Post monitoring report

Postal services in the financial year 2022-23

Report

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Overview

This report sets out key data and trends in the postal sector for the 2022-23 financial year. It also considers users' experience of UK postal services and Royal Mail's financial and efficiency performance.

Ofcom's regulatory framework for post is underpinned by our duty to secure a universal postal service which meets the needs of users and is affordable, while also considering its financial sustainability and efficiency. We also have wider consumer protection measures in place which apply to all parcel operators. Our regulatory framework is supported by a monitoring programme, of which this annual report is an important part. Alongside this report we have also published an interactive data set.

What we have found in financial year 2022-23

- **Parcel operators satisfy nearly eight in ten recipients (78%), but two thirds of consumers have experienced issues with parcel deliveries:** our survey data indicates a particularly high number of issues during the first half of 2023 following the Christmas peak period. More recently, operators have been making improvements to their processes following the introduction of our new complaints handling guidance in April. Disabled customers are still experiencing a disproportionate number of issues with deliveries – we expect the recent implementation of our new rules requiring operators to ensure the fair treatment of disabled customers to lead to improvements in this area and will be monitoring this closely.

- **Total parcel volumes across UK postal operators decreased for the second year running**: dropping by nearly 5% to 3.6 billion items. Volumes are still significantly above pre-pandemic levels (2.8 billion items in 2019-20). Parcel revenues decreased at a similar rate in nominal terms, down 5.7% to £12.8bn, although the fall was higher taking inflation into account (14.3%).

- **Total addressed letter volumes returned to decline following the post-pandemic increase in 2021-22:** the rate of decline accelerated to 9.5%, with 7.3 billion items delivered in 2022-23 (down from 8.0 billion items in 2021-22). This compares with an average 5% yearly fall between 2015-16 and 2019-20. Total addressed letter revenues were £3.6 billion in 2022-23, a nominal decrease of 5.8% year-on-year (and 14.4% when inflation is taken into account).

- **While post remains important to most users, it is increasingly seen as less important for some forms of communication:** 79% of users said there will always be things they need to send by post but those saying post is important to them for communicating with friends and family dropped to 65% (down from 75% 2021-2022) and nearly half of small and medium enterprises (SMEs) said they have moved their mail services to a different communication method in the last year. While overall satisfaction with Royal Mail remains relatively high (79%), an increased number of users are reporting dissatisfaction, particularly with the cost of postage where satisfaction has dropped to 40% (compared to 54% in 2021-22).

- **Royal Mail failed to meet its quality of service targets:** we investigated its failure to meet a number of these targets and, even after adjusting Royal Mail's performance for the impact of industrial action, extreme weather and the Stansted Airport runway closure, we found it had failed to meet its targets by a significant and unexplained margin. We issued Royal Mail with a penalty of £5.6m on 13 November 2023 and will publish full details of our decision shortly. These service failures led to a significant increase in complaints about Royal Mail.

- **Royal Mail made a loss, largely due to reduction in revenues**: the profit (EBIT) margin[1] for the Reported Business[2] decreased to -6.3% (compared to 3.6% in 2021-22), which is significantly below the indicative 5% to 10% range for a reasonable commercial rate of return. The decrease was largely driven by a drop in its revenues (by c.£950m year on year). This was in part caused by market factors (such as weaker online shopping trends), but a key factor was also the significant drop in Royal Mail's market share, which was affected by industrial action.

- **Efficiency performance is difficult to assess due to the impact of industrial action and poor QoS performance:** Royal Mail made some progress on efficiency, facilitated by revisions to its delivery and processing operations together with increased automation, including the opening of its second parcels hub in the Midlands. Royal Mail recently published its five-year efficiency expectations (required under our recently strengthened monitoring regime), which indicates that by 2027-28 it aims to achieve efficiency savings of 9% and an operational efficiency improvement of its frontline staff of 25%. We will be closely monitoring Royal Mail's progress against these expectations.

More recent developments and looking ahead…

While this report primarily focuses on the financial year 2022-23, we have been continuing to monitor developments closely throughout this year and note in particular that:

- **Royal Mail's QoS performance continues to be well below target:** this is having a significant negative impact on mail users, with delays being experienced across the UK. We are concerned that Royal Mail's performance has not shown any signs of improvement in recent months and are disappointed that it has been unable to provide us with a timeline for when its performance will improve. We will continue to hold Royal Mail to account for these issues, taking further enforcement action if necessary.

- **Royal Mail continues to make losses:** In November, Royal Mail reported an operating loss of £319m for the first half of 2023-24. The results were broadly in line with expectations, but parcels volumes were down on last year, and domestic parcel revenues, which are key to long-term profitability, were lower than expected.[3] We also have concerns around Royal Mail's ability to deliver sufficient efficiency savings; it has reached agreement with the Communication Workers Union on planned changes to working practices and terms and conditions, but it is likely to take time for the changes to be implemented and have an impact. Given these risks and uncertainties, our concerns about the longer-term sustainability of the universal service have further increased since last year and we are continuing to monitor the situation closely.

We recently announced that we are planning to produce potential options for the future of the universal postal service (the USO). We will set out evidence early next year on how demand for postal services is changing, the challenges and costs of delivering the existing USO and related bulk mail services and how it might need to evolve to more closely meet user needs. Ensuring that there is a UK postal service capable of meeting future consumer needs sustainably, and to a high quality, will be central to our assessment of potential options for changes to the USO.

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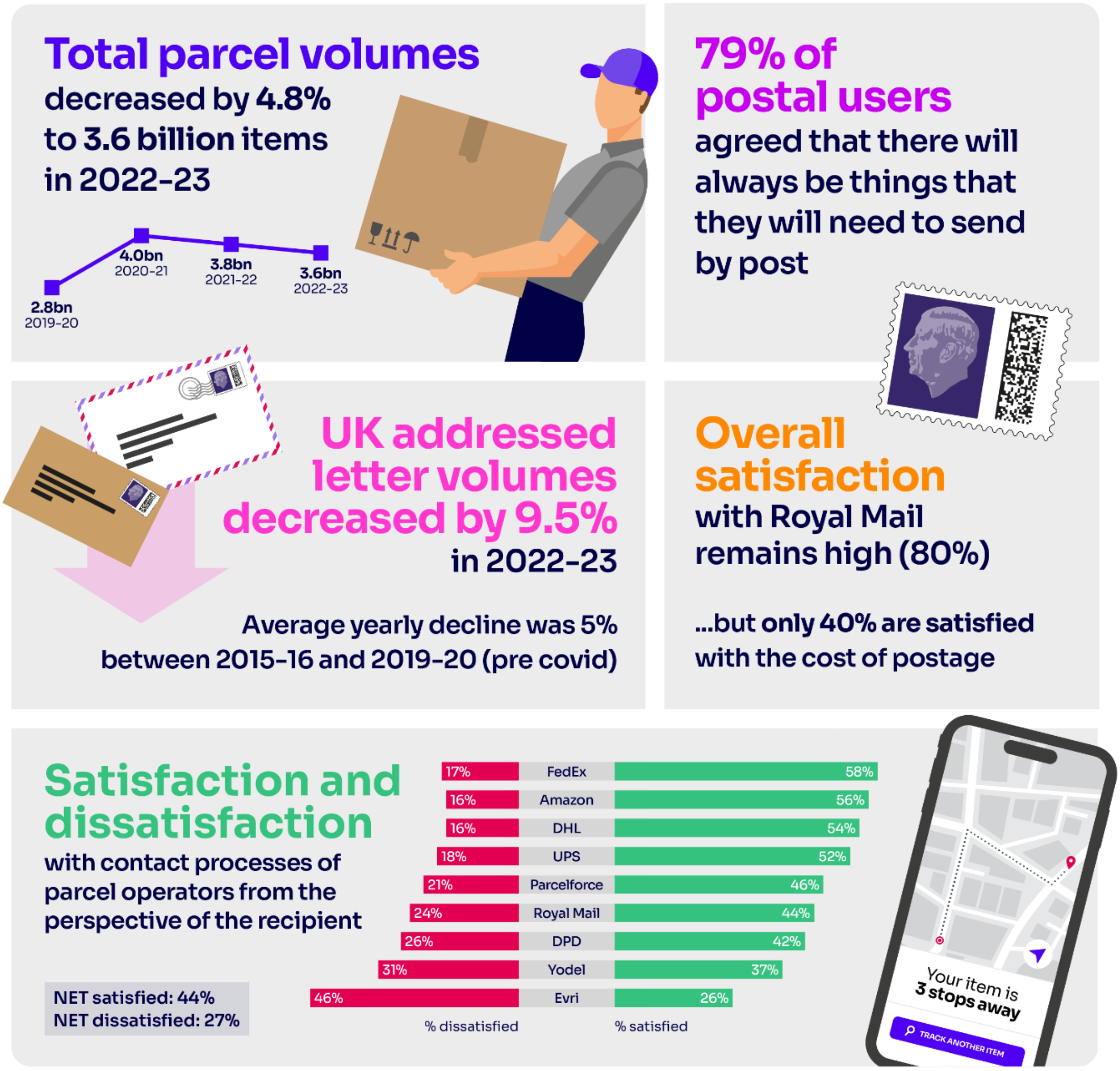
[1] This is the profit for the Reported Business calculated as revenue less all the costs of products and services provided (as well as transformation costs) before the deduction of interest and tax. It is one of the indicators we monitor in considering the long-term financial sustainability of the universal postal service.
[2] Our monitoring of Royal Mail's financial performance is focused on its 'Reported Business', which is the part of Royal Mail responsible for delivering the universal service.
[3] International Distribution Services plc, 2023. IDS plc half year results 26 weeks to September 2023, page 6.

Post monitoring programme infographic



Source: Market data – Ofcom analysis of postal operator data, including information gathered under statutory powers and Royal Mail regulatory reporting submissions. Consumer research data – Ofcom's Residential Postal Tracker and our new Parcel Tracker Survey

1. Market data

This section covers developments in the postal services market in 2022-23 and presents market-wide volumes and revenues data across both parcels and letters.

Factors impacting the postal market in 2022-23

In 2022-23 we continued to see the postal market re-adjust post-pandemic, with many users returning to the high street. Online shopping as a percentage of total retail sales has largely reverted to its pre-pandemic trend[4] with internet volumes consequently falling across 2022-23. Furthermore, the cost of living crisis and high inflation meant reduced spending, which had a dampening effect on demand in postal markets.

In addition to these broader market challenges, Royal Mail has also faced a number of specific challenges, including 18 days of industrial action between August and December 2022, issues with its QoS performance (see Section 2) and a cyber-attack in January 2023 which impacted its international business.[5]

This year we have also seen postal operators placing increasing emphasis on environmental considerations, providing greater transparency about the environmental impacts of their activities and giving customers the option to select products with lower emissions. Within the parcels sector in particular most operators have net zero targets in place. Key areas for action include fleet electrification for last mile delivery, low emission vehicles for transportation and some increased use of rail to replace road and air transportation. We recognise the importance of further developments in the postal sector to support meeting global sustainability challenges, and we will be discussing this further as part of our work on the future development of the USO early next year.

Parcels market

While Royal Mail is the main provider of single piece parcel services serving the consumer to business/consumer ('C2X') segment of the market (especially in relation to services weighing up to 2kg), there is increasing competition in this market with other operators (such as Evri, DHL, Yodel and DPD) offering a range of C2X services across weight steps. We estimate that Royal Mail's share of volumes in this market fell by around 10 percentage points in 2022-23.[6] The C2X segment accounts for approximately 10% of total parcel volumes across operators.

The main focus of competition, however, has continued to be in the larger business to consumer ('B2C') segment of the market, with these other operators and Royal Mail competing to meet online retailer and other e-commerce fulfilment demands.

Parcel prices

The increased competition in the C2X segment has been applying downward pressure on parcel prices. In particular, as set out in our Review of Second Class safeguard caps consultation, other

[4] ONS report on internet retail sales
[5] Reuters, January 2023. Royal Mail export services severely disrupted after 'cyber incident'.
[6] Using single piece parcel volumes as a proxy for C2X. See also Section [2] below where our residential and SME survey data shows increased awareness of parcel operators other than Royal Mail.

parcel operators are increasingly offering comparable, competitively priced alternatives to Royal Mail at weight steps up to 2kg.[7] Furthermore, operators have differentiated their services to attract different customer types, in particular marketplace sellers, for example by offering tracking on all standard services.

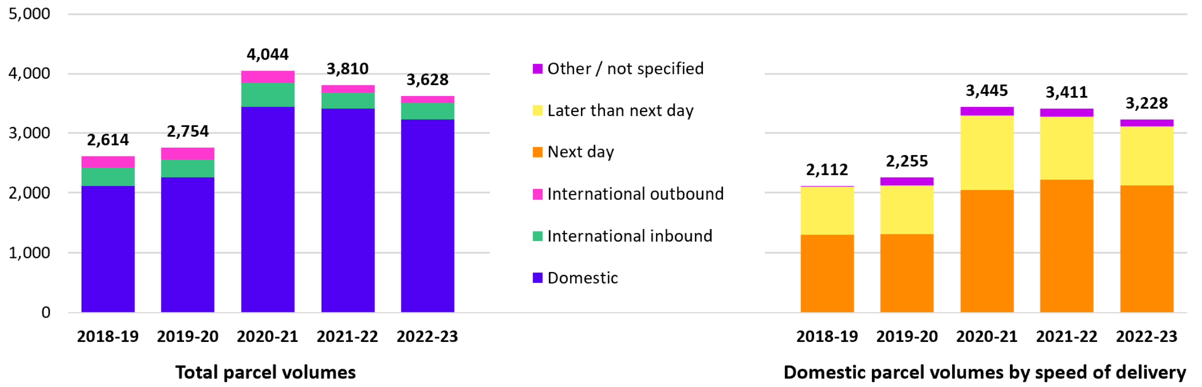
The price of Royal Mail's standard parcel products across both First and Second Class decreased in real terms by an average of 1.65% between April 2022 and April 2023. Royal Mail also increased the prices of its Second Class products but by less than inflation. For example, a small 0-1kg Second Class product increased from £3.35 to £3.49 (a 4% increase in nominal terms).

Parcel volumes

Total parcel volumes[8] decreased by 4.8% to 3.6 billion items in 2022-23, compared with a fall of 5.8% in 2021-22. Despite these falls, total volumes were still significantly above pre-pandemic rates (2.8 billion items in 2019-20).

Measured domestic parcel volumes fell by 5.4% year-on-year to 3.2 billion (following a 1.0% fall in 2021-22). Next day delivery items made up most of the total (66%, up from 65% in 2021-22). International inbound volumes increased by 4.6% to 0.3 billion (following a 31.8% fall in 2021-22), while international outbound declined by 8.7% to 0.1 billion (compared to a drop of 36.4% in 2021-22).

Figure 1.1: Total measured parcel volumes and domestic volumes by speed of delivery (millions)



Source: Ofcom / operator data. Note: Access mail volumes are included in domestic. Data for 2021-22 onwards includes additional postal operators and so is not directly comparable to data for previous years.

Next day delivery volumes have fallen (down 4.2%) but not by as much as other speeds. As a proportion of domestic parcel volumes, next day deliveries have risen from 62% in 2018-19 to 66% in 2022-23.

Parcel revenues

Measured parcel revenues decreased at a greater rate than volumes in 2022-23 (see Figure 1.2 below). Revenues fell by 14.3% in real terms (i.e. taking into account the effect of inflation) to £12.8bn, compared with a 6.8% fall in the previous year.

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[7] See in particular pp.32-34, including Table 3 of our Review of Second Class safeguard caps 2024 consultation.

[8] Our estimate of market-wide parcel volumes is based on a definition that differs from Royal Mail's definition of parcels (which includes Royal Mail 24/48 large letters, some fulfilment letters and large letters), and is therefore not directly comparable to Royal Mail's parcel volumes reported in Section 3 on financial performance.

In nominal terms (i.e. excluding the effect of inflation) the fall was less steep, down 5.7% and therefore more in line with the decline in volumes. Both real and nominal figures can be found in the interactive data report.

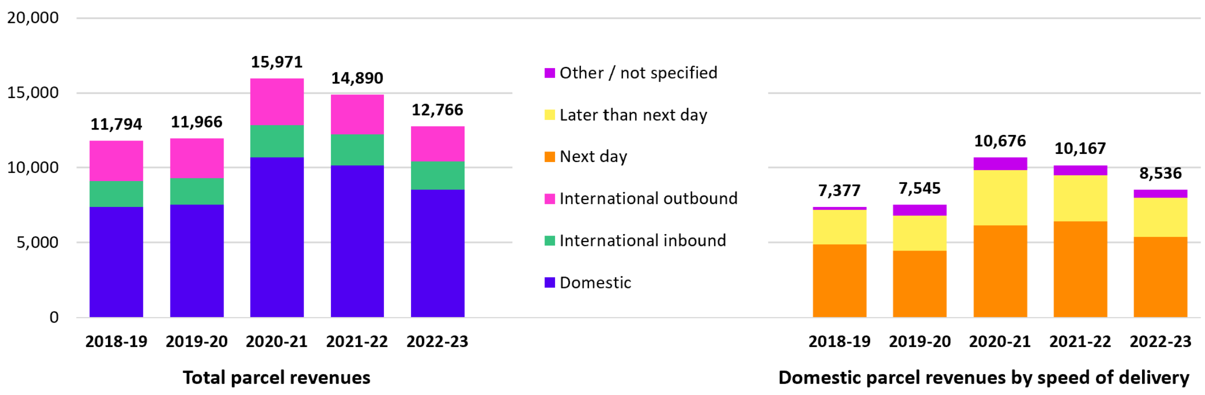
Real-term average unit revenue per measured parcel by fell by 10% year-on-year from £3.91 to £3.52. Average unit revenues will be impacted by any change in product mix but, overall, this data suggests parcel prices have gone up by less than inflation.

Domestic parcel revenues stood at £8.5bn in 2022-23, down 16% in real terms, and accounted for 67% of total parcel revenues (down from 68% in 2021-22). Next day delivery items made up the majority of domestic parcel revenues at 63%, unchanged from 2021-22.

International inbound parcel revenues declined by 8.7% to £1.9bn, despite volumes increasing by 4.6%, and accounted for 15% of total parcel revenues. International outbound parcel revenues declined by 11.8% to £2.3bn in 2022-23, representing 18% of total revenues.

Although parcel revenues continued to fall in 2022-23, they remained higher than 2019-20 pre-pandemic levels by 6.7%. This demonstrates an underlying upward trend over time driven by the increase in online shopping.

Figure 1.2: Total measured parcel revenues and domestic revenues by speed of delivery (£m, 2022-23 prices)



Source: Ofcom / operator data. Note: Access mail volumes are included in domestic. Data for 2021-22 onwards includes additional postal operators and so is not directly comparable to data for previous years.

Letters market

Royal Mail's end-to-end[9] letter (and large letter)[10] services are made up of the single piece letter services that Royal Mail is required to offer under the USO as well as retail and access bulk mail.

'Retail bulk mail' refers to services Royal Mail sells directly to larger customers such as banks, utilities and public sector organisations. The 'access bulk mail' market involves a postal operator other than Royal Mail (for example UK Mail and Whistl) collecting mail from larger businesses and organisations and then inserting it into Royal Mail's network for delivery to the end-customer. This type of access competition enables other operators to offer postal services to their customers without setting up a

[9] There remains some residual end-to-end services offered by operators other than Royal Mail, accounting for less than 1% of the market, by volume.
[10] Letters can be up to 24cm long, 16.5cm wide and up to and including 0.5cm thick, with a maximum weight of 100g. Large letters can be up to 35.3cm long, 25cm wide and up to and including 2.5cm thick, with a maximum weight of 750g.

'last mile' delivery network, and to compete with Royal Mail in the offer of initial stages of processing post.[11]

Royal Mail offers two types of access bulk mail services: D+2 services (with mail delivered two working days after the day of posting), and an economy D+5 service. The D+5 services allow Royal Mail to defer delivery of an item until there is another item already being delivered to the recipient's address, subject to a maximum of four working days after it enters its network.

Letter prices

Further information on Royal Mail pricing can be found in the interactive data report.

Standard and large letters

In April 2023 Royal Mail made a number of above inflation increases to the prices of its letter services, both for standard and large letter services. It also increased the price of a standard Second Class stamp prices by 7p (up to 75p and in line with our safeguard cap) – these prices therefore remained flat in real terms and this continued the trend of a widening gap between the price of standard First and Second Class stamps.

Figure 1.3 outlines price changes between 2022 and 2023 for Royal Mail's standard and large letter First and Second Class stamps.

Figure 1.3: Price change between April 2022 and April 2023 for Royal Mail services

Service	April 2022 price	April 2023 price	Nominal increase	Real increase
Standard First Class	£0.95	£1.10	15.8%	5.2%
Standard Second Class	£0.68	£0.75	10.3%	0.2%[12]
Large letter 0 -100g First Class	£1.45*	£1.60*	10.3%	0.3%
Large letter 0 -100g Second Class	£1.05*	£1.15*	9.5%	-0.5%

**Weighted average price across weight steps. **Real terms increase based on yearly average Consumer Price Index (CPI) from April to March.*

In October this year, Royal Mail took the unusual step of announcing several further increases to some of its stamp prices mid-year. In particular, it increased standard letter First Class stamps by 15p to £1.25, and the average weighted price for large letter First Class stamps increased to £2.22 (both in nominal terms). While Second Class standard stamp prices did not rise in October, Royal Mail increased Second Class large letter standard stamp prices to a weighted average of £1.83 (in nominal terms). These increases were within the current basket safeguard cap for large letters and parcels.[13]

Retail bulk and access mail

Royal Mail and other operators offer a number of products and services to business customers who send larger volumes of mail. Royal Mail made a number of price increases across its retail bulk mail and access services in April 2023 as set out in Figure 1.4 below. Overall, the prices of retail bulk

[11] Royal Mail also offers a similar access service for parcels on a commercial basis.
[12] Note our inflation cap on Second class stamps uses a CPI figure from September of the previous year (i.e. the 2023 price cap was set using the September 2022 CPI figure).
[13] In June 2023, we proposed to remove the safeguard cap on parcels and to impose a single basket cap on standard and large letters. This new cap would apply from 1 April 2024.

products increased by an average of 2.2% in real terms (or 12.4% in nominal terms) between April 2022 and April 2023. In business access mail, Royal Mail made real term price increases of c.10% for its standard products, whereas advertising access bulk mail saw a real term decrease of c.3% (c.6% nominal increase).

Figure 1.4: Price changes between April 2022 and April 2023 for a selection of Royal Mail retail bulk mail and access services

Service	April 2022 price	April 2023 price	Nominal increase	Real increase
Advertising Low Sort OCR First Class[14]	£0.60	£0.68	13.0%	2.7%
Advertising Low Sort OCR Second Class	£0.25	£0.28	13.1%	2.8%
Advertising Low Sort OCR Economy	£0.22	£0.25	13.1%	2.7%
Access 70 OCR	£0.36	£0.43	19.9%	9.0%
Access 70 OCR Advertising	£0.20	£0.22	6.6%	-3.2%
Access 70 Mailmark[15]	£0.33	£0.39	18.3%	7.5%
Access 70 Mailmark Advertising	£0.18	£0.19	5.4%	-4.2%

**Weighted average price across weight steps. **Real terms increase based on yearly average Consumer Price Index (CPI) from April to March.*

As with its standard and large letter stamp prices, Royal Mail implemented some further above-inflation price increases to its business and access mail services in October this year. These price increases ranged from 10-20% (in nominal terms) across the various products, although economy products received on average lower price increases than other products. This further widened the differential between economy and non-economy products.

Letter volumes and revenues

As set out in Figure 1.5 below, the overall trend for letters has seen accelerated decline in 2022-23 following the post-pandemic recovery in 2021-22, with UK addressed letter volumes decreasing by 9.5% to 7.3 billion items in 2022-23. This compares with an average 5% yearly fall between 2015-16 and 2019-20 (i.e. pre-pandemic).

Access bulk mail continued to represent the majority (70.4%) of letters sent in 2022-23 (5.1 billion items), with its share of volumes increasing by 3.5 percentage points in 2022-23. Overall, access bulk mail volumes declined by 4.8% year on year, compared to a 19% fall in Royal Mail end-to-end addressed letter volumes (to 2.2 billion).

Total addressed letter revenues for 2022-23 stood at £3.6bn in 2022-23, down 14.4% in real terms year-on-year (following a 1% increase in 2021-22). In nominal terms the fall was 5.8%. Both real and nominal figures are included in our interactive data report.

Payments made to Royal Mail by access operators decreased by 6.7% to £1.5bn (when taking inflation into account), while reported revenues retained by access operators stood at £0.1bn.

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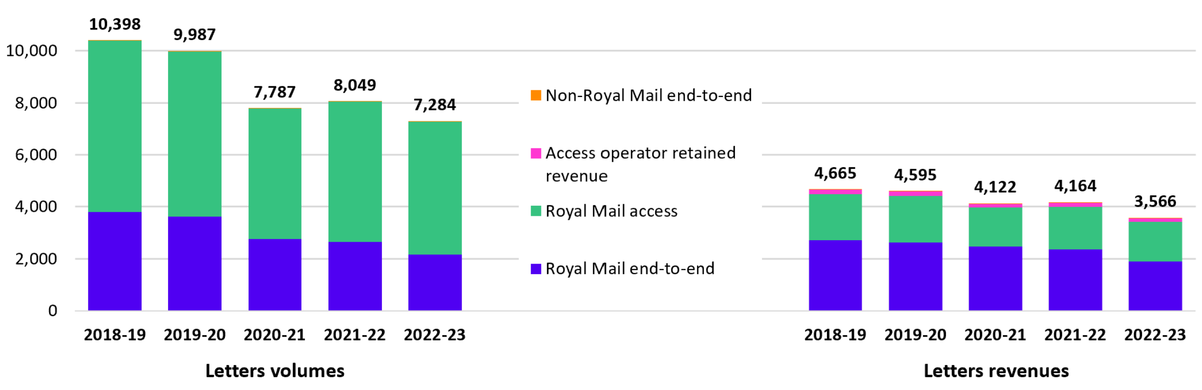
[14] Optical character recognition (OCR) is a type of mailing which must be able to be efficiently processed by automated mail processing equipment.
[15] Mailmark is a type of barcode franking which can provide business customers with greater levels of analytics.

Figure 1.5: Addressed letter volumes (millions) and revenues in real terms (£m, 2022-23 prices)[16]



Source: Ofcom / operator data. Royal Mail end-to-end is an Ofcom calculation and refers to Royal Mail total letters, excepting access. Figures exclude international. Access volumes include small volume of access parcels.

D+5 access volumes have increased significantly this year. As of Q4 2022-23 broadly a third of access letter volumes were D+5, with the remaining volumes predominantly D+2.

The switch by access operators from D+2 to the slower D+5 service has likely been driven by the increased pricing differential between the services, as well as Royal Mail's quality of service issues. The pricing changes introduced by Royal Mail in October 2023 further increased the price difference between D+5 and other access services and we therefore expect D+5 volumes to continue growing as more operators switch to the cheaper service.

[16] Addressed letter volumes and revenues in this section includes all end-to-end and access volumes (including election mail if applicable). This differs from the definition of addressed letters used in the analysis of the performance of Royal Mail's Reported Business in Section 3, which includes international mail but excludes election mail.

2. User experience

This section summarises information gathered from consumer research on how consumers used and engaged with postal services, including our new research data focusing specifically on parcel delivery services. We also set out our work to monitor new parcel consumer protection measures, as well as our ongoing work monitoring Royal Mail's quality of service and data on the complaints it receives.

Consumer experience of postal services

We conduct tracker surveys that provide data on experiences and attitudes of consumers and small medium enterprises (SMEs) towards postal services. The latest data from these surveys covers the period from July 2022- June 2023.[17] This year we also started a new tracker survey looking specifically at consumers' experiences of receiving parcels – we discuss this separately later in this section.

We have published slide packs summarising each of our research data sets which include further detail on the methodology used.[18] The data is also available as part of our interactive report, which allows selection of different fields, including by demographic group.

This year we have also undertaken additional bespoke research on the affordability of postal services and consumer requirements for postal services. This research, alongside our tracker data, is being used to support our work to review the safeguard cap on Royal Mail's second class stamps, and to assess potential options for the future of the USO. These separate research reports will be published alongside our discussion paper on the future of the USO and our statement on safeguard caps early next year.

Residential postal tracker key findings

While post remains important to most users, its reported importance and usage has dropped significantly this year amongst residential postal users:

- 79% of participants said there are things they will always need to send by post, with 57% saying they would feel cut off from society if they could not send or receive post;
- 65% of participants said post was important to them as a channel of communication with friends and family, down from 75% 2021-2022;
- around half of participants said they would only use post if there was no alternative; and
- the claimed incidence of post sent in the last month also dropped significantly to 73% (compared to 82% in 2021-22).

While overall satisfaction with Royal Mail remains relatively high (80%), there are increasing signs of dissatisfaction, particularly with the cost of postage: [19]

- 8% of participants expressed dissatisfaction with Royal Mail, up from 4% in 2021-22;

[17] To ensure that the survey remained up to date and fit for purpose, changes were made to the questionnaires in Q3 2022, which may have had some impact on comparability to previous data. The changes made included making a greater distinction between attitudes and behaviours with regards to letters and parcels, the removal of residential user questions about the experience of receiving parcel delivery (a topic which is now covered in more depth in our new parcels deliver survey, which is discussed later int this section), and the addition of a small number of new topics, including environmental sustainability.
[18] Slide packs, and also note data in Statistical release calendar 2023 - Ofcom.
[19] Price of First Class stamps varied during fieldwork. In April 2022 the price was 95p. In April 2023 it increased to £1.10.

- four in ten participants (40%) report satisfaction with Royal Mail's cost of postage (down from 54% in 2021-22) and 60% of participants report that they now send fewer letters due to the cost;
- 47% of participants rated First Class service as good value for money, a significant drop from 57% in 2021-22. There are also indications that value for money ratings have dropped further as prices have gone up; in Q2 2023 satisfaction with value for money fell to 42%; and
- participants report they are increasingly switching away from First Class to Second Class, with 25% reporting they use Second Class most of the time (compared to 21% for First Class, down from 24% last year). Of those users that choose Second Class most or all of the time, 72% report it is because of the cost (up from 67% last year).

Half (51%) of postal users reported experiencing a problem sending or receiving letters via Royal Mail, usually in the form of delayed (30%) or mis-delivered mail (20%). Just over half (54%) of those who made a complaint to Royal Mail were satisfied with the complaints handling process and a similar proportion (52%) of those who complained were satisfied with the resolution to their complaint .

When sending parcels, users are increasingly less likely to use the Post Office or Royal Mail, with relatively high awareness of other parcel providers:

- 68% of participants who had a sent a parcel in the last month reported using the Post Office (down from 77% in 2021-22). Use of post boxes (using stamps) has also dropped to 15% (compared to 31% in 2021-22);
- 17% of participants said they sent a parcel using non-Post Office counter services from suppliers such as DHL and Evri, up from 14% in 2021-22. Around one in ten (11%) used online collection and delivery services (i.e. organised pick up from home), down from 14% in 2021-22 and 10% reported using parcel lockers[20] provided by operators such as Evri and DHL to send their parcels;
- amongst the 23% who said they had used a non-Royal Mail method to send their parcel, a third (33%) point to cost as a contributory factor; [21]
- awareness of different parcel service providers is relatively high (c.90-95% for the most well-known providers), but usage for sending parcels is lower e.g. just over half, 53%, said they had used Royal Mail to send a packet or parcel in the last 12 months. The next most widely used provider, Evri, had been used by 18% of participants.

This year, we also asked users for their views on environmental sustainability in postal services:

- around half of participants (49%) agreed that they would prefer postal services to be delivered in an environmentally responsible way, even if it took longer for items to be delivered, but a smaller proportion (36%) agreed that they would prefer postal services to be delivered in an environmentally sustainable way even if they had to pay more; and
- six in ten participants said that a parcel provider operating in an environmentally sustainable way was important to them when selecting a provider to send or receive parcels.

[20] The use of parcel lockers provided by operators such as Evri, Amazon, DPD etc is tracked for the first time so no trend data for comparison available.

[21] Some of these behavioural changes may be partly explained by responses to industrial action, and perhaps to some extent by methodological change on our survey.

Small and medium enterprises (SME) tracker key findings

While SMEs generally reported that their spending on post is broadly the same as it was in 2021-22, some reported that they are sending less post overall and an increasing proportion are moving to other communication methods:

- 87% of SMEs said they spent less than £1,200 a month on post (this was 86% in 2021-22);
- while two thirds of SMEs (66%) said that the volume of post their business had sent has remained the same in the last year, 20% reported a decrease (with 10% reporting an increase);
- 62% of those who report a decrease in volume of post sent say that this has been driven by a decline in volume of letters sent (43% in 2021-22);
- 47% of SMEs said they had moved to other communication methods in the last year, up from 39% in 2021-22. Of those that had done so, more than half (58%) reported that this was because the new method is quicker, 50% said that the change related to cost savings or price and a notable minority (17%) pointed to the recent Royal Mail strikes.

Overall, SME customers report broadly similar levels of satisfaction across different postal suppliers, however, satisfaction with Royal Mail and other postal operators has dropped since 2021-22:

- overall satisfaction with Royal Mail dropped to 79% (down from 84% in 2021-22); Satisfaction with other operators also dropped slightly to 81% (from 84% in 2021-22);
- the area of lowest satisfaction with Royal Mail is 'price of postage' with 51% reporting they are satisfied (down from 54% in 2021-22), and 26% reporting dissatisfaction. In comparison, three-quarters (74%) of SMEs report they are satisfied with the price of postage from other postal operators, which is unchanged from 2021-22;
- the biggest fall in Royal Mail's satisfaction levels this year was related to delivery consistency/reliability (e.g. that the item arrives as promised consistently): 75% reported they were satisfied, compared to 82% in 2021-22; and
- the proportion of SMEs who agree that UK postal services are good value for money has also dropped to just over six in ten (62%) this year from 67% in 2021-22.

The number of SMEs reporting problems with their postal services has increased this year, across both users of Royal Mail and other providers. Around four in ten SMEs report that they had experienced problems with their postal services, compared to three in ten in 2021-22. The most frequently reported problems remain related to delivery reliability/consistency (16% among both users of Royal Mail and among other providers).

While most SMEs still primarily use Royal Mail to send post, there has been a significant increase in number of SMEs considering using an alternative provider:

- more than nine in ten use Royal Mail to send post overall (92%) and most (87%) report using them as their main postal provider (in 2021-22 96% of SMEs reported using Royal Mail overall and 90% reported using Royal Mail as their main postal provider). Seven in ten of those who send packets and parcels report using Royal Mail as their main parcel provider;
- three in ten SMEs that send parcels report using a different company as their main provider – Evri was reported as one of the most widely used alternatives (used by 6%);
- 25% of SMEs that use Royal Mail as their main provider say that they had considered using an alternative provider to Royal Mail, though just 11% had tried using an alternative;

- of the two thirds (67%) of SMEs that have not considered using an alternative provider, the main reasons reported for not considering another provider were their volumes of mail not being large enough (34%) or that they are near a Post Office (33%).[22]

When choosing a postal service provider for both letters and parcels, assurance of delivery remains the most important factor, though cost has become more important compared to previous years:

- delivery to a recipient's door is seen as the most important factor when SMEs are choosing which provider to use for sending letters (88%) and parcels (92%);
- the importance of low cost when choosing a postal provider for letters increased to 86% (compared to 82% last year) and was unchanged at 91% when choosing a postal provider for parcels; and
- six in ten (61%) SMEs said that fulfilment of their parcel or letter delivery in an environmentally friendly way was important to them, although just under a third of SMEs said they would be willing to pay more for a parcel provider that operates in an environmentally friendly way.

Consumer experience of receiving parcels

As part of our 2022 Review of Postal Regulation we found that, while the parcels market is working well for consumers overall, some consumers find it difficult to complain to operators when things have gone wrong, and disabled consumers are more likely than non-disabled consumers to experience problems with parcel services.[23] As a result, we introduced:

- new guidance on complaints handling (which came into force on 1 April 2023);[24] and
- a new consumer protection condition to ensure that parcel operators have policies in place for the fair and appropriate treatment of disabled consumers.[25] This came into force on 1 November 2023.

We have been closely monitoring the implementation of these new requirements by engaging regularly with the larger parcel operators and gathering data from them. Alongside this we have commissioned a new survey which tracks perceived quality of service of parcel delivery to residential addresses (our 'parcels tracker survey') over time. Below we summarise our findings so far.

Parcels tracker survey

The first wave of our parcels tracker survey took place in January 2023, which was shortly after the peak period for parcel volumes (i.e. November and December) and a period of significant industrial disruption at Royal Mail. This context is therefore likely to have affected the results. The second wave took place in July/August 2023.[26]

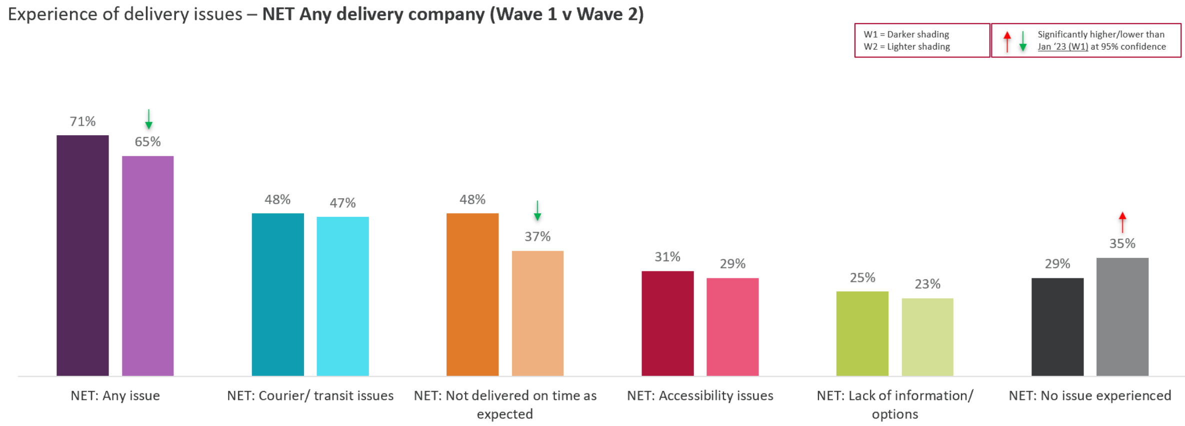
Overall, the research found that while consumer satisfaction with parcel operators is high (on average, delivery companies satisfy nearly four in five (78%) of their parcel recipients), more than two thirds of parcel recipients (68%) reported experiencing a delivery issue with any parcel operator in the past year.

[22] We note changes at the Post Office means a range of services will now be available over the counter from providers such as Evri and DPD, alongside those provided by Royal Mail.
[23] Ofcom, Review of Postal Regulation, July 2022. Section 6.
[24] Ofcom, Guidance for parcel operators on consumer complaints handling procedures.
[25] Ofcom, Consumer Protection Condition 5.
[26] Note methodology covered in slide pack, plus see our interactive data.

The proportion of recipients experiencing an issue decreased between the first and second waves of the research (dropping from 71% to 65%). In particular, the proportion of parcel recipients reporting that their parcels were not delivered on time/as expected decreased from 48% in the first wave to 37% in the second.

The most common type of issue experienced by recipients was courier and transit issues (including damage to a parcel, no attempt to deliver in person and the parcel being left in an inappropriate location). There was no significant change between waves for these issues, with nearly half of recipients experiencing these issues. In both waves around three in ten parcel recipients reported accessibility issues, for example that they were not given sufficient time to answer the door, or their parcel was left in an inaccessible place.

Figure 2.1: Quality of postal services – delivery issues (January 2023 to July 2023)



Source: Quality of postal services survey Jan-23/Jul-23

Q3. Delivery issues – all experienced: Which, if any, of the following issues have you experienced with these delivery companies in the last 6 months? Base: All respondents who have used [delivery company] in the past 6 months JAN/JUL 2023. (Total: 2038/2069)

There was lower reported satisfaction with the contact and complaints handling process than with the delivery experience from parcel operators overall. On average, across parcel operators, fewer than half of parcel recipients who had contacted the parcel operator were satisfied with the contact process (41%), the handling of their complaint (43%) and resolution of their issue (47%). These results were broadly similar for both waves of the survey but across both waves there was considerable variation between parcel operators – Amazon, DHL, FedEx and UPS had the highest levels of satisfaction over the three areas, while Evri and Yodel had the lowest.

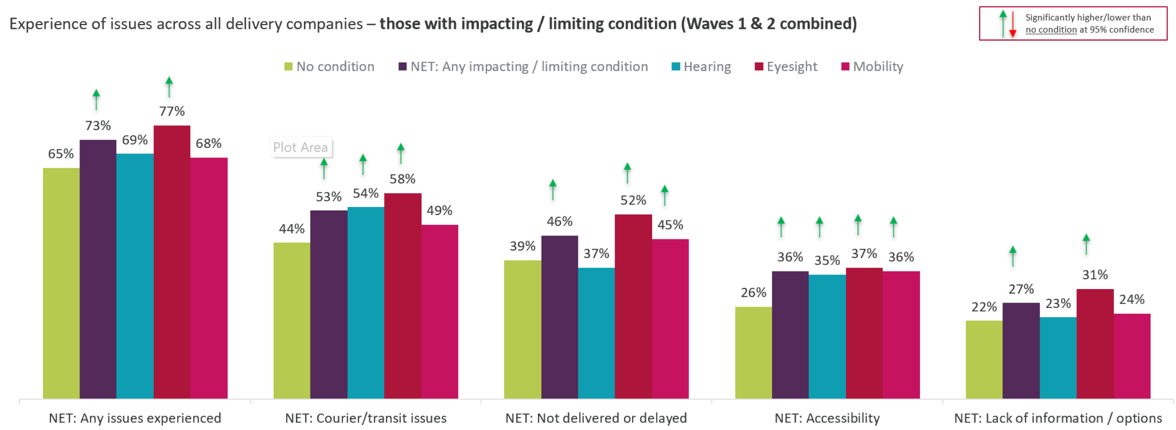
Among those dissatisfied with the contact process, 55% cited not being able to contact the company by telephone as the reason for their dissatisfaction. Evri parcel recipients were the least likely to be satisfied with being able to make contact (50% of those who made contact said that they were dissatisfied). Evri recently introduced a phone service (in October 2023), which should make it easier for parcel recipients to contact it in future.[27]

The research also provides insights into the experience of disabled consumers.[28] These parcel recipients are significantly more likely to experience any delivery issue (73%) than those without a

[27] See https://www.evri.com/contact-us.
[28] Respondents to the parcels tracker survey who declared they had an impacting and/or limiting condition.

limiting condition (65%) - those with an eyesight condition are particularly likely to report a delivery issue (77%). Disabled consumers are also particularly likely to say that they would like to see improvements in being given more time to answer the door (19% compared to 16% of those without an impacting and/or limiting condition).

Figure 2.2: Quality of postal services – delivery issues breakdown (July 2022 to July 2023)



Source: Quality of postal services survey Jan-23/Jul-23

Q3. Delivery issues – all experienced: Which, if any, of the following issues have you experienced with these delivery companies in the last 6 months? Base: All respondents who have used [delivery company] in the past 6 months JAN/JUL 2023. (Total: 4107. Breakdown: Any impacting/limiting condition 1581, Hearing 267, Eyesight 257, Mobility 417, No impacting/limiting condition 2394.)

Engagement with parcel providers

To support our understanding of the changes parcel operators have made to implement our new consumer protection measures, we have been regularly engaging with the largest operators[29] as well as gathering information on their complaints data and procedures.

The complaints data we have gathered indicates that, while individual operators have different approaches to categorising complaints, the most common categories of complaints across operators relate to lost, damaged and delayed parcels (which is consistent with our tracker survey data). We will be continuing to track operator complaint data to understand individual operator performance in terms of overall complaint numbers.

We have seen operators make a number of improvements to their complaints handling processes, including:

- more transparent and prominent information about complaints handling processes on their websites;
- improvements to IVR (interacted voice response) systems on their phone lines to ensure customers are directed to the appropriate place to resolve their issue;
- improvements to live chat, including being able to better identify when customer service agents should intervene to assist a customer;
- introducing an option for customers to request an email or call back to raise an issue; and

[29] Evri, DHL, DPD, Yodel, Amazon and Royal Mail. Royal Mail is already subject to more detailed complaints rules across its USO services, as discussed later in this section.

- refining their approach to recognising and categorising customer complaints to ensure issues are addressed quickly and without the need for repeat contacts.

We are also aware of some examples of best practice, with operators going beyond the requirements of our complaints-handling guidance. For example, DHL Parcel UK is a member of an alternative dispute resolution (ADR) scheme, which gives parcel recipients a route to receive an independent assessment of their complaint and seek redress.[30] We also welcome that some operators (for example, DPD, DHL Parcel UK and Royal Mail) introduced some measures to enable parcel recipients to communicate their delivery needs earlier this year, before our new consumer protection condition for disabled consumers came into force in November.

Overall findings from our parcels monitoring

Our consumer survey data shows that a significant proportion of customers are still experiencing issues with their deliveries, however, our new consumer protection measures have only recently come into force. We expect to get a better picture of the impact of the new measures, and a clearer indication of trends over time, in future waves of our research and data-gathering.

That said, it is encouraging that the research shows initial signs of improvement in customer experience in some areas. We welcome the changes parcel operators have put in place this year and we encourage them to keep their procedures under review to ensure improvements are ongoing, both in response to their own customer feedback and our survey data.

We will continue to monitor this area closely and if we identify any concerns about non-compliance with the new requirements we will take action as appropriate, in line with our enforcement guidelines. We will provide a further update on progress, particularly with respect to the actions operators have taken to implement our new consumer protection condition to protect disabled consumers, in next year's monitoring report.

Royal Mail's service performance

Quality of service (QoS)

As the designated universal service provider, Royal Mail is required to collect and deliver letters six days a week, and parcels five days a week, to all UK addresses, and to provide certain universal postal services (such as national First Class and Second Class services at uniform prices). Royal Mail is also subject to eight QoS targets which cover its performance against expected speed of delivery, collection activities, delivery route completions, as well as performance in 118 UK postcode areas. Royal Mail is required to report its performance against these targets on a quarterly and annual basis, and we formally assess its annual results.[31]

Royal Mail has experienced ongoing issues with its QoS performance throughout 2022-23 which has caused significant disruption to mail users across the UK.[32] In May 2023, Royal Mail published its annual results for 2022-23 which showed it had failed to meet all but one of its eight targets (the percentage of items deemed correctly delivered). Its results were significantly below target for First

[30] Dispute Resolution Ombudsman

[31] Royal Mail's quarterly and annual QoS reports are available on its website.

[32] Concerns about Royal Mail's QoS performance, and in particular whether it was prioritising the delivery of parcels over letters, were also raised by the Business, Energy and Industrial Strategy (BEIS) Committee earlier this year. In its report it noted its belief that Royal Mail had systematically failed to deliver against parts of the USO. BEIS, Royal Mail Report, March 2023.

Class (73.7% against the target of 93%) and Second Class (90.7% against the target of 98.5%).[33] In light of this, we immediately opened an investigation.

We issued our decision in November, finding that even after adjusting Royal Mail's performance to take into account certain exceptional events, Royal Mail still failed to meet its targets by a significant and unexplained margin.

We concluded that Royal Mail had breached its obligations by failing to meet the national First Class, Second Class and delivery routes completed targets during 2022/23.[34] We also decided that it was proportionate and appropriate to impose a financial penalty of £5.6 million[35] on Royal Mail for its failure to meet the First Class and Second Class national performance targets. Full details will be published shortly in our non-confidential decision document.[36]

Royal Mail's more recent QoS performance continues to be significantly below target. Its Q2 2023-24 results show its First Class performance was only 74.1%.[37] Royal Mail has noted that high levels of staff absence and vacancies were contributing factors to these results.[38]

Royal Mail's QoS performance for access mail has also been below target in 2022-23. Access mail is not part of the USO and our regulatory QoS targets, however it is subject to commercially agreed service standards with access mail providers. Given that access mail often includes communications that are highly valued and anticipated by mail users, such as bank communications and medical appointments, unpredictable or unanticipated delivery delays can have serious implications and further undermine user confidence.

We are very concerned about Royal Mail's continued under performance and recognise the negative impact that postal delays are having on mail users across the UK. We are continuing to engage closely with Royal Mail to scrutinise its results and understand the actions it is taking to improve its performance. While it has been putting in place several initiatives aimed at addressing the current issues, we are disappointed that it has yet to provide us with a clear plan setting out when those initiatives will lead to improved QoS performance. We will continue to hold Royal Mail to account, including taking further enforcement action next year if appropriate.

Complaints and compensation

As part of our monitoring programme, we also review the complaints and compensation data Royal Mail is required to publish.[39] As might be expected given the QoS performance issues outlined above, Royal Mail's complaint volumes increased significantly in 2022-23 to almost 2 million (up from 1.6m in 2021-22), representing a 26% increase. 'Loss' was the highest complaint category with nearly 900k complaints.

Royal Mail is required to provide compensation on a fair and reasonable basis where a customer experiences loss, delay or damage in relation to certain universal postal services. The total compensation paid by Royal Mail in 2022-23 increased by 46% to £26.2 million (up from £17.8

[33] See interactive data for full results and comparison with previous years.
[34] Ofcom Enforcement Bulletin
[35] The penalty includes a 30% reduction from the penalty we would otherwise have imposed, which reflects Royal Mail's admissions of liability and its agreement to settle the case.
[36] Our non-confidential decision document will be available on our website once published.
[37] Royal Mail, November 2023, Quality of Service and Complaints Report Quarter 2 2023/24.
[38] IDS press release, November 2023. "Royal Mail USO Quality of Service"
[39] Royal Mail, as the universal service provider, is required to publish an annual report setting out the number of complaints received in each financial year in relation to universal postal services and the amount of compensation paid in relation to those complaints. It is also required to report the top ten categories of complaint. See Royal Mail's Annual Consumer Complaints and Compensation Report 2022-23.

million in 2021-22). The total number of complaints where compensation was paid increased by 37% to almost 1 million. When compensation was given, the average compensation paid per complaint was £26.93 (an increase of £1.76 from last year).

The most recent report published by the Postal Redress Service (POSTRS)[40] - the ADR scheme which Royal Mail belongs to - shows that it received 800 disputes, of which 465 were within its scope.[41] This represents an increase of 33% in comparison to the disputes received and in scope in 2021-22.

Other universal service performance

Our monitoring of Royal Mail also looks at various other areas of its performance, which we provide an update on below. We are continuing to monitor the implementation and impact of developments in these areas as part of our wider monitoring programme.

Exceptions

In exceptional circumstances, we recognise that Royal Mail can depart from its USO obligations.[42] These include delivery and access point (typically post boxes or Post Offices) exceptions where there is an immediate risk to the health and safety of postal staff, the location is not sufficiently secure and/or there are access difficulties. Where Royal Mail decides that such exceptional circumstances exist in relation to a given delivery or access point for a sustained period, it must carry out a review every 12 months. Consumers are able to challenge any such 'exceptional circumstance' determination by Royal Mail.[43] In 2022-23:

- **delivery:** a total of 4,411 delivery points were reported by Royal Mail to be subject to exceptional circumstances. There are around 32 million delivery points in the UK, so excepted delivery points represent a very small proportion of the total footprint. [44]
- **access points:** Royal Mail reported 501 collection points where exceptional circumstances were present for 12 months or more.[45] There are around 115,000 post boxes and approximately 11,500 Post Offices across the UK, so the number subject to exceptions represents a very small proportion of the total number of access points.

Improved delivery on first attempt

Royal Mail has introduced some new initiatives to try and increase the number of parcels that are delivered on the first delivery attempt. This includes 'Safeplace' which allows customers to nominate a preferred delivery location if they are not at home when an item is being delivered.[46] Royal Mail states that this location can be any secure, weatherproof area of a property, that is safe and accessible. In August 2023, users were given the option to set their default Safeplace delivery

[40] Under our consumer protection conditions, Royal Mail is required to be part of an Alternative Dispute Resolution (ADR) scheme and it is part of the Postal Redress Service (POSTRS), which is managed by the Centre for Effective Dispute Resolution (CEDR).
[41] POSTRs ADR Entity Reporting - Annual Report. This report covers the period 1 July 2022 to 30 June 2023.
[42] This is recognised in Designated Universal Service Provide condition 1.3.2(b).
[43] See also Royal Mail's non-confidential USO Delivery Exceptions report 2022-23. Ofcom, December 2013. Direction relating to exceptions to the postal deliveries Universal Service Obligation and approval of alternative delivery points; Ofcom, December 2013. Direction relating to exceptions to the postal collections Universal Service Obligation and minor amendment to Designated Universal Service Provider Condition 1.
[44] Royal Mail's non-confidential USO Delivery Exceptions report 2022- 2023
[45] Royal Mail's USO Collection Exceptions report 2022-2023
[46] More information about the service can be found on Royal Mail's 'Change your delivery options webpage'. The service is available on all non-signature barcoded parcels (except Age and ID verification products).

options via the Royal Mail app which also allows users to opt out of the service. In some cases, users are also able to change their delivery options as the parcel is on its way.[47]

In May 2023, Royal Mail launched automatic redelivery.[48] This means that if an item cannot be delivered, a post person will automatically redeliver the item on the next working day. Royal Mail notes that this could save users time as they no longer need to visit a collection point. Users are also given flexibility as they can choose to reschedule the delivery to a more convenient day.

Redirections

Royal Mail is required to provide a redirection service, whereby personal and business customers can apply for their mail to be automatically redirected to their new address when they move home or premise.[49] As part of this service, it offers a concessionary rate scheme that allows discounts for residential customers in receipt of particular benefits.

In November 2021 Royal Mail updated its concessionary scheme to widen the qualifying benefits, reduce prices and promote it more widely.[50] In its most recent environment, social and governance (ESG) report, Royal Mail noted that applications to the scheme had increased to 4,700 between April 2022 and March 2023 (compared to only 700 applications from November 2021 to March 2022). It also noted its expectation that take up will increase further as awareness of the scheme continues to grow.[51]

[47] Ibid.
[48] Royal Mail's 'Auto-redelivery webpage'.
[49] Ofcom Designated USP Condition
[50] More information about the scheme and current eligibility criteria can be found on Royal Mail's website.
[51] Royal Mail's ESG report 2022-23 includes commentary around its concessionary rate redirection scheme (page 48)

3. Royal Mail financial performance and efficiency

This section summarises the results of our monitoring of Royal Mail's financial performance and efficiency improvements for the period 2022-23, including comparisons with previous years.

Financial performance

As we have a duty to have regard to the need for the provision of a universal service to be financially sustainable, we monitor both the financial performance of Royal Mail's Reported Business[52] and certain financial metrics relating to the wider group (International Distribution Services plc - 'the Group')[53] such as cashflow and cash headroom.

In our 2022 Review of Postal Regulation, we considered our approach to the assessment of sustainability remained appropriate, and Royal Mail agreed.[54] We therefore decided to retain the use of the EBIT margin to assess the commercial rate of return earned by the universal service and also to continue monitoring the wider range of financial health metrics for the Group.[55]

Reported business volumes and revenues

As explained in Section 1, there was a decline in Reported Business volumes and revenues across the wider parcels market driven by online shopping levels returning to their pre-pandemic trend.

However, during the year, Royal Mail lost market share and its volumes and revenues declined by more than the total market, with a 21.2% reduction in volumes and 18.1% reduction in revenues (or 15.6% reduction in volumes, if the impact of Royal Mail's contract with the Government for the delivery of Covid-19 test kits is excluded).[56] When announcing its results, Royal Mail pointed to the macro-economic headwinds and the unwinding of temporary benefits from Covid lockdown restrictions as one of the causes of its lower volumes. The impact of industrial action, with 18 days of mass strikes taking place at its busiest time of year, and its QoS performance issues were the other main drivers for the lower volumes. Compared against 2019-20 (i.e. pre-pandemic), parcel volumes (excluding test kits) were down 7.8%.

The Reported Business' addressed letter volumes and revenues declined by 8.6% and 5.2% respectively. This decline was a return to the structural decline in letters observed pre-pandemic and a substantial (25%) overall volume decline compared to the 2019-20 pre-pandemic period which represents a compound annual volume decline of 9.1%. This is greater than the 4-6% level of decline

[52] The Reported Business is a part of Royal Mail's UK business but excludes the activities and products of Parcelforce International and Royal Mail Estates Ltd. The services within the Reported Business include all universal service products (based on the universal service obligation, USO) and other 'non-USO' products which use the universal service network (for example, retail bulk mail and access).

[53] International Distributions Services (IDS) plc (formerly Royal Mail plc) is made up of Royal Mail Group Ltd, which contains the Reported Business and ParcelForce Worldwide (PFW), as well as a number of other entities including GLS. The Reported Business and PFW are reported in the annual report as part of Royal Mail UK.

[54] Ofcom, 2022, Review of Postal Regulation, paragraph 3.14.

[55] Ofcom 2022, Review of Postal Regulation, paragraphs 3.14-3.15, page 30.

[56] In the 2021-22 period, these test kits accounted for additional c.7% of parcel volumes. The Government contract for the test kits came to an end in March 2022.

expected pre-pandemic, which Royal Mail set out in its 2019 transformation plan. Its revenues have fallen at a slower rate than its volumes, largely due to the price increases it has introduced (see Section 1).

Table 3.1: Reported Business volume changes

Volumes	Current Year on Year Change 2022-23 vs 2021-22	Previous Year on Year Change 2021-22 vs 2020-21	Change from Pre Pandemic 2022-23 vs 2019-20
Domestic parcels	-22.8%	-7.2%	3.7%
International parcels	-6.0%	-43.3%	-50.6%
Total parcels	**-21.2%**	**-12.5%**	**-7.8%**
Addressed letters	**-8.6%**	**3.2%**	**-25.0%**

Table 3.2: Reported Business revenue changes

Revenues	Current Year on Year Change 2022-23 vs 2021-22	Previous Year on Year Change 2021-22 vs 2020-21	Change from Pre Pandemic 2022-23 vs 2019-20
Domestic parcels	-19.3%	-1.9%	17.4%
International parcels	-11.5%	-25.5%	-23.0%
Total parcels	**-18.1%**	**-6.4%**	**8.2%**
Addressed letters	**-5.2%**	**4.6%**	**-10.8%**

Reported Business EBIT margin

The profit margin made by the Reported Business, and its trend over time, is one of the indicators we monitor when considering the long-term financial sustainability of the universal postal service.[57] Specifically, we consider earnings before interest and tax (EBIT), calculated to include transformation costs and with pension costs restated on a cash basis.[58] We refer to this metric as the '*financeability EBIT margin*'.[59]

In 2022-23 the Reported Business made a loss; the EBIT margin fell to -6.3%, from 3.6% in 2021-22, and 2.7% in 2020-21.[60] Figure 3.1 shows that, for the last seven years, the Reported Business's EBIT margin has remained below the lower bound of the 5-10% EBIT margin range which we use as a first order indicator of a commercial rate of return for the Reported Business.

Figure 3.1: Reported Business financeability EBIT margin
margin

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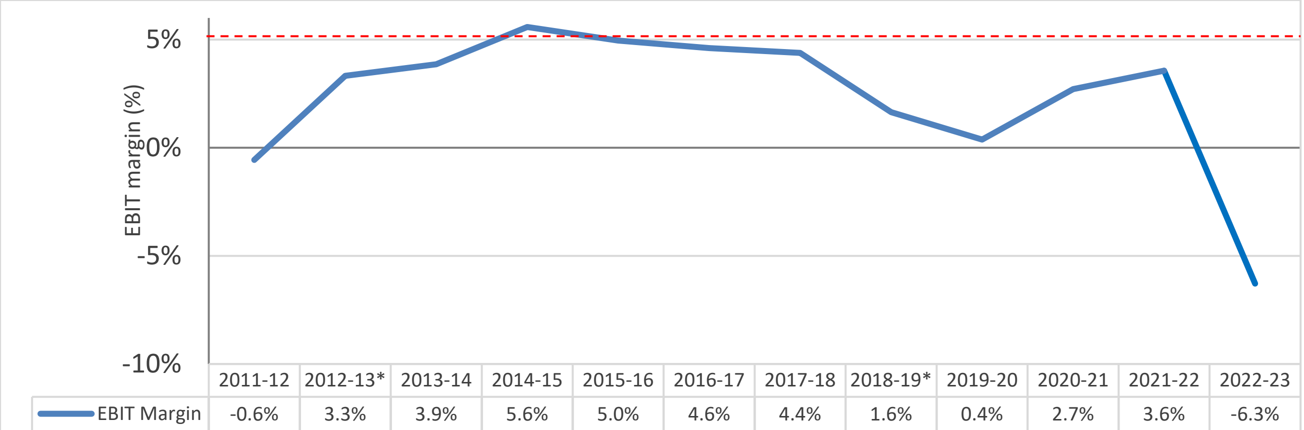
[57] In our 2022 Review of Postal Regulation, we decided to retain the use of EBIT margin to assess the commercial rate of return earned by the universal service. See paragraphs 3.14-3.15.
[58] The pension charge to cash difference adjustment largely comprises the difference between the IAS 19 income statement pension charge rate of 24.6% (2020-21: 19.5%) for the Defined Benefit Cash Balance Scheme (DBCBS) from 29 March 2021 and the actual cash payments agreed with the Trustee of 15.6% (2020-21: 15.6%). The increase in the IAS 19 pension charge rate is due to the decrease in the net discount rate (versus CPI) between March 2020 and March 2021.
[59] In our 2014 Review of End-to-End Competition Statement (p.15) we said it was appropriate to adjust Royal Mail's Reported Business EBIT margin to restate pension costs on a cash basis (i.e. the rate the contributions are actually paid at), rather than the rate calculated using the accounting standards. We considered that this methodology takes account of the true cost of pensions and we refer to this EBIT margin measure as the 'financeability EBIT margin'.
[60] Associated EBIT's 2022-23 -£437m, 2021-22 £282m and 2020-21 £216m.

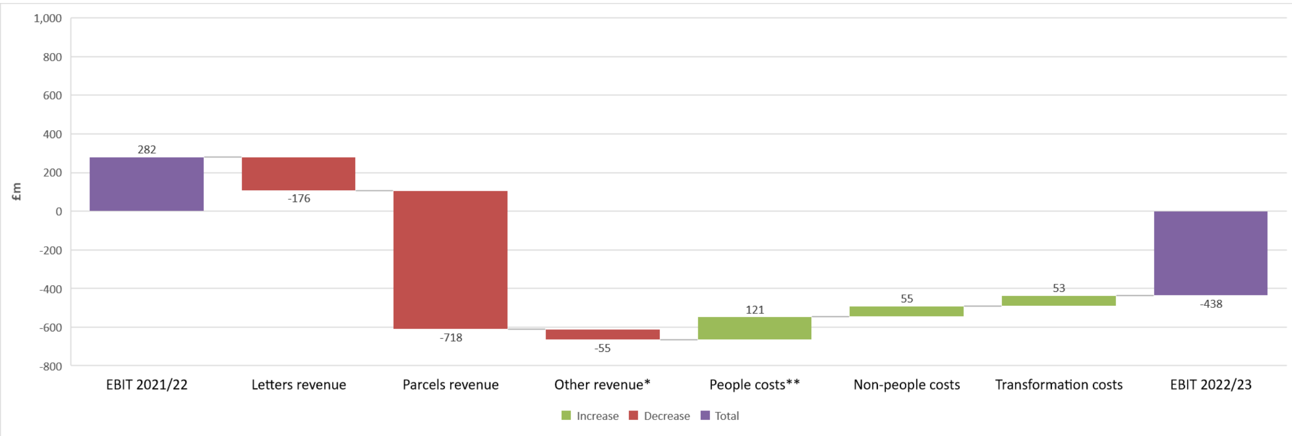


*Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis. *Adjusted to 52 weeks*

Figure 3.2 below breaks down the change in EBIT from 2021-22 to 2022-23. It shows that the fall in EBIT was driven largely by revenues which were down c.£950m. As discussed above, the poor revenue performance was due to a number of factors, including weaker online shopping trends, the impact of industrial disruption, the reduction in covid test kit volumes, a loss of domestic parcels market share and a return to structural decline in letters.

The Reported Business costs (including transformation costs) decreased by £230m (3.0%).[61] This was largely driven by a reduction in people costs, which was achieved via a reduction in FTEs outweighing frontline pay increases of 2%. It was not, however, enough to offset the fall in revenues.

Figure 3.2: Reported Business EBIT breakdown



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.
**Other revenue includes revenues relating to, unaddressed advertising mail, philatelic, other non-volume related items and inter-company charges.*
*** People costs include the costs associated with the delivery of election mail*

Other financial health indicators

Royal Mail is part of the IDS Group, but our monitoring focuses on Royal Mail's financial position, as our regulatory responsibilities relate to the UK business only. From a financial sustainability perspective, IDS has stated that it does not intend to cross-subsidise Royal Mail, and therefore Royal

[61] Excluding transformation costs, the change on 2021-22 was a £176m decrease or -2.3%.

Mail needs to be sustainable in its own right. However, as in previous years we also consider some financial health indicators that relate to IDS, as this is the entity which manages the cash for the Group, is listed on the stock market, and it is IDS that investors invest in or lend funds to.[62]

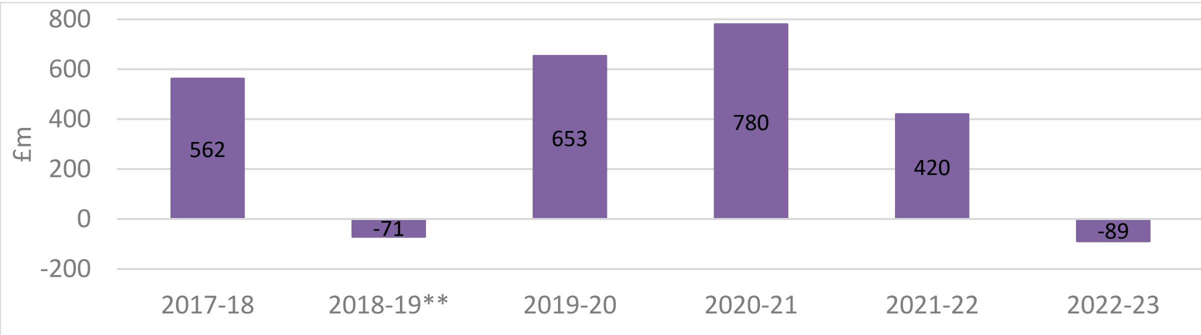
The financial health indicators provide us with a view of the financial position of the Group and its ability to service its debt and meet its cash requirements at the end of each financial year. These indicators match the level at which investors and analysts consider the Group's financial performance and health.[63]

The financial health indicators include cash flow and cash headroom, Standard & Poor's (S&P) credit rating and metrics underpinning covenants on borrowing assessed at a Group level.

Cash flow and cash headroom

Cash flow is an important component in ensuring the financial sustainability of the universal service. In 2022-23, free cash flow of the Group decreased to an outflow of £89m (see Figure 3.3 below) compared to a £420m inflow in 2021-22.

Figure 3.3: The Group's free cash flow

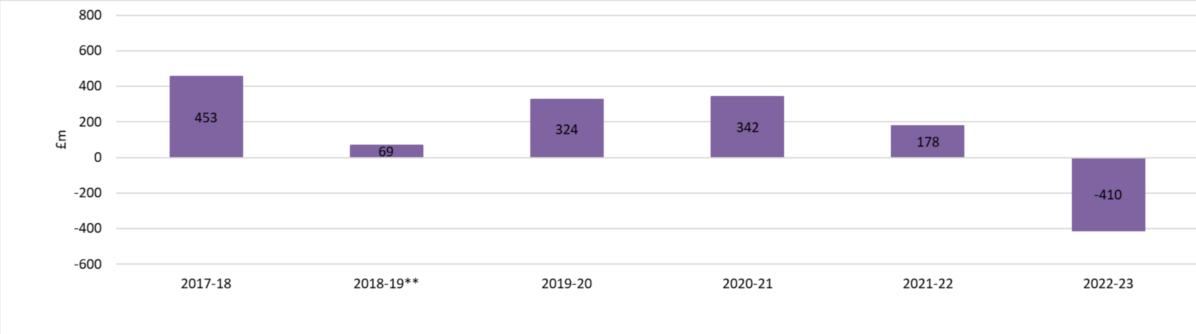


Source: International Distributions Services PLC annuals accounts[64]
*** 53-week year (unadjusted).*

As part of publication of its 2022-23 results, the IDS CEO stated "*We've reiterated our commitment not to cross-subsidise, but we'll support Royal Mail in the delivery of its business plan and its turnaround"*.[65] We have therefore also considered the cashflows of the UK business.

[62] We noted that it is conceivable that, while the Reported Business might make a commercial rate of return, the rest of the Relevant Group might not perform well. This has the potential to pose a threat to the financial sustainability of the provision of the universal service if the liquidity or funding of the Relevant Group was compromised.
[63] Ofcom 2016, Review of the Regulation of Royal Mail Annexes 5 to 11, Annex 6, paras A6.43 to A6.59.
[64] E.g., page 66 IDS Annual Report 2022-23.
[65] IDS plc, 2023. Full year results 2022-23 announcement transcript, page 6.

Figure 3.4: Royal Mail in-year trading cash flow on pre-IFRS 16 basis



*Source: International Distributions Services PLC annuals accounts[66]** 53-week year (unadjusted).*

For the UK business, free cash flow reduced significantly, from a £324m inflow in 2021-22 to a £306m outflow. As at year end, Royal Mail UK's cash balance was c.£450m.[67]

Efficiency performance

In discharging our duties in relation to post, we monitor the efficiency of the Reported Business. The Postal Services Act 2011 requires us to have regard to the need for the provision of a universal postal service to be financially sustainable, and for it to become efficient within a reasonable period, and then remain efficient at all subsequent times.

In this section we discuss:

- our standard indicators of efficiency and their interpretation;
- Royal Mail's progress against its 'Five Point Plan', announced as part of its 2022-23 Q2 results;[68]
- the key initiatives for future efficiencies agreed within Royal Mail's 'Business Recovery, Transformation and Growth Agreement'; and
- the recent changes to our regulations to strengthen our efficiency monitoring.

Indicators of Royal Mail's efficiency performance

As in previous years, we have considered a range of high-level indicators of efficiency, including the overall change in real costs, a break-down of the causes of cost movements in the year between Price, Volume, Efficiencies and Other changes (PVEO), changes in frontline gross hours in delivery and processing (which captures changes in paid hours) and Royal Mail's own productivity metric (Weighted Items per Gross Hours, or WIPGH) which measures efficiency by capturing the ratio of outputs to inputs.

The results are shown in Table 3.1 below and indicate that, whilst Royal Mail's reported productivity rates have fallen, it made improvements in real costs, paid hours and efficiency (within PVEO).[69]

However, the impact of industrial action and Royal Mail's poor QoS performance in 2022-23, means it is difficult to determine whether these changes represent sustainable ongoing efficiency improvements. For example, because of the strikes, pay abatements occurred over 18 days, resulting

[66] E.g., page 65 IDS plc Annual Report 2022-23.
[67] IDS plc, 2023. Full year results 2022-23, p.49.
[68] IDS plc, 2023. Full year results presentation 2022-23, slides 33-38.
[69] PVEO analysis takes account of the following changes to identify the effects of efficiency improvements 1) input price inflation; 2) changes in volumes; and 3) one off changes.

in reductions to hours and pay, and this will have affected the results. We will review these indicators again next year to assess progress.

Table 3.1 Unadjusted Indicators of the Reported Business' efficiency performance

Indicator	Performance in 2022-23
Total change in real costs	Real costs (excluding transformation costs) **decreased by 11.3%** to £6.2bn[70]
Price, Volume, Efficiency and Other (PVEO) analysis	Royal Mail achieved efficiencies of **£411m (5.6%)**
Frontline gross hours in delivery and processing	Total gross hours across delivery and processing **decreased by 7.6%**[71] Gross hours fell c.5% compared to pre-covid levels (2019-20)
Productivity - weighted items per gross hour (WIPGH)	**WIPGH fell 3.6%** as hours reductions did not flex down in line with reductions in workload.

In light of the factors affecting these indicators this year, we have taken a more qualitative approach to our assessment of Royal Mail's efficiency performance, including progress against its five-point plan and the implementation of the Business Recovery, Transformation and Growth Agreement.

Progress against Royal Mail's five point plan

In September 2022, Royal Mail served notice on several agreements and policies that were put in place at the time of privatisation. Royal Mail stated that '*This allowed us to move ahead with elements of our change programme during the second half [of the year]. Accordingly, we were able to complete revisions across all delivery and processing units and right size the workforce to current workload*'.

As part of its 2022-23 Q2 results announcement, Royal Mail announced a five-point plan[72] to restore cash generation and operating profitability in the UK business. The plan put into practice a number of initiatives from its Pathway to Change agreement with the CWU from 2021.[73] This agreement was superseded by Royal Mail's Business Recovery, Transformation and Growth Agreement in July 2023.

The five-point plan covered the following areas:

i) rightsizing the business;
ii) creating headroom to invest;
iii) new resourcing models;
iv) efficient use of network and assets; and
v) building management capability and effectiveness.

The table below summarises Royal Mail's view of its performance in 2022-23 against the first four areas.

[70] Indexed to 2018-19.
[71] This figure excludes gross hours from RDCs and Other, such as central administration staff.
[72] IDS plc, 2023. Full year results presentation 2022-23, slides 33-38.
[73] At a high level, the Pathway to Change agreement awarded a pay rise of 1% in April 2021 and shortened the working week of frontline full-time staff from 38 to 37 hours, for the same pay, with part-time staff getting an equivalent pay rise. The reduction in working week or equivalent pay rise was contingent on successful completion of delivery revisions and an increased use of technology within the business.

Table 3.2 Five Point Plan targeted and achieved efficiencies in 2022-23

Efficiency	Metric	Target	Achieved
(1) Rightsizing the business: Operational staff	Year on year reduction in Full Time Equivalent (FTE).[74]	5,000	Yes: 10,000[75]
(2) Creating headroom to invest: Capital expenditure	Reduction in capital expenditure	£100m	Yes: £100m[76]
(3) New resourcing models:	New (lower) starters terms and conditions and new attendance policy.	n/a	Yes: new hires were made in 2022-23 on new terms. Change to attendance policy commenced 1 October 2023.
(4) Efficient use of network and assets: (i) **Dedicated parcel hubs**	National roll-out of dedicated parcel hubs. Parcels sorted automatically at least once.	c.350 dedicated hubs. Achieve 80% by end of 2023-24.[77]	346 dedicated hubs. 76%[78] [79]
(ii) **Electronic timesheet rollout**		All delivery offices	Yes: introduced in all delivery offices.[80]

In terms of the fifth area '**building management capability and effectiveness',** Royal Mail's stated aim was to achieve this via investment in management training programmes and the removal of several layers of management. In its 2022-23 annual report, Royal Mail stated that its '*new operational management structure is now embedded and delivering improved operational grip…. We are upskilling our managers through our recently opened Royal Mail Academy …. Our Trust Score*

[74] FTE calculated as the total of a week's paid hours at the end of March divided by 37 (the number of full time weekly hours).
[75] Point-in-time comparisons can be misleading due to their volatility. However, our analysis of headcount and total paid hours (gross hours) supports the view that Royal Mail has made people efficiency savings.
[76] The reduction of £100m in capital expenditure, down to an amount of c.£255m, resulted in the cancellation of 3 parcel sortation machines but is largely the outcome of considerably higher than normal capital expenditure of c.£440m in 2021-22 due to the parcel super hubs. The amount is higher than the average capital expenditure in 2019-20 and 2020-21 of c£215m. Royal Mail Group Annual Report 2020-21, page 64: Royal Mail capital expenditure £210m in 2020-21 and £222m in 2019-20.
[77] This target was set under the Journey 2024 plan. Parcel automation was not set as target under the five-point plan. However, we still see this as An important metric to measure efficient use of network.
[78] Up from 50% at the end of 2021-22 and 33% end of 2020-21. See IDS plc, 2023. Full year results 2022-23, page 13.
[79] The absolute levels of parcel sortation achieved will depend on the total volume of parcels. The metric adopted captures the proportion sorted, which, absent any other changes, will increase when parcels decline. Royal Mails parcel volumes declined across 2022-23.
[80] This technology was only in place at 43 sites, including all Mail Centres and Regional Distribution Centres at the end of FY 2021-22.

survey has shown our managers' relationship with our frontline team continues to improve, despite the backdrop of the CWU dispute, which demonstrates the advantages of smaller teams, better trained managers and better communication'.

Royal Mail's Business Recovery, Transformation and Growth Agreement

Looking ahead, one of the key enablers for Royal Mail to achieve its expectations for efficiency and productivity over the next five years is the recently agreed Business Recovery, Transformation and Growth Agreement. This was agreed between Royal Mail and the Communication Workers Union (CWU) in July 2023 after nearly a year of dispute and 18 days of strikes.

The agreement awarded a consolidated pay rise[81] of 2% for financial year 2022-23, a consolidated 6% for financial year 2023-24 and a consolidated 2% for financial year 2024-25 as well as a separate one-off lump sum payment of £500 per employee and introduced a profit-sharing payment for the years of the agreement where Royal Mail Group Ltd generates an operating profit.

According to IDS, the key changes to working practices within the agreement relate to later start times, seasonal working patterns, the creation of a single parcels network used by Royal mail and Parcelforce, changes to indoor mail preparation, Sunday working and changes to sick pay, attendance standards and ill health retirement policies.[82]

We will monitor Royal Mail's progress towards these changes as part of our future efficiency monitoring.

Changes to our efficiency monitoring

In our 2022 Review of Postal regulation, we strengthened our monitoring regime in relation to efficiency by requiring Royal Mail to publish its expectations for improvements in efficiency (by reference to PVEO) and productivity (based on Weighted Items per Gross Hours) for the next five-year period and annually publish progress against them.

Royal Mail published this information for the first time on 30 June 2023,[83] outlining that:

- its PVEO efficiency expectation is that efficiency savings of £690m or 9% will be achieved by 2027-28; and
- its WIPGH productivity expectation is that the expected operational efficiency improvement of its frontline staff by 2027-28 will be 25%.

Publication of these expectations should increase stakeholders' understanding of Royal Mail's progress on efficiency and provide a public reference point for future considerations of Royal Mail's efficiency. The combination of an upfront benchmark and provision of actual data will provide insight into Royal Mail's view of the scope for efficiencies and progress against expectations, enabling us to identify any sustainability concerns relating to efficiency promptly.

[81] With the exception of fleet technicians who were awarded a 8.7% base pay increase from 1 April 2023 instead of the consolidated pay rise of 2% for financial year 2022-23 and consolidated 6% for financial year 2023-24 see appendix 4 of the agreement.

[82] International Distributions Services welcomes CWU ballot result

[83] IDS plc, June 2023. Five-year cumulative expectation for PVEO and productivity.

We have provided an overview of the initiatives Royal Mail has in place to support these expectations above. We will be monitoring Royal Mail's progress against these initiatives and will provide an update in next year's report.