may have alarming and maybe some unintended effects.

Ofcom have proposed the cap in order to protect vulnerable customers in the USO - with individual domestic customers in mind. This is clearly important, however Intellect would like to emphasise that small and medium businesses play an important role in helping to commercially underpin the USO and these are potentially threatened by this proposal.

Indeed, our members are concerned that the proposals to only price cap second class stamps would lead to excessive first class rises which could have serious and lasting detrimental effects on small business users and, therefore, the USO. Below we describe a scenario to support our views:

- Only price capping second class stamps will free Royal Mail to increase the price of first class stamps which may well force social users to down-trade to second class.
- However the First class infrastructure remains in place and to ensure that costs are covered by the users of First class mail Royal Mail reallocates costs from social to business users.
- To cover the reallocated cost Royal Mail then increases the price of First class business single piece mail prompting small and medium business customers to switch to second class.

Intellect members point out that the major first class users of single piece items are meter customers – and it is these customers, who help to underpin the USO. In today's economic environment business budgets are not increasing in line with Royal Mail price rises and excessive increases will lead in the first instance to switching. Class switching has occurred before in the business mail sector, which means there is a real possibility it could occur again if encouraged by the regulatory situation.

Furthermore, this is not simply a singular problem for Royal Mail; it threatens a downward spiral for Royal Mail revenue potentially resulting in the death of the first class service itself as it becomes too expensive to maintain. The key question for Ofcom to be aware of is where do they see the first class service heading and have they considered the business consequences?

At the current stage of the development of the postal market Royal Mail still retains market power in the small to medium size mailer segment and the majority of users would have few options of using alternative providers of postal services. Therefore, we do not believe that competition in the high volume (above 250 mail pieces) would act as a constraint.

Over the past 5 years metered mail first class volumes have fallen from over 50% of metered mail volumes (Royal Mail Regulated Accounts 2004/2005) to a current figure of circa 40%. Price increases have clearly encouraged customers to down trade. We are concerned that there is significant potential for switching based on past experience, raising the potential for Royal Mail to lose significant revenue and for the cost dynamics of the USO to suffer. As such we believe that the seven year timeframe proposed by Ofcom is too long and therefore to monitor the effects of the proposed changes that there should be an interim review to assess the volume changes by payment channel and class of the products constituting the USO.

The key point here is that this is different to what Ofcom reports regards vulnerable customers favouring second class – this may be true for domestic customers however this is not the case for small and medium businesses which are also vulnerable parties and which underpin the USO in the first class revenues generated.

Intellect recommendations

- Ofcom's 'Safeguard 1' is entitled *Ensuring that a basic universal service product is available to all* and Intellect encourages Ofcom to be aware that the USO depends on both first and second class services – they cannot be considered in isolation as the consequences of only price capping one will significantly impact the behaviour of customers regards the other.
- Ofcom should also price cap first class letter stamps to avoid the potential negative consequences outlined above.
- Ofcom should undertake an interim review after 3 years to understand the effects of the proposed changes by payment channel on the volumes of the products remaining within the USO.

Effective monitoring of Royal Mail's performance

As Ofcom has identified, this is an important issue which Ofcom must be clear on from the outset. Ofcom has an opportunity as the new regulator to improve this process and is rightly consulting on the best way to do so.

Ofcom have asked the question of what it could appropriately monitor as the regulator and how does monitoring need to work to ensure this regulatory safeguard is successful. Intellect members would make the following recommendations:

- A clear statement of what financial information is available is needed for the industry.
- Clear, granular financial information is essential to the profitability of the USO. Data should be widely published and broken down into stamps and business mail. For example, industry needs to know what the stamp channel is making and losing in the USO against business mail. Business mail is an enormous contributor to the USO and withholding information regarding the viability of stamps versus business mail could have highly detrimental consequences.

Royal Mail may understandably be reluctant to share such data; however it should be emphasised that this is for the core benefit of the USO, and is thus fundamental to Ofcom's primary objective. In the past, Royal Mail has provided information on the financial viability of the USO, and a clear statement that this is crucial to USO profitability should be in Ofcom's proposals.

A stated Ofcom objective is to '*Monitor the profit and cash contributions of different product groups to the common costs of the universal service network*'. Intellect endorses this objective and would recommend for this to be split out at a granular level in order to gain a better understanding of the USO and, crucially, its profitability. We note, for instance, the lack of such data in Ofcom's otherwise impressive document – it would significantly help both industry and regulator to understand the environment.

VAT

One point Intellect members would like to raise here is the issue of VAT. Intellect is aware and appreciates that this is fundamentally a matter for HMRC, however the implications VAT decisions may have on the regulatory implications before HMRC becomes involved mean it is something Ofcom must be aware of and have under advisement.

Now that Royal Mail has advised that bulk mail retail products attract VAT from 2nd April 2012, there is a potential threat to the USO if the equivalent downstream access products are VAT exempt, as this could cause further switching to alternative providers.

Given that it is Ofcom's stated primary duty under the Act to ensure the provision of the USO, the implications of the introduction of VAT must be factored into Ofcom's decision making process. A failure to do so could be an additional threat to the existence of the USO.

Summary

Intellect believes that the stability and predictability of the USO, including pricing, is critical for all businesses which use the Royal Mail's network both to communicate with their existing clients and as a means of advertising their services to potential customers.

For businesses it is vital that these USO services are available through the meters channel to enable them to connect with their customers. We also believe that the new technology to be introduced into the meters channel and across the Royal Mail network will result in an improved customer experience measured in higher levels of customer satisfaction.

Ongoing Dialogue and Next Steps

Intellect and its Postal Services Focus Group would like to thank Ofcom for the willingness to engage with them to understand some of the complex issues regarding the postal regulatory framework at an important juncture.

We trust that our submission is helpful to Ofcom in its thinking and decision making and hope that Ofcom will take onboard the importance of the meters channel and the concerns it has regarding the potential impact of some of the proposals on the USO.

As Ofcom's thinking develops we are very happy to continue this dialogue in view of our members deep understanding of the sector.

We would also be very happy to discuss this response in more detail.

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