Royal Mail plc

Response to Ofcom's Review of Postal Regulation - Call for Inputs, March 2021

Royal Mail Submission

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Public version

Confidential information which has been redacted from this document is indicated by: [✂]

Contents

1. Executive summary

Royal Mail wants to be the UK's most trusted, reliable and customer-focused delivery company. To be successful, we need to provide the services that our customers need and want. Over the last year, we have started collecting parcels from the customer's doorstep, delivering on Sundays, providing prescriptions to those in urgent need of medication, and introducing barcoded stamps. None of this was required by regulation. To regain relevance and stay sustainable, the Universal Service must offer the flexibility for Royal Mail to adapt quickly to the changing needs of all users. Otherwise, Universal Service customers are in danger of being increasingly left behind.

Regulatory change can make the postal Universal Service relevant for the next generation. Given the significant changes we continue to see in the market – more parcels, fewer letters - we continue to believe the best way to ensure that the Universal Service continues to meet customers' needs is to rebalance our UK business model more towards parcels. We remain absolutely committed to the universal affordable, 'one price goes anywhere' nature of the Universal Service. But as customers change, so must we. This year, Royal Mail will simplify and improve its product offerings under a "good", "better", "best" approach. As we develop this further, we will engage with Government and Ofcom about the regulatory changes needed to allow us to adapt quickly to offer what customers want, and to ensure the Universal Service regains relevance and is sustainable.

Ofcom's regulatory review is a timely opportunity to introduce more commercial and operational freedoms for Royal Mail, continuing the journey started in 2012. Royal Mail is doing everything in its gift to change in line with consumer and market dynamics. This review should unlock further opportunities for customers. We are also undergoing a major operational transformation programme following the union agreement struck in December 2020. We have identified a number of areas for change through this regulatory review. We have grouped them under three key themes below:

Theme 1 – We need a flexible regulatory framework that enables innovation.

- **Products and service innovation** - We request that Ofcom removes the prohibition on tracking in the USO on all First Class and Second Class services – covering letters, large letters and parcels. Consumers and SMEs need the guarantee of an affordable, high-quality, UK-wide tracking service. In 2020, The Consumer Council for Northern Ireland found that nine in ten consumers believe tracking should be included as standard for parcels. Our own independent research conducted by Illuminas in 2019 backs this up. It found that nearly two-thirds (63%) of residential customers would find being able to track large letters or parcels they send First or Second Class very or fairly appealing. Marketplace platforms - a major revenue source contributing to the financial sustainability of the Universal Service Obligation - are increasingly recommending parcel operators to vendors based on performance and service options, including whether tracking is available.

- **Second Class safeguard price caps** - We need greater commercial flexibility to react quickly to changes in market conditions which affect our financial sustainability. Ofcom noted in its 2019-20 Annual Monitoring Report (AMR) that "*We remain of the view that postal services are currently affordable for most residential consumers. We note net satisfaction levels from our residential tracker data remain high*". We request that Ofcom removes the Second Class safeguard price caps or - at a minimum - provides a significant uplift in the headroom of both the letter, and the large letter and parcel price caps.

Theme 2 – Clarity on efficiency and financial sustainability.

- **We request that Ofcom enhances its framework when assessing Universal Service financial sustainability, including recognition of the growing importance of the environmental and social agendas.** Any monitoring framework should contemplate a range of measures, including debt and equity metrics, since a financially sustainable business must be able to invest and offer returns to shareholders. In 2012, Ofcom defined 5-10% EBIT margin as the indicative commercial rate of return for the Reported Business. Royal Mail has been below this range for seven of the nine years since then, and in early 2020 highlighted that it was due to become materially loss making and cancelled its final dividend. No action was taken by Ofcom. Whilst Royal Mail's financial position has improved in the last 12 months, additional clarity is required on when, why and how Ofcom would intervene in the event of sustainability concerns arising.

- **When Ofcom reviews our draft 2021 Business Plan, it should confirm whether or not it views our efficiency ambition as "within a reasonable range".** This added clarity will enable Royal Mail senior management (and all our people) to focus on the job of delivering on behalf of customers.

Theme 3 – Mandate downstream access services only where necessary.

- **As concluded by Ofcom in 2017, there is no need for any extension to the mandated regime to include parcels and we request that Ofcom reconfirms this position early in the review process.** In its 2012 and 2017 reviews of the postal regulatory framework, Ofcom concluded that there was insufficient evidence to support the imposition of any additional forms of access. Since then, the parcels industry has become even more competitive. In 2019-20, Royal Mail's volume share in Business-to-Business/Consumer (B2X) was c. [✂]% (and only c. [✂]% in revenues). Royal Mail has commissioned Oxera to undertake a market analysis of the parcels delivery industry in the UK. It finds a competitive, vibrant industry where numerous end-to-end operators have challenged and continue to challenge Royal Mail across the full spectrum of segments, for example Hermes, Yodel, DPD, Amazon logistics. Any threat of extending access mandation into parcels could undermine existing and future investments, as well as our broader transformation plans. The three statutory tests for mandating access in lightweight parcels are not met (ie promoting efficiency, promoting effective competition and conferring significant benefits on the users of postal services).

- **Ofcom actively considers removing Fulfilment Large Letters (FLLs) from the mandation**. Independent analysis from Oxera demonstrates that there are no substantial demand or supply side differences between a FLL and a smaller sized parcel (eg one that is small enough to fit through the letterbox). There is sufficient competition for these services from other end-to-end parcel operators. Competition enables customers to send FLL at low prices and high quality with a range of providers. We handle FLL as parcels in our network. Given that FLLs are in effect small parcels, these should be included in any parcel market analysis and therefore the same conclusion applies. FLLs should therefore be removed from the downstream access mandation regime.

The other areas raised by Ofcom in its Call for Input not referenced above are also addressed in this report for completeness.

2. Summary of regulatory positions

Below we provide a short summary covering our specific regulatory positions across each of Ofcom's questions in its Call for Inputs. We provide more details and evidence to support these positions in the chapters below aligned to Ofcom's individual questions:

<table>
<tr><th>Question</th><th>Royal Mail Response</th></tr>
<tr><td colspan="2">Section 3: Approach to regulation</td></tr>
<tr><td>3.1: Do you consider that Ofcom's overall regulatory approach remains appropriate for regulating postal services over the 5-year period (2022-2027)? If not, please explain the areas where you think changes should be made, with supporting evidence.</td><td>The postal sector is changing at an unprecedented rate and Ofcom's regulatory framework must change with it. To regain relevance and stay sustainable, the Universal Service must adapt to life in the 21st Century. At a high-level, there are three key themes requiring reform as part of this review:
First, we need a flexible regulatory framework that enables innovation. Royal Mail needs greater commercial and operational freedom to meet the evolving needs of customers and to allow us to rebalance from letters towards parcels. Ofcom's review is a timely opportunity to introduce more flexibility for Royal Mail, continuing the journey started in 2012. We expand on operational freedoms under question 3.1. For more detail on the commercial change requests, please see our responses to questions 5 and 6.
Second, we would like to collaborate with Ofcom on providing greater clarity around efficiency and financial sustainability. On financial sustainability, this includes expanding the metrics to cover equity measures and establishing "tramlines" to identify when sustainability concerns may arise alongside clarifying supportive actions Ofcom could take. We would also like to discuss the implications for the regulatory framework of the growing demands for action on the environmental and social agendas. On efficiency, when Ofcom reviews our draft 2021 Business Plan, it should confirm whether or not it views our efficiency ambition as "within a reasonable range". For more details on this area, please see our response to question 4.1.
Finally, there is no case for any extension to the access regime to include lightweight parcels. We request early confirmation that this policy option is off the table to remove unnecessary regulatory uncertainty. Rather, we request that Ofcom actively considers removing Fulfilment Large Letters (FLLs) from the access regime. For more details on this area, please see our response to question 7.1.</td></tr>
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Section 4: Financial sustainability and efficiency	
4.1: Do you consider that Ofcom's current approach to financial sustainability and efficiency of the universal postal service will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.	No. On financial sustainability, we would like to collaborate with Ofcom on a revised approach to financial sustainability. This includes: **(1)** enhancing the metrics to include equity measures; **(2)** adding "tramlines" for each metric to identify when financial sustainability concerns may arise; **(3)** clarifying the actions that Ofcom could take to secure the provision of the Universal Service; and **(4)** discussing the implications for the regulatory framework of stakeholders' demands for progress on the ESG agenda. On efficiency, much of Ofcom's current approach remains appropriate for the next regulatory cycle. We do however ask that Ofcom: **(1)** refreshes its monitoring to include metrics that align to Royal Mail's new transformation plan and remove those no longer relevant; and **(2)** confirms whether or not it views our efficiency ambition as "within a reasonable range" when it reviews our draft 2021 Business Plan. This added clarity will enable Royal Mail senior management (and all our people) to focus on the job of delivering on behalf of customers.
Section 5: Universal service obligations	
5.1: Do you consider Ofcom's approach to the safeguard cap and ensuring affordability will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.	No. Royal Mail needs greater commercial flexibility to react quickly to changes in market conditions which affect our financial sustainability. We have a strong track record of pricing responsibly and affordably. We therefore believe that both Second Class caps are an unnecessary, one-size-fits-all tool that act as a constraint on our wider mail pricing structure and pricing flexibility. We therefore propose that Ofcom continue the journey it started in 2012 by removing the Second Class safeguard caps or - at a minimum - providing a significant uplift in the headroom in the caps. Ofcom put forward the option of focusing the safeguard cap on consumers who are particularly vulnerable, such as people who are in receipt of certain benefits. We firmly agree that the current safeguard caps are sub-optimal. But, we think that a targeted discount would be complex to administer and therefore not feasible.
5.2: Do you consider Ofcom's approach to the regulation of residential and business redirections services will remain appropriate going forward? If not, please explain what	Ofcom's current approach to the regulation of Redirection products has worked well for many years. Customers are very satisfied with the product offered by Royal Mail. We have invested in a number of initiatives to further improve the consumer experience, including a fairer pricing structure, a concessionary rate to support vulnerable customers, and refunds for businesses during Covid that do not need the full term of the product that they purchase. We believe that all our Redirection products offer good value for money, but recognise that some customers may have affordability concerns. To inform future developments, we will commission research to ensure that the Redirection product set

changes you think should be made, with supporting evidence.	remains fit for purpose, including reviewing our existing concessionary scheme. We aim to implement any feasible new initiatives as soon as is practical.
5.3: Do you consider Ofcom's approach to regulating quality of service for key USO services remains appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.	Yes. We continue to support all the main quality-of-service targets at the heart of the current regulatory framework. Quality is driven by customer demands. There are, however, some technical anomalies within the current targets that we would welcome Ofcom addressing: **(1)** update the 99.9% Delivery Route target to accurately reflect the impact of part-route failures; **(2)** revise the Postcode Area (PCA) target from 91.5% to 90% to statistically align with the First Class 93% target; and **(3)** review the Special Delivery Guaranteed by 1pm 99% target to reflect any changes to the product specification.
5.4: Do you consider Ofcom's approach to regulating USO services, including access requirements, Special Delivery Guaranteed by 1pm, Signed For and Meter mail will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.	No. We need a flexible regulatory framework that supports innovation and enables Royal Mail to bring new products, services and features to market rapidly, without the need for a protracted consultation process. Our asks include: • Tracking in the USO - Royal Mail requests the removal of the prohibition of tracking on First and Second Class services within the Universal Service - see response to question 6.4. • Special Delivery Guaranteed by 1pm - Remove unnecessary prescription from the Special Delivery product - including the 1pm deadline - to allow consumers to decide when they want delivery. The requirement to offer registered and insured services together should also be unbundled so that they can be offered as separate products. • Recorded Signed For - A signature may have historically been the only way to confirm delivery, but a range of options are now available including scans, photos, etc. We need flexibility to develop products that better meet individual consumer needs. • International - Remove services that are not aligned with customer needs, such as the International Economy (72 day) service. We also request greater flexibility to offer a range of confirmation of delivery options. Ofcom should maintain its current approach to regulating Meters. Among SMEs that use metered/franked mail, 85% consider this method of sending mail to be "important" or "very important" to their business. It is an important component of a wider regulatory framework to support the financial sustainability of the Universal Service.

Section 6: Parcels regulation	
6.1: Do you think the parcels market is working well for all senders and receivers of parcels (such as online shoppers, marketplace sellers and/or small retailers)? If not, please explain what changes you think should be made, with supporting evidence.	Yes. The UK has the most competitive and dynamic parcels sector in Europe. As the sector has become more competitive, customers' expectations have increased. All carriers – including Royal Mail – have invested and innovated to develop features customers want, provide a great experience and deliver greater convenience. Customers are benefiting from increased flexibility, speed and choice. At the same time, across the parcel sector in the UK, prices have declined in real terms. This is despite a significant shift to higher value next day and tracked products. This indicates strong pricing pressures driven by competition and that efficiency gains are being passed onto consumers in the form of lower prices. Royal Mail commissioned Oxera to undertake a market analysis of the parcels delivery sector in the UK, with the primary focus on B2X deliveries (see Appendix "Parcels market analysis and implications for the scope of the access regime" for the report's Executive Summary). The report presents evidence of a highly competitive sector where numerous operators have challenged and continue to challenge Royal Mail. Ofcom should not increase regulation in this area. We request that Ofcom allow end-to-end parcel competition – and all the benefits that this bestows customers – to thrive.
6.2: What is the nature and extent of detriment (if any) that consumers may suffer in the C2X or B2C segments of the parcels market? Please provide your views with supporting evidence	We have not observed any systemic consumer detriment in the supply of B2C or C2X parcels that requires regulatory intervention from Ofcom. Customers across all segments of the parcels industry have benefitted from greater choice, lower prices than would otherwise be the case, and innovation, over the past few years. Ofcom's own research suggests a high degree of consumer satisfaction, with 85% of residential customers being satisfied with overall postal services.[1] Royal Mail goes to great lengths to ensure that our customers get a positive doorstep experience. For example, our resource planning approach ensures that staff have sufficient time to complete their round, including time for customers to answer the door when we knock. Our best-in-class terms and conditions mean that staff have the ability to focus on quality and not just speed. A number of our parcel service improvements also benefit disabled and vulnerable customers in particular. For example, estimated delivery windows give more visibility of when an item will be delivered and help customers to plan their day. Inflight Redirections and the expanded SafePlace give customers more control over their delivery. Parcel Collect means that customers can have their parcels collected from their door.
6.3: How effective are the existing consumer protection measures for users of parcel services, in particular CP 3? Is a change in	CP3 is fit for purpose. It balances sufficient clarity over complaints and redress without over-prescription. Royal Mail has a robust approach to complaints and redress, and therefore does not see any case for change. Over recent years, we

[1] Ofcom, Annual Monitoring Update on Postal Services – 2019-20, Page 26, Para 4.6

regulation needed to protect users of postal services (as senders and recipients) and if so, what measures? Please provide your views with supporting evidence.	have made our process easier for customers to navigate, understand and pursue. We suggest that Ofcom focuses on enhancing its monitoring of the existing Consumer Protection regulations across the industry. If Ofcom does intend to extend consumer protection regulations to a wider set of parcel operators, it is vital that there is consistency in reporting definitions and oversight.
6.4: Are there any changes to the universal service obligations required for parcels, such as including tracking for First/Second Class services? If so, please provide your views with supporting evidence.	Royal Mail supports the removal of the prohibition of tracking on First and Second Class services within the Universal Service - covering letters, large letters and parcels. The rise of e-commerce and online shopping has seen a significant rise in parcel volumes, which has shifted customer expectations. This includes the flexibility for customers to choose services that meet their needs, such as tracking. Marketplace platforms - a major revenue source contributing to the financial sustainability of the Universal Service - are recommending parcel operators based on performance and service options, including whether tracking is available. Current modelling indicates a long-term c.£[✂]m revenue and c.£[✂]m profit risk to Royal Mail's finances if tracking is not able to be provided on USO parcel products and marketplace sellers require a tracked service.
6.5: Do you have any other comments on Ofcom's approach to regulating parcels? If so, please provide your views with supporting evidence	The minimum Postal Services Act 2011 (PSA) requirements require us to deliver parcel services five days a week (Monday to Friday) to every address across the UK. In practice, we already deliver parcels six days a week (Monday to Saturday). This reflects consumer demand and market dynamics in the parcels sector. As such, we see no immediate need to add Saturday parcel deliveries to existing requirements. However, we welcome dialogue with Ofcom and the Government to ensure that the Universal Service regains relevance and is sustainable. The current USO parcel weight limit should be retained. Reducing the limit to below 20kg could be detrimental to customers. There are some areas of the country where the market is not providing a reliable, affordable collection and delivery service at these parcel sizes.
Section 7: Access regulation	
7.1: Does the current scope of access regulation remain appropriate or should this be changed and, if so, how and why? Please provide your views with supporting evidence	Ofcom should mandate downstream access services only where necessary. Our requests include: • As concluded by Ofcom in 2017, there is no need for any extension to the mandated regime to include parcels and we request that Ofcom reconfirms this position early in the review process. In its 2012 and 2017 reviews of the postal regulatory framework, Ofcom concluded that there was insufficient evidence to support the imposition of any additional forms of access. Since then, the parcels industry has become even more competitive. In 2019-20, Royal

	Mail’s volume share in Business-to-Business/Consumer (B2X) was c.[✂]% (and only c.[✂]% in revenues). Royal Mail has commissioned Oxera to undertake a market analysis of the parcels delivery industry in the UK. It finds a competitive, vibrant industry where numerous end-to-end operators have challenged and continue to challenge Royal Mail across the full spectrum of segments. A mandated parcel service could have a detrimental impact on competition and innovation in the parcels market. Moreover, growth in parcels is vital to the future financial sustainability of the Universal Service. We are investing significantly in parcel automation, including parcel hubs. Any potential changes to the access regime to include parcels would have a material impact on the business case outcomes. Indicative modelling (assuming that up to 1kg parcels are subject to access mandation) suggests that, over the medium term, mandation is likely to reduce revenue by somewhere in the range of £[✂]m to £[✂]m. • We request that Ofcom actively considers removing FLLs from the access mandation. Independent analysis from Oxera demonstrates that there are no substantial demand- or supply-side differences between a FLL and a parcel that is small enough to fit through the letterbox. There is sufficient competition for these services from other end-to-end parcel operators. Competition enables customers to send FLL at low prices and high quality with a range of providers. We handle FLL as parcels in our network. Given that FLLs are in effect small parcels, these should be included in any parcel market analysis and therefore the same conclusion applies. FLLs should therefore be removed from the downstream access mandation regime. • We agree with Ofcom that there is no evidence that would support the view that D+1 services should be mandated. Royal Mail currently provides an access premium service which provides for a late access window (22:30-00:30) for next day delivery on a commercial basis.[✂] • Finally, we request that access mandation is not widened to any point in our network other than the Inward Mail Centre (IMC). Access at points downstream of the Inward Mail Centre (IMC) would introduce additional inefficiency and unnecessary cost into Royal Mail’s network.
7.2: How well is our approach to access price regulation working in supporting access-based competition? Are there any improvements or changes that we should make? If so, please provide your views with supporting evidence	The current approach to access price regulation has been effective in facilitating access-based competition in letters and “paper” large letters. There is no evidence that this approach needs to materially change. Replacing the current regulatory margin squeeze control (USPA6) with either a direct price control or price cap on access carries a significant risk of regulatory failure. The current margin squeeze can be improved through some technical modifications to align it better to market dynamics. The current design acts as a barrier to us competing effectively. Our key proposed change is to remove the contract level

	test. Maintaining the USPA6 contract level test is disproportionate. We believe it should be removed or at the very least set at a level that reflects economic fundamentals (ie long run incremental costs). If Ofcom is not minded to take this step, as a minimum, it should refresh the FAC cost benchmark to allow us to price in line with the market. Using a 50% FAC cost benchmark is not a reasonable proxy for long run average incremental costs. It overstates our incremental costs meaning that we are priced out of competing for some contracts. Ofcom should set the cost standard at [✂]% of FAC. This would allow Royal Mail to compete for traffic on the merits – based on our variable cost - rather than being constrained by a regulatory safeguard that is no longer required in a mature market.
7.3: Is our current approach to access regulation working well in delivering fair, reasonable and not unduly discriminatory terms of access, and are there any changes we should make? If so, please provide your views with supporting evidence.	We believe that the existing safeguards are adequate and that the current approach is working well to deliver fair, reasonable and not unduly discriminatory terms of access. As a result, there is no need for Ofcom to materially expand access regulation. However, there are areas where Ofcom could provide additional clarification in the access condition without compromising its preference for less interventionist regulation: • Removing the requirement at USPA 8.1A for Royal Mail to publish the fall to earth volumes of D+2, D+3 and D+4 for the new D+5 service would be consistent with Ofcom's stated intention of allowing Royal Mail and access customers to retain the flexibility of commercial negotiations. • There would be merit in explicitly permitting Royal Mail's Wholesale team, under USPA5.3, to use access information for purposes that benefit access customers and/or the mail industry as a whole.

3. Approach to regulation

3.1 Approach to regulation

Ofcom question 3.1: Do you consider that Ofcom's overall regulatory approach remains appropriate for regulating postal services over the 5-year period (2022-2027)? If not, please explain the areas where you think changes should be made, with supporting evidence.

Overview

The postal sector is changing at an unprecedented rate and Ofcom's regulatory framework must change with it. Given the significant changes that we continue to see in the market - more parcels, fewer letters - we continue to believe that the best way to ensure that the Universal Service continues to meet customers' needs is to rebalance our UK business model more towards parcels.

We remain absolutely committed to the universal, affordable "one price goes anywhere" nature of the Universal Service. Customers tell us that the ability to send and receive letters and parcels remains important both socially and economically. It offers a means of social communication that is accessible to all, but particularly to more vulnerable groups. But as customer needs change, so must we. We will engage with Government and Ofcom about the regulatory changes needed to allow us to adapt quickly to offer what customers want, and to ensure that the Universal Service regains relevance and is sustainable.

At a high-level, there are three key themes requiring reform as part of this review:

- First, we need a flexible regulatory framework that enables innovation. Royal Mail needs greater commercial and operational freedom to meet the evolving needs of customers and to allow us to rebalance from letters towards parcels. Ofcom's review is a timely opportunity to introduce more flexibility for Royal Mail, continuing the journey started in 2012. **We expand on operational freedoms under question 3.1. For more detail on the commercial change requests, please see our responses to questions 5 and 6.**
- Second, we would like to collaborate with Ofcom on providing greater clarity around efficiency and financial sustainability. On financial sustainability, this includes expanding the metrics to cover equity measures and establishing "tramlines" to identify when sustainability concerns may arise alongside clarifying supportive actions Ofcom could take. We would also like to discuss the implications for the regulatory framework of the growing demands for action on the environmental and social agendas. On efficiency, when Ofcom reviews our draft 2021 Business Plan, it should confirm whether or not it views our efficiency ambition as "within a reasonable range". **For more details on this area, please see our response to question 4.1.**
- Finally, there is no case for any extension to the access regime to include lightweight parcels. We request early confirmation that this policy option is off the table to remove unnecessary regulatory uncertainty. Rather, we request that Ofcom actively considers removing Fulfilment Large Letters (FLLs) from the access regime. **For more details on this area, please see our response to question 7.1.**

Context

Importance of the postal Universal Service

3.1 Royal Mail is proud to provide the postal Universal Service for the UK - a service connecting companies, communities and countries. The Universal Service is part of the fabric of our society and the lives of the millions of people who use it every day. It brings simplicity to what could be a very complicated system by giving us all access to a reliable, one-price-goes-anywhere delivery service to every address in the UK.

3.2 Customers tell us that the ability to send and receive letters and parcels remains important both socially and economically. It offers a means of social communication that is accessible to all, but particularly to more vulnerable groups. Even in today's digital age, 85% of people and 77% of SMEs report that they will always have something they need to send by post.[2] A majority of consumers (57%) say that they would feel cut off from society without the Universal Service Obligation (USO).[3] This figure is significantly higher amongst certain vulnerable groups, including those aged 65+ (67%), those with a physical impairment (67%), and those on a low income (63%).[4] Post is integral to the economy, with a majority (59%) of SMEs saying that their business would not be able to operate without mail, as many depend on it for attracting customers, invoicing, supplying goods and receiving payments.[5]

The pandemic has reminded people how important the Universal Service is - with 86% of people saying that Royal Mail is an important part of UK society.[6] Daily deliveries have been a source of enormous comfort in the pandemic, coupled with the trusted and familiar sight of red vans, red pillar boxes and red uniforms. Importantly, these deliveries have enabled people to follow Government guidance to "stay at home". Our postmen and postwomen have been out on the streets every day, delivering the items that people need so that they can remain safe at home.

The case for change

3.3 In recent years, the postal tectonic plates have been shifting. Royal Mail is committed to changing too, through significant investment in transformation. But we need Ofcom's regulatory framework to play its role and enable more innovation to generate good consumer outcomes as part of this review. It must also introduce mechanisms to enable ongoing flexibility so that Royal Mail can react quickly to changing market conditions.

3.4 The postal sector is changing at an unprecedented rate. Parcel volumes are growing rapidly. Royal Mail is a major physical delivery arm of the UK's flourishing e-commerce industry. Conversely, letters face ongoing and increasing structural decline. Before the Covid pandemic, addressed inland letter (AIL) volumes had already plummeted over 50% since 2004.[7] The arrival of the pandemic has only accelerated these trends - with AIL volumes falling by a further 20% in 2020-21.[8] As a result, over the last 11 years, the average number of items that our postmen and women are delivering per address has halved from two to one.[9] The Reported Business has not been able to achieve returns within the indicative 5-10% EBIT margin range deemed appropriate by Ofcom for some time.

3.5 We are undergoing a major transformation programme on the back of a union agreement struck in December 2020. This creates a platform to rebalance our business towards the rapidly growing parcels industry while delivering letters efficiently that is better aligned to the changing needs of customers. We can now introduce change more quickly, including the development of a 24/7 operation for parcels, and the rollout of new technology and automation - creating an enhanced infrastructure and a more efficient overall business. This year, Royal Mail will also simplify and improve its product offerings under a 'good', 'better', 'best' approach.

3.6 In the face of a rapidly changing industry, Ofcom's regulatory framework needs to adapt too. Customers require a contemporary USO which remains universal, uniform, affordable and high-quality. To achieve this, we set out below a series of priority areas for reform. But, beyond this review, regulation must remain flexible, enabling and supporting innovation at pace, while also providing the certainty needed for Royal Mail to invest in rebalancing towards parcels. This review is vital to securing a platform for Royal Mail to deliver the Universal Service demanded by the public, and for that service

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[2] Royal Mail User Needs Research, Illuminas, 2019
[3] Royal Mail User Needs Research, Illuminas, 2019
[4] Royal Mail User Needs Research, Illuminas, 2019
[5] Royal Mail User Needs Research, Illuminas, 2019
[6] Royal Mail Consumer Satisfaction and Brand Survey, Watermelon, 2020-21
[7] Internal Royal Mail analysis.
[8] Royal Mail Annual Report and Accounts, 2020-21
[9] Internal Royal Mail analysis.

to be delivered sustainably. Without reform, regulation will fast become a blocker to progress and innovation.

Flexible regulatory framework

3.7 For many years, the UK took a strongly pro-competition approach to postal regulation, against a backdrop of continuously rising letter volumes. We became the only country in the EU that mandated access and guaranteed a margin for access competitors. From 2005 onwards, however, the landscape changed profoundly. Letter volumes declined, and e-substitution took hold. The regulatory system, which was highly prescriptive, was unable to cope with these changing market dynamics.

3.8 In a sector such as post, with a high level of common and fixed costs and facing structural decline in letters, the wrong type of regulation can have serious consequences. Royal Mail's financial condition continued to worsen. By 2010-11, Royal Mail was balance sheet-insolvent and cash-negative, and the UK business was loss-making (in the order of £(120) million). Ofcom acknowledged this regulatory failure in its 2011 consultation: "*There is widespread recognition that the approach to regulation adopted in the past, has failed in the face of the particular circumstances affecting this sector*."[10]

3.9 The Postal Services Act 2011 (PSA) introduced a requirement that Ofcom secure the provision of the Universal Service. In a letter to Ofcom in 2011, Secretary of State Vince Cable noted that "*the Government is keen to ensure that regulation is lifted wherever possible… to give the universal service provider the necessary financial and commercial flexibility.*"[11] In 2012, Ofcom promised to *"grant Royal Mail further commercial and operational freedoms so that it could adapt to the considerable challenges facing the market"*.[12] We believe that this journey is not yet complete. The unique circumstances pertaining to post remain very much in place: an ongoing structural decline in letters, and intense competition in parcels. Ofcom's review is a timely opportunity to introduce more operational and commercial freedoms for Royal Mail, continuing the journey started in 2012.

Regulatory asks

3.10 The regulatory asks for increased commercial freedoms are set out in our responses to questions 5 and 6; the asks for financial sustainability and efficiency are set out in response to question 4; and the asks for scope of downstream access mandation are set out in response to question 7. We therefore focus the response to this question on addressing areas not discussed elsewhere in this document.

3.11 **We request that Ofcom removes remaining operational prescription in the form of red tape.** Operational red tape adds a significant regulatory compliance cost and slows our ability to change and innovate. We have identified the following examples:

- **Regulatory and financial reporting** - We are required to provide over 150 financial and non-financial reports to Ofcom every year. The vast majority of these are not required by Royal Mail management to run the business. Royal Mail is now more streamlined than ever due to the significant reduction in management headcount announced in 2020 and deployed by March 2021. Ultimately, customers pay through product prices for our overhead costs. Now is a good time to reset reporting to a more appropriate level that relies on existing management information.

  For example, on productivity reporting, we are required to provide an analysis of productivity and workload changes using 2015 planning values (PVs). This requirement should be removed as the values use historic assumptions that do not reflect operational reality. We invest considerable time and resource in making sure that our workload calculation reflects what we do now. 2015 PVs do

[10] Ofcom, Securing the Universal Postal Service, Proposals for the future framework for economic regulation, October 2011, Page 4, Para 1.21

[11] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31798/11-874-postal-regulatory-framework-letter-to-ofcom-postcomm.pdf

[12] Ofcom, Securing the Universal Postal Service, Decision on the new regulatory framework, March 2012, Page 1, Para 1.2

not reflect the changing volumetrics on average fill rates, planning values, etc, nor the improvement to our measurement of street time from delivery point growth.

- **Change control processes** - Following consultation, Ofcom reformed its process to monitor changes to Royal Mail's costing system as part of its review of Regulatory Financial Reporting in 2019. Ofcom had proposed a new requirement to report the impact of the methodology changes on products. At the time, we highlighted that the proposals would significantly increase the regulatory burden. Ofcom concluded that this change was necessary, but changed the requirement to an annual reporting obligation. In practice, this means that all data to support the original and new methodology needs to be collated over the year, as well as model structures. This is time-consuming and complex.

  The practical solution that we have put in place is to approve and implement methodology changes in Q4 only. We delay putting changes through at the time when they are first identified. As a result, during the year, our costing system is not necessarily reflective of what the year-end position will be, and it is therefore less useful as a management tool to understand within-year product costs. We ask that Ofcom removes the obligation to provide the full-year results with and without methodology changes. As part of the change control notification process, we will continue to provide Ofcom with an assessment of the impact of the individual changes each quarter.

- **Essential condition** - We encourage Ofcom to review and update the recording and reporting on incidents as required by the Essential condition. As government and police have explored "alternative"' outcomes, we too have sought to implement swift resolutions through our conduct code and civil restitution methods of loss recovery. Reflecting this change in approach to incidents in our reporting requirements would be more helpful and meaningful than the current specification.

- **Reporting inconsistencies for submission deadlines** - Ofcom's monitoring framework has evolved over time and has led to inconsistencies in reporting deadlines. Removing these deadline inconsistencies will be helpful to Royal Mail to ensure its efficient timely compliance with its regulatory obligations through a standardised reporting framework. For example, Consumer Protection Condition 3.3.14 states that a complaints report should be published by 30 June. Consumer Protection Condition 4.3.1 states that an annual compensation report should be published no later than three months from the end of the year to which it relates. We would welcome a review of the reporting deadlines, to put them on a consistent denomination - ie a certain number of working days from period end rather than the current mix of working days, days and months. We are not suggesting material changes to the reporting deadlines, but rather a consistency in terminology.

4. Efficiency and financial sustainability

4.1 Efficiency

Ofcom question 4.1: Do you consider that Ofcom's current approach to financial sustainability and efficiency of the universal postal service will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

We provide our feedback to question 4.1 in two sections: (1) efficiency; and (2) financial sustainability. This section focuses on **efficiency**.

Overview

Efficiency is fundamental to our success. That is why we have been investing many hundreds of millions in transforming our business and are continuing to do so - we have spent £0.7bn over the last three years and expect to invest a further c£[✂]bn over the next three years.[13] To enact meaningful operational change, we need to work 'hand in glove' with our people - through our managerial structures and our unions. Union support is vital in building buy-in to change. But it can also lead to differences of views and industrial unrest. This can delay reforms which unlock efficiencies.

We have undertaken a number of activities over recent years to drive efficiency and transform our operation, including:

- **Closing the Defined Benefit Pension Scheme** - In March 2018, we closed the Defined Benefit Pension Scheme. This avoided additional cash costs of £800m p.a. from April 2018,[14] equivalent to a 10% efficiency (using Ofcom's 'price, volume, efficiency and other' - PVEO - approach but recognising avoided pension costs).
- **Significant action due to Covid** - we took immediate steps to manage our costs, which should result in a £330m cost saving by 2021-22 and a capex cut of c.£250m (compared with our Journey 2024 plan) over two years.[15] We changed our operation, at pace, to protect our people, our society and our customers.
- **Rolling out transformation initiatives** - we have made good progress in deploying Parcel Sorting Machines and digital tools (eg Personal Digital Assistant Outdoor Actuals) that are key enablers for future change.
- **Delivering letters more efficiently** - we recently launched our new Economy product.

However, over recent years, we have not delivered as much change as we would have liked due to industrial unrest and, more recently, the Covid pandemic. **We have now signed a new deal with CWU[16] which is targeted to unlock significant change reflected in our draft 2021 Business Plan.** Our recent history demonstrates the importance of working together.

Much of Ofcom's current approach to efficiency of the Universal Postal Service remains appropriate for the next regulatory cycle. We agree with Ofcom that we have all the incentives we need to deliver on efficiency improvements.

We request that: (1) Ofcom refreshes its monitoring framework to include metrics that align to Royal Mail's new transformation plan and remove those that are no longer relevant; and **(2)** when Ofcom reviews our draft 2021 Business Plan, it confirms whether it views our efficiency ambition as

[13] Capital expenditure investment, excluding operating cost and voluntary redundancy costs.

[14] Royal Mail, 2017-18 Annual Results. The Royal Mail Defined Benefit Pension scheme was closed to future accrual "*to avoid expected increase in cash contributions to around £1.2 billion per annum*" and "*It is anticipated that the ongoing annual cash cost of pensions to the Company will continue to be around £400 million.*" This is therefore a net avoided cost of £0.8bn.

[15] Royal Mail, 2019-20 Annual Results. The £330m cost saving comprised £130m management restructure, and £200m non-people costs. The latter was intended to keep non-people costs flat year on year, subject to parcel growth.

[16] This agreement includes a two-year pay deal to March 2022. Further agreements will be required for future years.

"within a reasonable range". This added clarity will enable Royal Mail senior management (and all our people) to focus on the job of delivering on behalf of customers.

Context

4.1 Ofcom's Call for Inputs (CFI) set out its view of our recent efficiency performance. It stated: "*Efficiency performance continues to be a concern*"[17] and that many of the enablers of efficiency were behind schedule. We take this opportunity to set out our view of:

A. **Efficiency** performance - from 2009-10 to 2020-21.

B. Recent **transformation** progress.

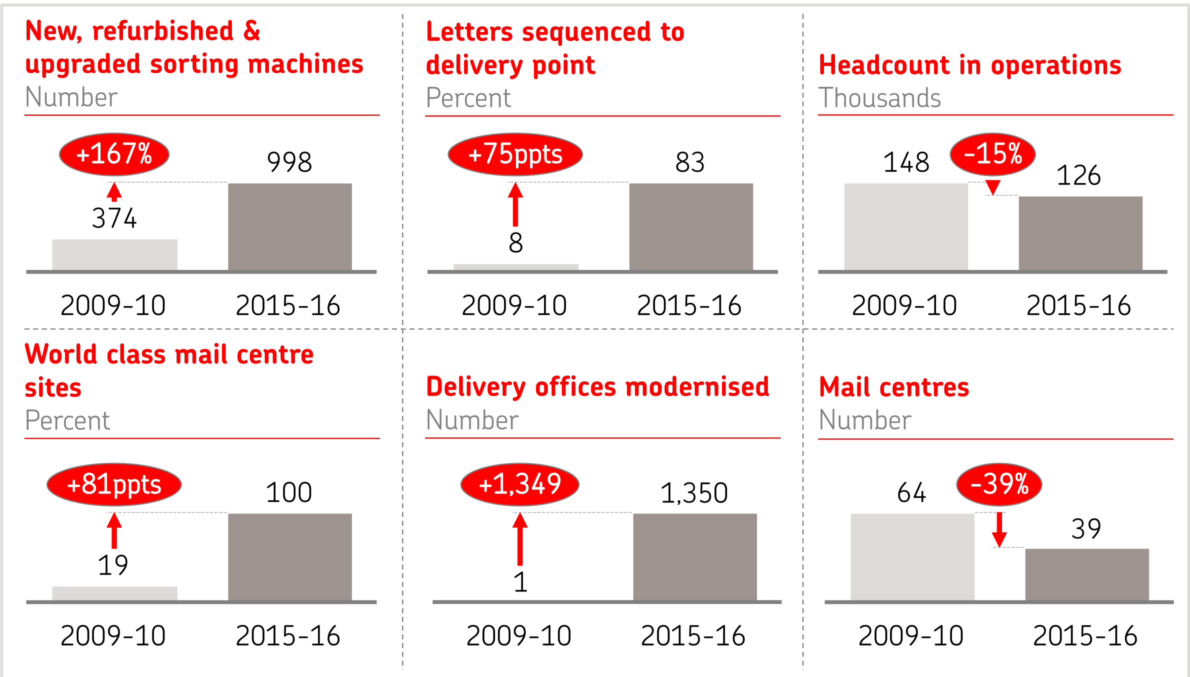
C. Delivering mail more efficiently through **innovation**.

D. Key elements of our **latest agreement with the CWU**, which sets up the potential for future transformation change reflected in our draft 2021 Business Plan.

A. Efficiency performance: 2009-10 to 2016-17

4.2 In August 2016,[18] we set out our view of Royal Mail's historic and expected efficiency performance. The figure below showed the significant strides in operational improvement that Royal Mail had made from 2009-10 to 2015-16, and the results of our modernisation programme. This programme ran during a period of significant letter volume decline and alongside the challenges of privatisation. We started transformation later than our international peers due to Government funding constraints. As WIK acknowledged, "*Royal Mail is implementing a number of major steps at the same time, illustrating the complexity of Royal Mail's transformation programme. Other postal operators tackled these challenges consecutively rather than simultaneously*".[19] Figure 4.1 provides a snapshot of key metrics at the time, demonstrating our modernisation achievements from 2009-10 to 2015-16.

Figure 4.1: Royal Mail key operating metrics, Royal Mail response to Ofcom's May 2016 Fundamental Review of the Regulation of Royal Mail (Exhibit 2.2)



[17] Ofcom, Review of postal regulation – Call for inputs, March 2021, Para 4.15
[18] Royal Mail, Response to Ofcom's May 2016 Fundamental Review of the Regulation, August 2016, Chapter 2
[19] WIK-Consult, Review of the Projected Costs within Royal Mail's Business Plan, March 2016, Page 14

4.3 Ofcom concluded, informed by WIK-Consult's review of our 2015 Business Plan, that "Royal Mail's future efficiency plans demonstrated greater ambition than its past performance and were within a reasonable range".[20]

Efficiency performance: 2017-18

4.4 In 2017-18, we continued to make good progress on cost-efficiency. UKPIL costs were flat year on year. We also exceeded our three-year cost-avoidance target (£500 million). We avoided around £640 million[21] of costs while continuing to deliver on our service and product innovation.

4.5 However, labour productivity was below our expectation. Our productivity target was to deliver 2 - 3% improvement p.a., and we achieved 1%. As stated in our Annual Results and Financial Statements for 2017-18: "*This was driven by the challenging industrial relations environment for much of the year, high levels of sickness-related absence and adverse weather conditions in the last month of the year*."

4.6 The industrial relations environment in 2017-18 was becoming increasingly challenging. We had set out a pressing need for us to close our Defined Benefit Pension Scheme. As part of our Annual Results and Financial statements for 2015-16, we stated that the Pension Scheme was not sustainable: "*Current financial market conditions suggest that keeping the Plan open to accrual in its current form beyond 2018 will not be affordable.*" At the same time, in June 2016, we wrote to our employees stating that discussions had started with the CWU on the future of the plan after March 2018. In January 2017, we announced a consultation on the scheme that closed in March 2017. In April 2017, we announced our plan to close it in March 2018.[22]

4.7 The CWU fundamentally disagreed with Royal Mail's position. The CWU's four pillars campaign included one pillar that was "*A lasting pension solution that delivers a decent wage in retirement*".[23] Discussions became increasingly challenging between CWU and Royal Mail, leading to a strike ballot in September 2017. It was only through a High Court Injunction that a 48-hour strike on 19 October 2017 was averted.[24]

4.8 The impact of the change in pension arrangements on our staff should not be understated.[25] Closing the pension scheme would, in many instances, lead to a fundamental reduction in people's retirement income expectations. This impact was greater for younger employees. For a 50-year-old Scheme C member with 30 years' service, the impact of the change was a 15% lower pension (excl. state pension). For a 30-year old with ten years' service, the impact of the change was a 50% lower pension (excl. state pension). Colleagues had complete visibility of the impact of this change on their pensions.

4.9 Following the High Court Injunction, Royal Mail and CWU returned to the negotiating table with mediation to work out a way forward. On 1 February 2018, the Pay, Pension and Pipeline agreement[26] was concluded. It closed the Defined Benefit Pension Scheme to new accrual, and provided pay increases and a shorter working week. Through these discussions, Royal Mail and CWU developed an innovative solution to the pension challenge - a Collective Defined Contribution (CDC) scheme for all employees.[27]

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[20] Ofcom, Review of the Regulation of Royal Mail, March 2017, Para 3.2

[21] Royal Mail, 2017-18 Annual Results and Financial Statements

[22] Royal Mail, Royal Mail 2018 Pension Review Update RNS, 13 April 2017

[23] CWU, LTB 28/17 – Pillars of Security, January 2017. https://www.cwu.org/ltb/ltb-2817-pillars-of-security/

[24] BBC, Royal Mail wins strike injunction, 12 October 2017

[25] These examples and impacts are sourced from a Royal Mail booklet provided to staff in 2017.

[26] Royal Mail, Royal Mail and CWU agreement and trading update RNS, 1 February 2018

[27] The CDC scheme is subject to necessary legislative changes being enacted. Transitional pension arrangements were put in place from 1 April 2018 until a CDC scheme could be established. These comprise a Defined Benefit Cash Balance Scheme and an improved Defined Contribution scheme.

4.10 However, due to the difficult industrial relations over 2017-18, progress on labour productivity was significantly affected. This was a necessary and difficult process to go through to enable the closure of the Defined Benefit scheme without a strike, and avoided an increase in Royal Mail's contribution to the Pension Scheme from c£0.4bn to c£1.2bn p.a. - a saving of £0.8bn p.a..

Efficiency performance: 2018-19 and 2019-20

4.11 In Ofcom's most recent annual monitoring report on Royal Mail's performance, it states: "Royal Mail did improve its performance against some of our efficiency metrics in 2019-20, we continue to be disappointed by its overall efficiency performance."[28] We recognise that we have not made as much progress on efficiency as we intended. The Pay, Pension and Pipeline Agreement was concluded in February 2018. The after-effects of the industrial dispute led to a delay in the implementation of cost-avoidance projects and productivity initiatives in 2018-19. During 2018-19 we sought to make significant changes to our network at pace. This created further tension with CWU and Unite, and led to a significant slowdown on transformation.

4.12 During 2019-20, industrial relations worsened. There were a variety of issues, including our proposed transformation plan to pivot from a letters business to a parcels business that delivers letters efficiently. A strike ballot was called in September 2019, which was overturned by the High Court[29] and followed by a strike ballot in February 2020.[30] The worsening industrial relations climate had a significant impact on our ability to transform, and affected productivity in 2019-20.

4.13 Industrial harmony with our unions is vital for the long-term health of the Universal Service. One or more material disagreements or disputes could result in widespread localised or national industrial action. This would cause material disruption to our UK business, affecting the service that our customers receive, and would be likely to result in an immediate and potentially ongoing significant loss of revenue. It may also cause Royal Mail to fail to meet the Quality of Service targets on Universal Service products set by Ofcom. This, in turn, may lead to enforcement action and fines and a loss of customers and revenue.

4.14 As set out below, we believe that Ofcom's approach to measuring efficiency does not fully recognise the progress that we have made over this period. As we have said before, we disagree with Ofcom's Price, Volume, Efficiency and Other (PVEO) methodology. Ofcom's approach uses the Consumer Price Index (CPI) as the price inflator, and a narrow view of volume (workload). We believe that the Retail Price Index (RPI) is a more realistic price inflator. We note that CWU, as with all unions in the UK, still negotiates on the basis of RPI.[31] The impact of workload on our network is more widespread. Ofcom's PVEO calculation does not recognise that increased workload (i.e. demand) will lead to increased costs in national distribution, so Ofcom's view of efficiency, measured by PVEO, will be understated. Further, it does not recognise the pension cost saving as efficiency. Using our methodology, the PVEO metric shows efficiency progress made in 2018-19 and 2019-20,[32] albeit at a lower rate than in previous years.

4.15 Ofcom's metrics do not capture the £800m in avoided costs that Royal Mail delivered through the 2018 Pay, Pension and Pipeline agreement. The efficiency progression is very different when this saving is included. We have estimated what these metrics would look like having included this avoided cost. We estimate that the PVEO efficiency metric increases to 10%[33] - which is larger than the PVEO

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[28] Ofcom, Annual monitoring update on Postal Services, 2019-2020, Para 6.40

[29] See BBC, Royal Mail wins bid to halt Christmas postal strikes, 13 November 2019

[30] Royal Mail, Outcome of ballot for industrial action RNS, 17 March 2020

[31] See https://www.tuc.org.uk/news/union-leaders-call-rpi-be-renewed-not-scrapped and http://www.cwu.org/wp-content/uploads/2021/01/CWU-Response-to-Treasury-UKSA-RPI-Consultation-17-August-2020.pdf

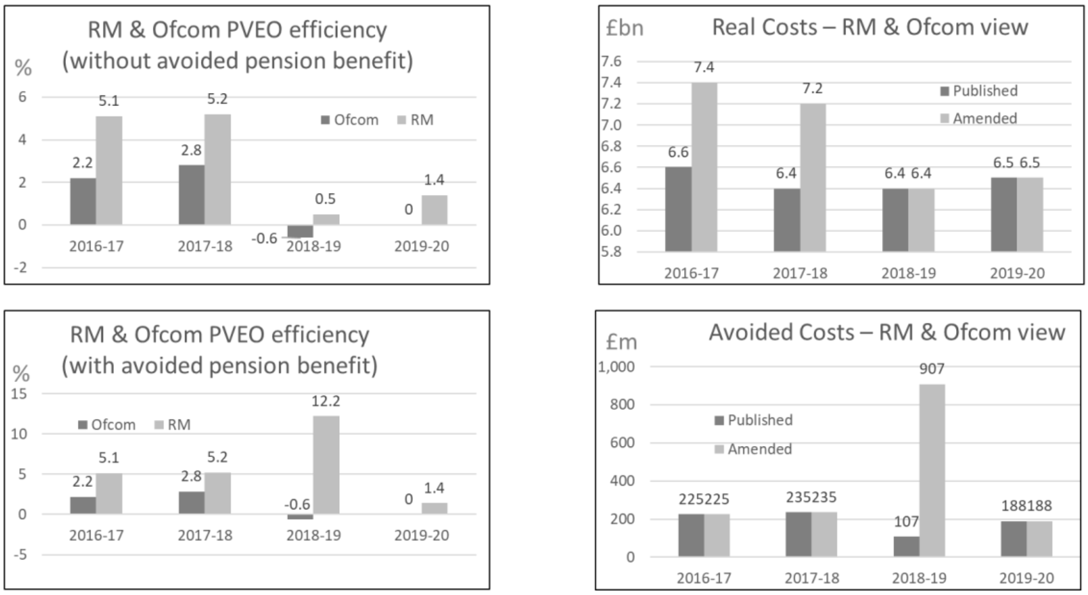
[32] Royal Mail's PVEO submissions are provided to Ofcom confidentially as part of Royal Mail's regulatory reporting obligations.

[33] Opening cost base of £6,709m increased by £800m = £7,509m. Efficiency is £800 - £42m = £758m. PVEO efficiency is £758m / £7,058m = 10% using Ofcom's assumptions. Using Royal Mail's assumptions of RPI and a broader volume driver, the PVEO efficiency is 12.2%, as shown in the chart.

efficiency benefits over the previous five years using Ofcom's PVEO methodology. It is a fundamentally different perspective on the progression of efficiency. This is shown in the Figure 4.2 below.[34]

Figure 4.2: Ofcom efficiency metrics – as published and amended for avoided pension cost benefit

In our view of the PVEO efficiency, we have been efficient over the last four years. When the benefit of the avoided pension cash cost is included, there has been noticeable efficiency improvements in 2018-19.



Efficiency performance: 2020-21

4.16 When Covid struck, we (1) prioritised doing the right thing – protect our people, our society and our customers; and (2) took immediate and drastic cost action. At our 2019-20 annual results, our interim Executive Chair set out three key areas of operational change that would reduce Royal Mail's cash outflow. We are on track to deliver all of these savings:

- **Significant management restructure** - We had to take some difficult decisions in 2020-21. We set ourselves the target of delivering £130m of savings from 2021-22 through the removal of around 2,000 managerial roles out of a total population of around 9,700. Within this target, our senior management population reduction was even more significant, at 50% reduction.
- **Capex savings** - We have targeted a reduction of c£250m over two years compared with the Journey 2024 plan. This was intended to be delivered through cancelling projects, deferring projects, driving down the cost of projects, and exploring leasing options. We remain committed to our investment in parcels and parcel hubs.
- **Addressing non-pay costs** - We targeted a £200m cost saving in 2021-22 across procurement, admin costs and managing our demand.

B. Transformation progress

4.17 Ofcom's Annual Monitoring Report for 2019-20 explained that we had made some progress on our transformation in certain areas but not in others. In our view, we have made good progress on our digital tools (as set out below). These are key enablers for our efficiency improvement and provide a platform to leverage benefits in the future. We have changed our operation, such as the successful roll-out of parcel sorting machines (PSMs). Our parcel hubs are behind our Journey 2024 ambitions,

[34] Information is from Royal Mail's confidential PVEO schedules and Ofcom's Annual monitoring updates on the Postal Market. Real costs chart includes an amended view where the impact of the avoided cash is shown as if a cash payment of £0.8bn was made in 2016-17 and 2017-18. Avoided cost chart includes an amended view where the impact of avoided cash of £0.8bn is shown in 2018-19.

but we have firm plans for when these will be launched. We have made efficiency improvements on letters including in our Postbox Strategy, delivery to specification, and removing letter-sorting machines.

Digital Initiatives

4.18 Digital **tools in use** - Ofcom has noted progress - Personal Digital Assistant Outdoor Actuals (PDA OA) has been implemented and is increasingly used. Final Mile Optimisation (FMO) is being used to design route revisions. These are important enabling changes:

- **PDA OA:** The alignment of PDA devices to planned routes has improved the visibility and control of outdoor activity. It has facilitated the ability to create fair and manageable workloads. It is enabling more informed and effective decisions on workload-based resourcing plans through the use of observed data.
- **FMO:** Ensuring routes are optimally planned is fundamental to operational efficiency. FMO delivered a platform that facilitated greater alignment of efficiency to workload through greater data accuracy and reduced route-planning cycle time.

4.19 Digital **tools not yet in use** - Ofcom noted that Automatic Data Hours Capture (AHDC) was in discussion between Royal Mail and CWU. This has two parts:

- **SISO (Scan In/Scan Out):** This is an underlying technology tool used as the automated solution for employees to log in and log out when starting and finishing work respectively. This provides more accurate data on attendance hours. National rollout has commenced in Mail Centres (MCs), with Delivery Offices (DOs) to follow. Installation of scanning equipment is expected to take 12 months. Full deployment is expected to take [✂].
- **Resource Scheduler:** This optimises efficiency by accurately and automatically allocating and aligning resource to workload. Trial activity is underway, delayed due to Covid, but is due to complete in May 2021 in two MCs, one regional distribution centre and two DOs. Evidence from the trial, when complete, will inform a national rollout.

4.20 Royal Mail has also implemented **Traffic Transformation**. This has simplified, standardised and made more efficient and accurate our mail traffic recording and reporting. It has replaced manual, paper-based counts with digitally enabled recording, harnessing focused sampling where appropriate.

Operational Initiatives

4.21 Ofcom reviewed four operational initiatives:

- **Revisions** – Ofcom noted that Royal Mail had implemented 73 in 2019-20 and was targeting 300 in 2020-21.[35] 2020-21 performance was affected by Covid - we delivered eight revisions by March 2021. We address the latest plans for revisions under the Pathway to Change section below.
- **Parcel automation** - Ofcom noted our plan to significantly increase parcel sortation. We have done so - 20 PSMs are currently in service, with the next one currently under construction and expected to be online by summer 2021 - see Figure 4.3 and 4.4 below.

[35] Royal Mail, Annual Results and Financial Statements, 2019-20

Figure 4.3: PSM - Parcels are fed in, scanned and sorted into yorks.

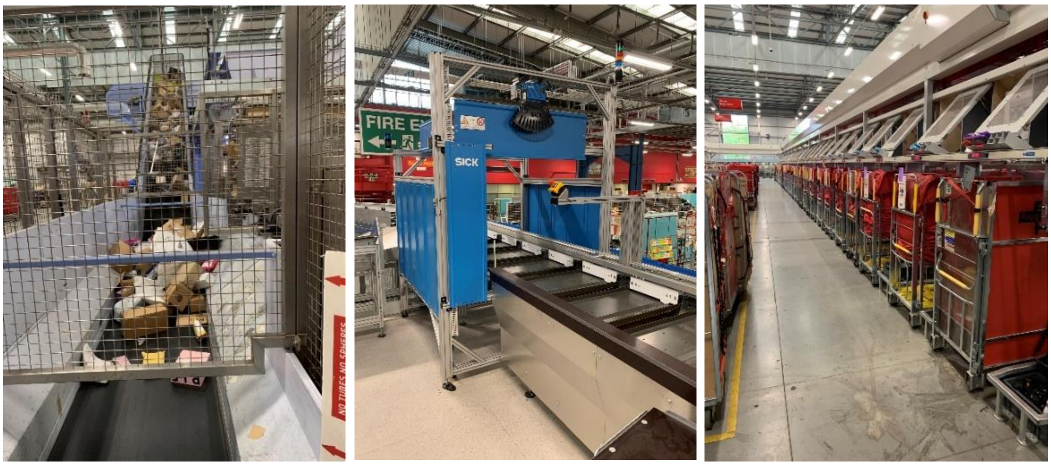


Figure 4.4: PSMs in service

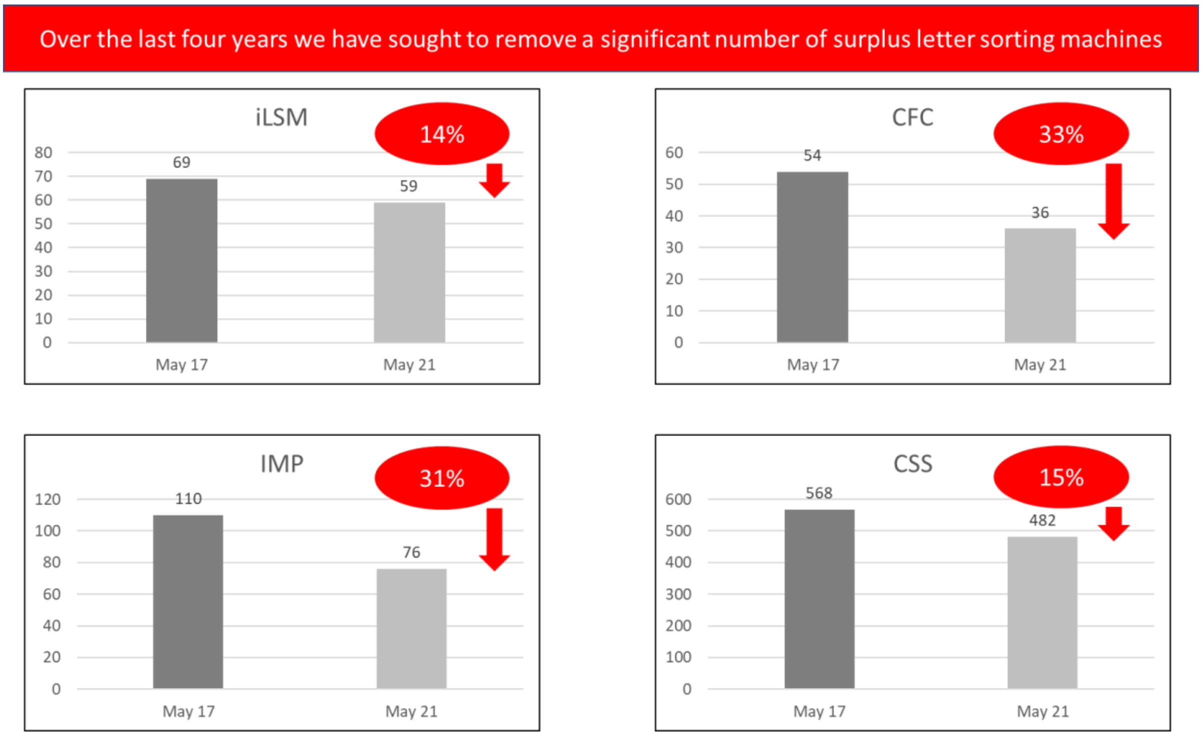
	2016-17	2017-18	2018-19	2019-20	2020-21
	Swindon	Home Counties North Chelmsford Greenford	Warrington South Midlands Jubilee Gatwick Birmingham Leeds	Preston Sheffield Bristol Manchester Peterborough Glasgow Home Counties North 2 Bristol 2	South Midlands 2 Jubilee 2
Total	**1**	**4**	**10**	**18**	**20**

- **Automated Parcel hubs** - Ofcom notes that our plans are about a year behind for the rollout. We announced in May 2019 our plan to launch three hubs. Parcel hubs are bespoke, high-cost and complex. The contractual and design negotiations for the parcel hubs were more complex than anticipated at the start. This led to a delay in agreeing the final design and contract for the first hub (North West, NW). The NW hub will be launched in May 2022, and the Midlands hub in 2023.
- **Dedicated parcel routes** - Ofcom notes that our plan set out in May 2019 was to trial dedicated parcel routes up to 2020. Trials started in early 2020 but were, inevitably, affected by Covid. The Pathway to Change agreement allows us to deploy dedicated parcel deliveries in all offices where appropriate, and these will be considered in the context of the structural revisions. Meanwhile, supporting processes and technology development (eg delivery manifests) are being further developed and refined.

4.22 There are a number of other operational improvements. These include:

- **Removing letter-sorting machines to optimise the MC estate.** The layout of MCs was typically designed to optimise the efficient handling of letters. With the significant switch in traffic between letters and parcels, we are having to reconfigure our MCs to efficiently handle the new traffic mix. Figure 4.5 shows how we have reduced the volumes of our four different letter-sorting machines over the last four years – see Annex A for more details on different letter sorting machines.

Figure 4.5: Reduction in letter-sorting machines



- **Changing Postbox collections from dedicated van collection to collection on delivery.** We developed a balanced proposition to improve Royal Mail efficiency on low-usage postboxes while ensuring that our customers retain access. Our postmen and postwomen collect mail from postboxes whilst on delivery rather than on dedicated collection routes. This structural change enables us to remove some fixed cost. Our Postbox strategy (PBS) programme began in 2014. PBS phase 1 successfully moved 52k postboxes[36] from a dedicated evening collection to Collection on Delivery, and in 2018 PBS phase 2 moved a further 10k postboxes to collection on delivery. We carefully monitored customer feedback and made changes to our rollout plans where required. We deployed PBS without any significant concerns from the public. We are now in the early planning and deployment for PBS Phase 3.

C. Delivering mail more efficiently through innovation

4.23 We can also deliver efficiency through product innovation as well as good outcomes for our customers. For example, on 4 January 2021, we introduced a new suite of access services[37] - DSA economy Letter (Mailmark) access services - which enable us to deliver letters more efficiently. The new services "defer" the letter until there is another item already being delivered to the recipient's address, subject to a maximum of four working days after it enters our network. This enables more efficient delivery of letters through improving the number of items delivered when a postman or woman delivers mail to an address (i.e. the "call rate"). It also provides bulk customers with greater product choice.

D. Royal Mail and CWU - a new agreement and way forward

4.24 In the UK, we recognise two unions: CWU and Unite/CMA. Around 89% of our operational and administrative-grade employees are members of CWU, and approximately 65% of our managers are members of Unite/CMA. In the UK around 99% of employees are covered by our agreements with these two unions. We work closely with our unions with the aim of maintaining a productive and positive relationship. Our agreements with them are designed to support industrial stability. The key focus for the past year has been to ensure colleague safety while delivering customer services. The

[36] Figures quoted in this section were provided to Ofcom as part of a confidential update on PBS Phase 3 in July 2020.
[37] https://www.royalmailwholesale.com/news/access-notice-mailmark-economy-service-standard

pandemic brought major changes in customer demand and operational challenges. At the same time, we have worked with our unions to secure the financial position of the Group and create foundations for future success.

4.25 We are pleased that Ofcom recognised and called out the recent agreement between Royal Mail and CWU - Pathway to Change - in its CFI. This agreement gives us a runway to achieve material productivity improvements. All parties are working very well together, and the deployment of the agreement is on track. And most importantly, we are changing our relationships and mindset. This has allowed us to move faster to make changes that will benefit our customers, including the provision of new services such as Sunday deliveries.

4.26 Through Pathway to Change, we have an opportunity to work with CWU to transform Royal Mail at pace. Some of the key points in the agreement are:

- **Joint working group on productivity.** This group has already agreed a common productivity metric of Weighted Items Per Work Hour (WIPWH). This was an outstanding point of difference from the previous negotiations and represents a major step towards a common way to view and assess performance across DOs and MCs.

- **Revisions across our DO and MC estate**. We are carrying out revisions to improve productivity (WIPWH) across our estate. Different offices now have different productivity targets to ensure that the less efficient offices catch up with the more efficient offices. As each unit undertakes its revision process, this enables the second hour of the shorter working week to be implemented. The expectation is that all c1,300 DOs and 37 MCs will have undertaken a revision (400 DO revisions and all MCs are structural; the remaining DO revisions are desktop) by October 2021. Revisions for collections and national distribution will also be undertaken. This is very ambitious. It will be the first time that we will have undertaken this number of revisions in a ten-month period.

- **Network review.** The findings of our network review, which we have been conducting jointly with CWU, support the need for greater automation in the existing MC estate, as well as the need for additional hub capacity. We are now working with CWU to undertake more detailed future modelling and planning over the coming months.

4.27 The Pathway to Change agreement is a key enabler for the productivity savings in our draft 2021 Business Plan. Good progress is currently being made, but the success of the agreement is dependent on actual change happening at pace in our operation. We have had previous agreements that have not delivered on necessary change. We will be closely monitoring progress against key milestones.

Use Royal Mail's Transformation metrics in Ofcom's monitoring

4.28 We agree with Ofcom that "market conditions and shareholder incentives were more likely to be effective in securing an efficient universal postal service than the imposition of additional regulation."[38] We have all the incentives we need to improve efficiency. Senior executives, management and our staff have strong incentives to improve efficiency:

- There is a clear link between company performance and the payment of any bonuses (note that senior management have not had bonus payments for two years due to thresholds not being met).

- Management at all levels are incentivised to support the return to profit.

- Our staff are shareholders.

- Our staff know that the success of our company relies on our ability to transform. In turn, the success of our company enables Royal Mail to afford to pay good wages with industry-leading terms and conditions.

[38] Ofcom, Review of postal regulation – Call for inputs, 2021, Para 4.12

4.29 We agree that Ofcom's approach to monitoring should "*avoid the risk of regulatory micromanagement or failure.*"[39] It was the commercial and operational freedoms provided in the regulatory settlement of 2012 that provided the foundation for Royal Mail to improve its efficiency and profitability in the initial years following the introduction of the new regulatory framework.

4.30 The Postal Services Act 2011 recognised that it will take time to become efficient, stating that the provision of the Universal Postal Service should be "*…efficient before the end of a reasonable period…*"[40] We consider carefully the level of efficiency that we can reasonably achieve over different time periods. If we drive change too hard through major operational or pay-related initiatives, this could have consequences for our quality of service and/or revenues. Major operational changes come with implementation and technical risks. Going too fast could lead to disruption of service as the operation struggles to deal with complex change. Driving too hard could affect our industrial relations and adversely affect the co-operation between staff and management in delivering for our customers and implementing change. Ultimately, it could lead to industrial action. So, in formulating our plans, we take account of both the need to become more efficient and the rate of change that our business can deal with while continuing to deliver a high-quality service to all our customers.

4.31 In this context, with our new CEO, learnings from the past Covid year, and a new agreement with CWU, we have produced a stretching and ambitious draft 2021 Business Plan. We will engage separately with Ofcom on this plan, which will set out "leading" metrics - for example, our progress on our new parcel hubs and on our PSM rollout. These leading metrics will provide early insight into whether we are on track to deliver the efficiency savings in our Business Plan.

When Ofcom reviews our draft 2021 Business Plan, it should confirm whether or not it views our efficiency ambition as "within a reasonable range".

4.32 Due to the unique nature of the market dynamics faced by Royal Mail, our regulatory framework is, rightly, significantly different to utility-style regulation. In utility-style regulation, the Regulator's efficiency expectations are set out clearly through the setting of charge controls. This system of price controls is clearly not appropriate for the postal industry.

4.33 Ofcom is not silent on efficiency. It publishes its view of Royal Mail's performance in its Annual monitoring report. Ofcom's benchmarking of parcel automation, published in its most recent report, was helpful, specific and targeted analysis. We also found it helpful that Ofcom said our plans would bring us "*more closely in line with the parcel operation and levels of automation of its European peers*".[41]

4.34 We agree with Ofcom that it should not set efficiency targets. The market provides the appropriate incentives for us to set challenging efficiency improvements as demonstrated by our ambitious Business Plan. Nevertheless, there are clear benefits from increased transparency on Ofcom's view of efficiency. One of the factors that Ofcom will consider, when thinking about potential changes to the regulatory framework, is whether Royal Mail is making sufficient progress on efficiency improvement. Our draft 2021 Business Plan is stretching and ambitious in terms of the transformational change and productivity improvements over the next three years. It leverages our recent Pathway to Change Agreement.

[39] Ofcom, Review of postal regulation – Call for inputs, 2021, Para 4.20
[40] https://www.legislation.gov.uk/ukpga/2011/5/section/29, Para 3
[41] Ofcom, Annual Monitoring Update on Postal Services 2019-20, Para 6.40

Regulatory asks

4.35 We ask that Ofcom update its approach to monitoring to include metrics that align to Royal Mail's new transformation key metrics such as progress on parcel hubs and parcel automation, and remove those that are no longer relevant. This will provide a clear metric that Ofcom can use to monitor Royal Mail's transformation progress. At the same time, there is the opportunity to refine and reduce the existing regulatory reporting obligations (see response to 3.1). We would welcome further discussion with Ofcom on these metrics in order to understand whether they provide the information that Ofcom would find helpful in monitoring our efficiency improvements and hence help to secure the provision of the Universal Service.

4.36 We ask that, when Ofcom reviews our draft 2021 Business Plan, it confirms whether it views our efficiency ambition as "within a reasonable range". Our draft 2021 Business Plan is stretching and ambitious in terms of the transformational change and productivity improvements over the next three years. The added clarity from Ofcom in terms of its expectations will enable Royal Mail senior management (and all our people) to focus on the job of delivering on behalf of customers.

Annex A – Different letter sorting machines

iLSM (Intelligent Letter Sorting Machine) Used to sort letters to batches and used to walk sequence to delivery walk order	
CSS (Compact Sequence Sorter) Used to sort batched letters to delivery walk sequence order	
CFC (Culler Facer Canceller) Used to cull, face and cancel the mail ready for next stage of sorting	
IMP (Integrated Mail Processor) Integrated because it performs both CFC and LSM functions	

4.1 Financial sustainability

Ofcom question 4.1: Do you consider that Ofcom's current approach to financial sustainability and efficiency of the universal postal service will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

We provide our feedback to question 4.1 in two sections - (1) efficiency; and (2) financial sustainability. This section focuses on **financial sustainability**.

Overview

Ofcom's regulatory framework, including its approach to financial sustainability, was largely effective in the initial years following its introduction in 2012. The commercial and operational freedoms granted provided a platform from which Royal Mail could take action to improve the profitability of the Universal Service, securing the provision of the Universal Service.

Over the last five years, however, the returns on the Reported Business[42] have fallen materially outside the commercial rate of return.[43] Ofcom has increased its monitoring of Royal Mail over this period. Despite a significant deterioration in our financial position, Ofcom has not taken action. It is not clear to us in what circumstances Ofcom would act and what form that action would take.

We have invested heavily in our core Universal Service network, and continue to do so. To make these investments, we need to be able to raise funds from debt and equity markets. We need to be confident that our investors have a reasonable expectation of making returns on their investment. Clarity and transparency on the regulatory framework are key to providing confidence to investors and hence secure the provision of the Universal Service.

With the help of Oxera, we have considered the appropriate approach to use in assessing financial sustainability of the Universal Service. We propose an approach that includes profit alongside debt and equity metrics. We will use this to help to inform discussions with our banks and investors.

For each of the proposed metrics, we believe that it would be helpful to identify the tramlines indicating where there are no financial sustainability concerns (green), where there are signs of concern (amber), and where there are major concerns (red). This clarity would be helpful for both Ofcom and Royal Mail. We would also welcome a discussion on how the Environmental, Social and Governance (ESG) agenda should be factored into the regulatory framework.

We ask that Ofcom and Royal Mail work together on the following areas:

1. Enhancing the approach to monitoring financial sustainability to include equity metrics. It would be helpful to understand Ofcom's view on both our dividend and capital allocation policy.[44]
2. Enhancing the approach to monitoring to include "tramlines" to identify when there may be financial sustainability concerns.
3. To have a clearer understanding of the interventions and supportive action that Ofcom could take to secure the provision of the Universal Service.
4. The implications of stakeholders' demands for progress on ESG for the regulatory framework.

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[42] Ofcom defined the Reported Business as the regulatory entity which contains the Universal Postal Service network and all the products provided through or in relation to that network. Ofcom, Review of the Regulation of Royal Mail, March 2017, Footnote 34

[43] Ofcom, Securing the Universal Postal Service, 27 March 2012, Para 5.47 "*An indicative EBIT margin range of 5% to 10% is appropriate and consistent with the need for Royal Mail to earn a reasonable commercial rate of return commensurate with the level of risk within the business.*"

[44] Our capital allocation policy sets out our approach to capital management. This is how we allocate our capital between investing in the business for growth, supporting our credit rating, paying dividends, and M&A activity.

Context

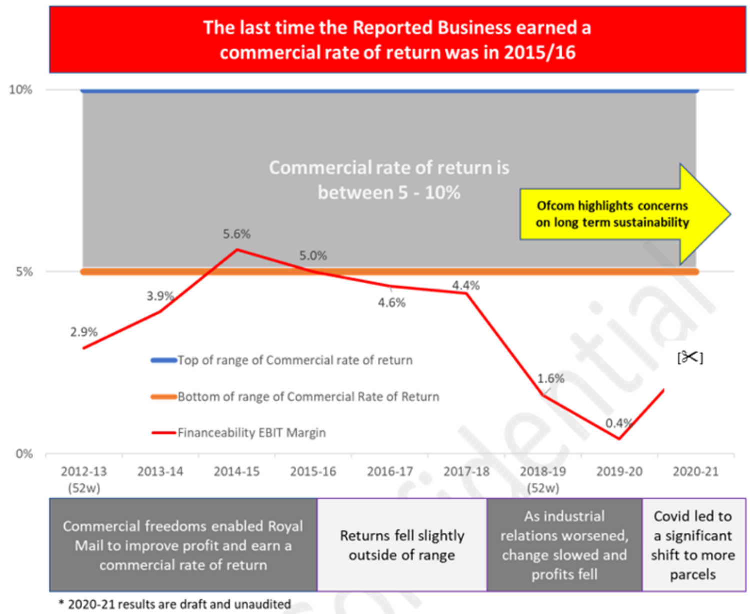
4.37 Under the Postal Services Act 2011 (PSA), Ofcom's primary duty is to secure the provision of the Universal Postal Service. The PSA states that, in exercising this duty, Ofcom "*must have regard to the need for the provision of a universal postal service to be financially sustainable*" and "*efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times.*"[45] The financial sustainability requirement "*includes the need for a reasonable commercial rate of return for any universal service provider on any expenditure incurred by it for the purpose of, or in connection with, the provision by it of a universal postal service*".[46] The regulatory settlement that Ofcom put in place in 2012 reflected these responsibilities.

4.38 The framework was a significant step forward from the Postcomm regime. It recognised that, in the vast majority of cases, price controls were not appropriate in the postal sector. The normal regulatory toolkit - price control based on a reasonable return (weighted average cost of capital) on a regulatory asset base and efficiency targets - does not work in post. This was recognised by Ofcom, which put in place a unique regulatory framework for post in 2012 and reconfirmed it in its 2017 regulatory settlement. It provided Royal Mail with greater operational and commercial flexibility, enabling Royal Mail to respond more quickly to the changing market dynamics (letters in structural decline, parcel growth) and manage our high operational gearing (high proportion of fixed costs).

4.39 In the early years of the Ofcom regime, when assessing financial sustainability, there was a focus on the EBIT financeability margin. Ofcom provided guidance that it believed an indicative 5-10% margin on the Reported Business was commensurate with a commercial rate of return. It further enhanced its approach to monitoring financial sustainability in 2017 by including additional Group debt metrics and other measures, such as taking account of Royal Mail's Viability Statement in its Annual Results.[47] We were supportive of these additions.

4.40 History suggests that this approach was largely effective for the initial years following the introduction of the new regulatory framework - see Figure 4.6 for the history of the Reported Business margin from 2012-13. The new commercial and operational freedoms enabled Royal Mail to drive transformation, radically reducing our mail centre footprint, increasing productivity, and driving innovation (see response to Q6.1 and 6.2 on parcel innovation and Q4.1 on efficiency for further information). This approach was an important element to enabling the successful privatisation of Royal Mail in 2013.

Figure 4.6: Reported Business Financeability EBIT margin



45 https://www.legislation.gov.uk/ukpga/2011/5/section/29, Para 3

46 https://www.legislation.gov.uk/ukpga/2011/5/section/29, Para 4

47 Ofcom, Review of the Regulation of Royal Mail, March 2017, Para 3.63

There is a lack of clarity and transparency in Ofcom's approach to financial sustainability

4.41 However, the challenges over recent years,[48] manifesting in low returns, have highlighted the need to enhance the toolkit for assessing the financial sustainability of the Universal Service. Royal Mail has become increasingly concerned about the toolkit used by Ofcom to assess whether there is a financial sustainability issue for the Universal Service and the potential for regulatory intervention.

4.42 For the last five years, the EBIT margin on the Reported Business has been below the commercial rate of return. In June 2020, we announced that we expected to be significantly loss-making in 2020-21. During this period of deteriorating financial performance, Ofcom stepped up its monitoring of Royal Mail, although it did not intervene. It is not clear to Royal Mail when and whether Ofcom would take action, and what form that action would take. We believe that there needs to be more clarity on Ofcom's approach to financial sustainability, including potential supportive regulatory interventions. This clarity would be helpful for both sides. We have engaged Oxera to help develop our thinking on the appropriate toolkit.

A transparent approach to financial sustainability supports incentives to invest

4.43 We want to deliver a high-quality, market-funded Universal Service. To do this, we need to invest to transform our business. To attract capital, investors must have a reasonable expectation of making sufficient returns given the risks associated with the business they are investing in. We know that the regulatory framework cannot provide a guarantee of a return, but greater clarity would deliver better incentives to invest and secure the provision of the Universal Service.

4.44 Government recognised the importance of the Universal Service Provider being able to make a commercial rate of return by explicitly including this requirement in the PSA. At that time, Baroness Wilcox stated that "*it is not within the gift of the regulator to determine precisely what returns Royal Mail can make; that should depend on the market and the company's performance. However, it is essential that the regulatory framework should provide the space and incentives for Royal Mail to be successful, to make the necessary efficiency improvements and to allow for good performance to be rewarded, without regulation eroding the effect of increased efficiency.*"[49]

4.45 Investment supports our drive to become more efficient - through greater parcel automation, new parcel hubs, and investments in technology to deliver letters more efficiently (eg our delivery to specification initiative). It also supports our commitment to a high quality of service and innovation - helping us to deliver new products, such as Parcel Collect, and additional service features, such as Inflight Redirections.

4.46 However, we need a regulatory framework that provides the stability, predictability and transparency that investors need in order to confidently invest in the network, to the longer-term benefit of users. By contrast, Ofcom's current Call for Input (CFI) raises a spectrum of potential major changes leading to an increase in uncertainty in the regulatory framework with the potential to undermine incentives to invest. We therefore call for further transparency on how Ofcom views financial sustainability, including when, why and how it would intervene. This will enable investors to understand whether the regulatory framework will support investment now and into the future.

Expanding the existing approach to take explicit account of equity metrics

4.47 The right regulatory framework is one that enables the Universal Service to be market-funded and for investors to have a reasonable expectation of earning a commercial rate of return. We consider that

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48 Market dynamics worsened - increased structural decline in letters, parcel revenue not offsetting letter revenue decline, and high fixed costs due to the Universal Service obligation - led to a deterioration in the Report Business EBIT margin.

49 https://publications.parliament.uk/pa/ld201011/ldhansrd/text/110517-0001.htm Column 1264

the regulatory framework put in place by Ofcom in 2012 has many elements that are appropriate for the next regulatory cycle.

4.48 We agree with Ofcom that the EBIT financeability margin, at the Reported Business level, is a key metric providing insight on the financial sustainability of the Universal Service. The Reported Business contains the revenues and costs associated with meeting the Universal Service Obligation (USO) - a one-price-goes-anywhere, six-day-a-week letter and parcel collection and delivery service.[50] The scale of the network required is significant: it must be capable of delivering to over 31 million addresses on a daily basis. This leads to high fixed costs. To ensure an efficient and effective service, we use the Universal Service network for other products, which enables customers to benefit from economies of scale and scope - with efficiencies passed on to customers. We need to be successful in parcels to ensure the long-term financial sustainability of the market-funded Universal Service. With letters in structural decline, we need to be able to sustain and grow our revenue from parcels.

4.49 On the EBIT financeability margin, Ofcom's 5-10% is the minimum appropriate indicative commercial rate of return. We believe that regulatory consistency on the EBIT margin is important, as this is a key metric for the Reported Business. Oxera has undertaken a high-level review of the returns that other European postal operators are achieving. This supports the continued use of the current 5-10% range as a minimum.

4.50 We also support the enhancements that Ofcom made to its approach to monitoring financial sustainability in 2017, bringing in debt metrics used by credit rating agencies. However, Ofcom's current approach has relied too heavily on these financial viability metrics (eg debt covenants, cash flow and other metrics) rather than sustainability measures.

4.51 We believe that a financially sustainable Universal Service provider should be able to maintain a comfortable investment-grade credit rating and a progressive dividend policy. Investors should have the ability to earn a reasonable return on their investment. However, if there is a need to suspend dividend payments and/or amend the credit rating, that would suggest that there may be cause for concern, and further consideration needs to be given to the reasons.

4.52 Since privatisation, we have had to change our dividend policy as we have not been generating sufficient cash to fund our transformation programme and our dividend policy. More recently, in 2019-20, Royal Mail announced that we were stopping dividend payments in order to deal with the significant financial challenges facing the business due to Covid.[51] We continued to fund investment. This significant action, of material financial consequence to our shareholders, was only covered in a footnote in Ofcom's 2019-20 Annual Monitoring Report, as it was not one of Ofcom's 'key metrics'. Inclusion of equity metrics would significantly enhance the current analytical toolkit for assessing financial sustainability.

4.53 However, not all relevant metrics are available at the Reported Business level, as it is a regulatory construct. Under our current Group structure, debt and equity are raised at the Group level. We believe that the Universal Service business should be self-funding. At this time, however, we have not calculated financial metrics at this level. We welcome discussion with Ofcom about whether there is merit in developing financial metrics at Royal Mail UK or Reported Business level. Figure 4.7 below sets out at what level the metrics are currently calculated.

[50] PSA 2011 requires a five-days-a-week parcel collection and delivery service. Royal Mail collects and delivers USO parcels six days a week.

[51] This was published in our Annual Report and Financial Statements for 2019-20.

Figure 4.7: Proposed and existing metrics

Metric	New or current metric	Calculated at:
Profitability		
EBIT margin	Current	Reported Business, Royal Mail UK and Royal Mail Group (RMG)
Debt metrics		
FFO/net debt	Current	RMG
Debt/EBITDA[52]	Current	RMG
EBITDA/interest[53]	Current	RMG
Liquidity	New	RMG
Equity metrics		
Dividend cover (if input)	New	RMG
Dividend yield[54] (if input)	New	RMG
Total shareholder returns	New	RMG

4.54 In addition to the inclusion of equity metrics in Ofcom's monitoring, it would be helpful to have Ofcom's view on both our dividend and capital allocation policy. Our capital allocation policy sets out how we allocate our capital between investing in the business for growth, supporting our credit rating, paying dividends, and M&A activity. We look for a consistent policy over time. A key part of capital allocation is the dividend policy, and we believe that a financially sustainable Universal Service provider should be able to maintain a progressive dividend policy. These policies are published in our Annual Report and Financial Statements. We would welcome Ofcom's view on our policies.

Benefit of "tramlines" around metrics

4.55 Ofcom's approach can be further enhanced by having greater clarity on the appropriate tramlines for assessing whether there is a financial sustainability concern. Oxera has looked at this from the perspective of the financial indicators that are important to debt and equity investors when considering the creditworthiness and attractiveness of Royal Mail as an investment proposition. Oxera has benchmarked the financially sustainability level using market evidence, and has identified some illustrative thresholds. We would welcome further discussion with Ofcom on the appropriate tramlines.

52 Current metric is based on our Group revolving credit facility covenant metrics methodology.
53 Current metric is based on our Group revolving credit facility covenant metrics methodology.
54 To work out dividend yield and TSR on forecast metrics requires a forecast of the share price. This may mean that applying these metrics to Business Plan data is too judgement-based, and these metrics may be more appropriate for use in historical monitoring.

Figure 4.8: Metrics and proposed tramlines

Metric	Likely cause for concern	Below financially sustainable level	Financially sustainable level
Profitability			
EBIT margin			
Debt metrics			
FFO/net debt (S&P)			
Debt/EBITDA (S&P)[55]			
EBITDA/interest (S&P)[56]			
Liquidity			
Equity metrics			
Dividend cover (if input)			
Dividend yield (if input)			
Total shareholder returns			

Tramlines to be discussed with Ofcom

4.56 On the basis of external benchmarking, Oxera has suggested three metrics for monitoring equity. Of the three, two require assumptions on share price - Total Shareholder Returns (TSR) and dividend yield. These metrics may be more appropriate (to avoid judgement) for monitoring historic performance. They would help to answer the question of whether our equity investors have earned a “commercial rate of return”, though obviously an element of this performance would relate to unregulated parts of our business.

4.57 Dividend cover could be used to assess future performance. For example, if it was not possible to adequately cover our dividend in future years of the Business Plan, that might indicate a long-term sustainability issue. It is important to note that, while dividend cover is a helpful metric, for the purposes of a forward-looking regulatory financeability assessment, the company’s actual dividend policy does not have to be set in accordance with a fixed payout of earnings or a certain dividend cover.

4.58 Our view is that a financially sustainable business is one that can maintain a progressive dividend policy over time - i.e. a stable, consistent and certain policy. We intend to set out our new capital allocation and dividend policy in our 2020-21 Annual Report and Financial Statements. This policy will describe the approach that the business will take to allocating capital between potential uses, such as re-investment, capital structure and shareholder returns. Should our Board subsequently decide to amend the policy (which could be due to ordinary dividend cover issues), we would suggest that there would need to be a process to understand the causes of the change and whether this indicates a threat to financial sustainability of the Universal Service. We would welcome engagement with Ofcom on how best to reflect equity metrics in the framework, including in order to understand Ofcom’s view of our dividend policy and capital allocation.

4.59 It is also important that Royal Mail retains efficient access to debt capital markets. As such, the debt metrics should fall within a range that returns a comfortable and sustainable investment-grade rating over the medium to long term, with headroom for a credible downside scenario.

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[55] Oxera suggests using S&P methodology for calculating debt/EBITDA.

[56] Oxera suggests using S&P methodology for calculating EBITDA/interest.

How this new 'toolkit' approach could be used

4.60 Financial sustainability is an inherently forward-looking question. We see clear benefits in having a transparent[57] toolkit for assessing the likelihood that the Universal Service will be financially sustainable in future years. The toolkit would also enable both Royal Mail and Ofcom to test out different scenarios/assumptions, including the impact of potential regulatory interventions on the projected financial outcomes. This toolkit could be used as an "early warning system" to provide guidance on financial sustainability concerns and hence whether corrective action is needed, either by Royal Mail and/or by Ofcom. It will be helpful to work through this approach with Ofcom, including how "red" metrics would be reviewed and addressed.

4.61 We will be using this approach to assess whether our Business Plan will support a financially sustainable Universal Service, using tramlines. A forecast, by its nature, will depend on key assumptions supporting that Plan. Different assumptions would inevitably lead to different outcomes. We will consider both our base case and a range of scenarios. As we have seen over recent years, Royal Mail faces significant uncertainties. A three-year time horizon will not be sufficient for assessing long-term financial sustainability, and a set of longer-term projections will be required. We suggest that this long-term projection is undertaken once per regulatory cycle (ie once every five to seven years) due to the additional resource it will take. We would not typically undertake such an exercise, as it is not needed by our business for operational or statutory reporting purposes, so we will need to invest time to consider the appropriate long-term assumptions, use them to extrapolate our financials, review and test. Such high-level modelling would by its nature be less granular than our Business Plan, to avoid unnecessary complexity in modelling spurious detail and accuracy.

4.62 The projections will be highly subjective and, as such, subject to a wide range of outcomes. Hence sensitivities will need to be developed. In considering the scenarios to be applied, we need to identify the main drivers of financial sustainability. Ofcom has stated that there are three main drivers of financial sustainability: growth in parcels, decline in letters, and cost transformation. We agree that these are key drivers of sustainability over which "*Royal Mail has either direct control or can influence*".[58] However, there is a fourth driver of financial sustainability - regulation. Unlike other regulated network businesses (such as network businesses in water, telecoms or energy), our investors do not have certainty on returns or revenues over the regulatory cycle. There is no regulatory-driven expected revenue over the next five years from 2022, and it is the market (parcel and letters) that will determine our revenues. Our costs will be shaped by our ability to deliver on our cost transformation journey, allowing that much of our cost base is framed by the requirements of the Universal Service Obligation.[59] However, our investors look for a stable regulatory framework. Clarity on when, why and how Ofcom may intervene will provide greater certainty to investors.

4.63 In assessing the financial sustainability of the Universal Service, we propose that Ofcom place significant weight in its consideration of financial sustainability in downside scenarios on Royal Mail's Business Plan for a number of reasons. First, we operate in a highly uncertain market and a radical cost transformation with execution risk. Second, Royal Mail is highly operationally geared. When volumes or workload fall, our costs fall by less, exposing Royal Mail to financial loss. Third, Ofcom's regulatory tools are asymmetric. It has more tools to lower returns, such as price controls or extending access mandation to lightweight parcels (see response to Q7.1), but appears to have limited (and sluggish) tools to raise returns, such as periodic reviews to change the regulation by, for example, including the option of having tracking in the USO. It does not have a significant price lever, unlike

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57 Transparency is also a general regulatory principle that is captured in the Communications Act 2003 Section 3 (3) ("*regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed*") and Ofcom's regulatory principles ("*Ofcom will strive to ensure that interventions are evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome*") https://www.ofcom.org.uk/about-ofcom/policies-and-guidelines.

58 Ofcom, Review of Postal Regulation Call for Inputs, Para 4.10

59 For example, we are required to deliver and collect Universal Service letters six days per week, as set out in the Postal Services Act 2011, with a high quality of service. Accordingly, we need to resource a comprehensive and robust network to do so.

other UK economic regulators. Some downside scenarios could occur quickly, such as significant market change or industrial action, whereas the time to deploy Ofcom's limited tools may not be sufficiently quick enough to address financial sustainability issues.

Dialogue on the integration of Environment, Social and Corporate Governance (ESG)

4.64 There are growing demands from customers, the Government, shareholders and the public at large for progress on ESG agendas. According to a YouGov survey of UK adults,[60] the environment is seen as the third most important issue facing the country. Global, national and local environmental policies - including the introduction of emission-based charging zones in several UK cities and the UK Government's ban on the sale of new petrol and diesel vehicles from 2030 - are driving the transition to low- and zero-emission fleets. Policymakers are particularly focused on reducing emissions from last-mile deliveries. For example, "decarbonising how we get our goods" is one of six strategic priorities identified by the UK Government for its Transport Decarbonisation Plan.[61] In terms of the social agenda, our postmen and women have been recognised as key workers during the pandemic, and we take our responsibility to appropriately reward them through good pay, conditions and benefits seriously.

4.65 We recognise the importance of the growing debate on ESG. This may have material impacts on how we run our business and our investment strategy going forward:

- On the **environmental agenda**, as one of the largest fleet operators in the UK, we recognise the part we have to play in reducing emissions and improving air quality in the communities we work in. Having the largest "feet on the street" network of 85,000 postmen and postwomen in the UK means that Royal Mail has the lowest reported CO_2 emissions per parcel among the major UK delivery companies. Our long-term carbon reduction ambitions are set in line with the 2015 Paris Agreement. We aim to reach net zero emissions by 2050.

- On the **social agenda**, Royal Mail prides itself on being a good employer with a strong track record on pay, pensions and other benefits. We offer high-quality jobs across the country. The nature of the Universal Service - where we walk every street in the UK to deliver mail - means we will always need a large workforce across each and every part of the country. The recent Supreme Court ruling on Uber[62] serves to underpin the growing importance of offering fair and reasonable employment terms and conditions in the UK.

4.66 However, the regulatory framework does not address these important matters. Ofcom's principal duty under section 3 of the Communications Act 2003 is to further the interests of citizens and of consumers, where appropriate, by promoting competition. Ofcom's current toolkit for assessing efficiency relies heavily on cost reduction. However, the ESG agenda may well lead to increasing costs for our business. We believe that there is merit in exploring with Ofcom how best to integrate ESG factors into the regulatory framework. We note that, in other regulated sectors, there will be explicit allowance built into price controls to fund environmental investment (eg energy and water). This is not an option under our current regulatory framework.

Regulatory asks

4.67 We propose that Ofcom and Royal Mail work together on the following areas:

1. We ask that Ofcom's approach to monitoring financial sustainability is enhanced to include equity metrics, recognising the significant role of equity in financing the Universal Service. Further details on the metrics are set out in the Oxera report (see Appendix "Financial sustainability of the universal postal service"). It would be helpful to have Ofcom's view on both our dividend and capital allocation policy.

[60] As of 5 April 2021: https://yougov.co.uk/topics/politics/trackers/the-most-important-issues-facing-the-country

[61] Decarbonising Transport: Setting the Challenge, Department for Transport, March 2020

[62] See: https://www.supremecourt.uk/cases/docs/uksc-2019-0029-judgment.pdf

2. We ask that Ofcom's approach to monitoring financial sustainability is enhanced to include "tramlines" to identify when there may be financial sustainability concerns. In this approach:

   - When Ofcom assesses our Business Plan, we ask that it gives sufficient weight to downside scenarios in Royal Mail's Business Plan.
   - In considering scenarios, Ofcom should include an assessment of how changes to the regulatory framework could affect the ability of the Universal Service to earn a commercial rate of return.

3. It would be helpful to have a clearer understanding of the interventions and supportive action that Ofcom could take to secure the provision of the Universal Service.

4. We ask to discuss the implications of stakeholders' demands for progress on ESG for the regulatory framework. Royal Mail takes the ESG agenda seriously and is investing significantly to address many of the issues. We ask that Ofcom's approach to regulation, including its assessment of efficiency, can be enhanced to actively promote and reward good environmental and societal outcomes. This may require Ofcom to obtain wider powers from Government in this area.

5. Universal Service Obligations

5.1 Affordability and safeguard caps

Ofcom question 5.1: Do you consider Ofcom's approach to the safeguard cap and ensuring affordability will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

Overview

The pandemic has created considerable uncertainty over future parcel and letter volumes. The regulatory framework should provide the foundation for the Universal Service to remain financially sustainable into the future. Royal Mail needs greater commercial flexibility to react quickly to changes in market conditions that affect our financial sustainability.

We do not believe that affordability is a concern for the overwhelming majority of Stamp users, and nor do we believe it would become a concern in the event of the cap being removed. Consumer expenditure on Stamps remains very low, at around 70p per week, equivalent to 0.12% of total household expenditure. On letters, our First and Second Class Stamp prices are well below the European average. Our consumer research also demonstrates that a higher Second Class Stamp price would be affordable. On parcels, the UK has the most competitive and dynamic parcels market in Europe, which in turn has led to strong pricing pressures. **We therefore propose that Ofcom continue the journey it started in 2012, removing the Second Class safeguard caps or - at a minimum - providing a significant uplift in the headroom in both caps.**

Ofcom put forward the option of focusing the safeguard cap on consumers who are particularly vulnerable - for example, people who are in receipt of certain benefits. We firmly agree that the current safeguard caps are sub-optimal. However, **we think that a targeted vulnerable discount would be complex to administer and therefore not feasible.** Given that expenditure on Stamps is low, the potential savings that a customer could make from such a scheme would be limited. [✂]

Background

5.1 Ofcom's primary duty is to secure the provision of the Universal Service. The Reported Business is not delivering returns within the indicative 5-10% EBIT margin range deemed appropriate by Ofcom for securing a financially sustainable Universal Service.

5.2 When Ofcom introduced the safeguard caps in 2012 and 2013, they were not intended to unduly constrain Royal Mail's pricing flexibility. One of Ofcom's four cap objectives was to "Minimise the effect of the safeguard cap on Royal Mail's pricing freedom".[63] When considering the trade-off between affordability and financial sustainability, Ofcom noted that "*absent any concerns that the range of prices are (or would become unaffordable), we were pre-disposed to set the cap at the top end of the proposed range to give more weight to financeability concerns.*"[64]

5.3 Ofcom's 2019 Decision also recognised that *"Any changes to the standard letter cap should ensure Royal Mail has sufficient commercial flexibility to respond to threats to the universal service."*[65] However, Ofcom's 2019 Decision provided Royal Mail with very limited headroom. It raised the level of the cap only enough to *"grant Royal Mail sufficient headroom to continue making price increases in line with RPI until 2024".*[66]

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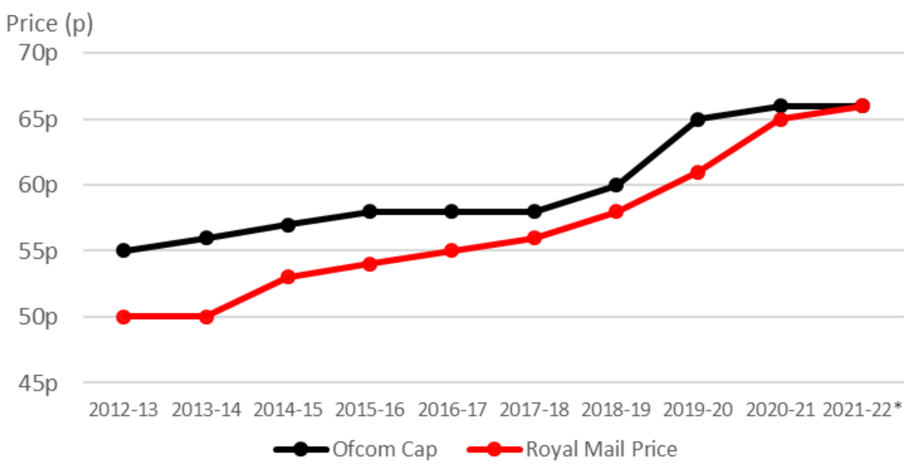
63 Ofcom, Securing the Universal Postal Service, March 2012, Para 8.63
64 Ofcom, Securing the Universal Postal Service, March 2012, Para 8.96
65 Ofcom, Review of the Second Class Safeguard Caps, 2019, heading on page 4
66 Ofcom, Review of the Second Class Safeguard Caps, 2019, Para 5.40

The letter cap

5.4 We are currently pricing the Second Class Stamp letter at the cap. As a result, we have no commercial flexibility on this cap. Further, it constrains our pricing flexibility in relation to First Class Stamps. Over the last two years, we have widened the price differential between First Class and Second Class Stamps from 9p to 19p. [✂]. Maintaining the existing Second Class letters safeguard cap will significantly curtail our commercial flexibility on First Class Stamp letter prices. It is likely that, during the next regulatory period, it will begin to constrain our commercial flexibility on Meter letter prices.

5.5 Providing greater commercial flexibility within the safeguard cap does not mean that we would necessarily price to the maximum level allowed. [✂]. However, we need the ability to react if the market changes. Ofcom introduced the safeguard caps in 2012. For the letter cap, in nine out of ten years since then, we have priced below the maximum level permitted, as shown in Figure 5.1. We estimate that we have forgone £[✂]m of revenue over this period that we could otherwise have earned had we priced at the maximum level permitted by the cap, as shown in Figure 5.2 below.[67] For the basket cap, we have priced on average of [✂]% below the cap.

Figure 5.1: Ofcom Second Class letters cap vs Royal Mail price - 2012-13 to 2021-22



** Prices for 2021-22 came into effect in January 2021*

Figure 5.2: Second Class Stamp letter revenue forgone - 2012-13 to 2021-22

	2c Price	2c Cap	Headroom	Headroom rounded down	Volume m	Revenue forgone
2012-13	50p	55.0p	5.0p	5p	[✂]	[✂]
2013-14	50p	56.2p	6.2p	6p	[✂]	[✂]
2014-15	53p	57.7p	4.7p	4p	[✂]	[✂]
2015-16	54p	58.4p	4.4p	4p	[✂]	[✂]
2016-17	55p	58.4p	3.4p	3p	[✂]	[✂]
2017-18	56p	58.9p	2.9p	2p	[✂]	[✂]
2018-19	58p	60.7p	2.7p	2p	[✂]	[✂]
2019-20	61p	65.2p	4.2p	4p	[✂]	[✂]
2020-21	65p	66.4p	1.4p	1p	[✂]	[✂]
2021-22*	66p	66.7p	0.7p	0p	[✂]	[✂]
Total						[✂]

** Prices for 2021-22 came into effect in January 2021*

[67] Assuming volumes remained constant.

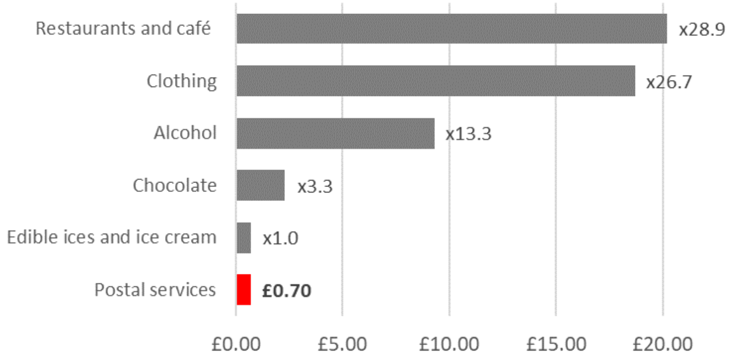
Stamp letters are affordable for the overwhelming majority of users

5.6 Assessing affordability requires applying judgement across a variety of evidence. In the 2019 Safeguard Cap Decision, Ofcom recognised that "*there is a range of evidence and no single price point emerges as clearly being the limit of affordability.*"[68] Below we set out evidence on why prices would remain affordable even if the cap were to be removed or significantly increased:

- **Consumers' spending on post continues to be very small.** ONS data on weekly expenditure shows that consumers' spending on post continues to be very small.[69] On average, consumers spend only 70p per week on post, against a total expenditure of £588. This is equivalent to only 0.12% of total weekly spending. There is a very similar picture for those in the lowest income decile, who on average spend 40p per week - or 0.16% - on post. These figures include all spending on postal services including First Class Stamps and parcels, so actual expenditure on Second Class letters will be even lower.

  By contrast, weekly spending on utilities and other items is significantly higher. For example, spending on telecoms and other communications services is £20.70 (3.5%), while spending on energy is £24.50 (4.2%). Spending on restaurants and cafés is 29x higher (£20.20), clothing is 27x higher, alcohol is 13x higher (£9.30), and chocolate is 3.3x higher (£2.30).[70] Spending on post - 70p on average and 40p for the lowest income decile - represents the same amount of money that people spend on ice cream, as shown in see Figure 5.3.

Figure 5.3: Spending per week on other items in comparison with post



- Second Class Stamps offer excellent value for money in comparison to other day-to-day items. For less than half the price of a takeaway cup of coffee (£1.50 to £2.50) or a Sunday newspaper (£1.30 to £3.00), customers are able to securely send an item from one end of the country to the other.[71]

- **Our prices are materially below the European average.** Figure 5.4 shows that both Royal Mail's First Class and Second Class Stamp prices remain significantly below the European average. Our Second Class Stamp price of 66p is the third cheapest in Europe, well below the average of 90p and the median of 80p. That equates to 27% and 18% lower respectively. Our First Class Stamp price of 85p compares more favourably still, with the European average of 125p and median of 105p, 32% and 19% below respectively.[72]

[68] Ofcom, Review of the Second Class Safeguard Caps 2019 (2019), Para 4.76

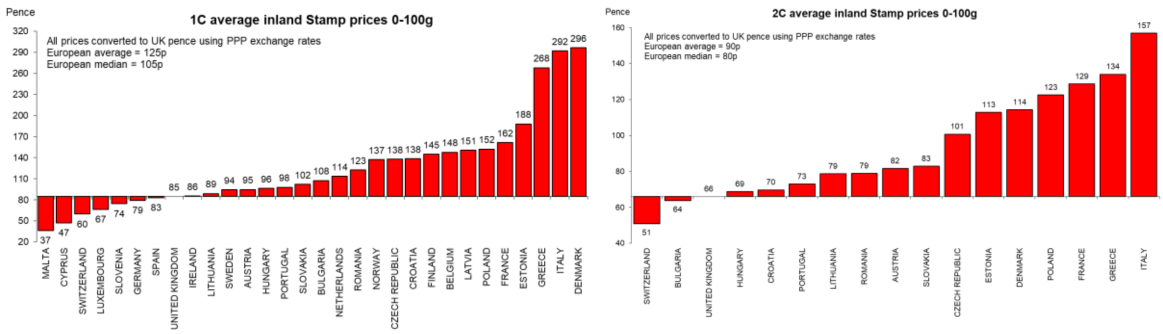
[69] ONS Family spending in the UK: financial year ending 2020, issued March 2021

[70] ONS Family spending in the UK: financial year ending 2020, issued March 2021

[71] Based on Royal Mail analysis.

[72] Based on Royal Mail analysis.

Figure 5.4: Comparison of Stamp prices with other European countries



- **Market dynamics constrain our pricing.** In letters, market dynamics - namely, e-substitution and the threat of tipping points - mean that we must self-regulate our pricing behaviour to remain competitive. Competition in the form of e-substitution means that there is a real risk that price increases would encourage customers to permanently switch away to alternative forms of communication. We are also actively trying to avoid "tipping points" experienced by other European countries - in particular, the dramatic reductions in volume experienced by other postal operators, such as in Denmark and the Netherlands, following significant price increases. Both of these constraints show no signs of diminishing, and together create a powerful incentive for us to maintain our prudent letters pricing policy.

- **Ofcom's consumer research shows that customers overestimate stamp prices.** As noted above, Ofcom's consumer research shows that the majority of customers are satisfied with the cost of postage and consider that postal services offer value for money. The Residential Postal Tracker also shows that customers significantly overestimate the price of stamps. The average estimate for the price of a Second Class stamp in the Residential Postal Tracker was 79p, against a price when the research was conducted of 65p. The corresponding estimate for First Class was £1.09, against a price of 76p.[73]

- **Independent research from 2018 shows customers would find a significant uplift in headroom affordable.** Royal Mail commissioned independent customer research into the affordability of Second Class stamps in 2018. The research found that the majority of consumers do not report experiencing affordability issues. It showed that customers would continue to find that a Second Class stamp price of 81p would remain affordable [✂]. Adjusting for inflation since the interviews were conducted suggests a price today of 84p would remain affordable.[74]

- Consumers would continue to have significant affordability protections through the PSA and Ofcom's Designated Universal Service Provider Condition. These both require Royal Mail to provide Universal Service products at "affordable" prices. Ofcom's current monitoring instruments and one-month notification on Stamp price increases enable it to identify and intervene quickly if there is a problem.

- **Consumers are satisfied with value for money of postal services.** We have a strong track record of pricing responsibly. In the 2019-20 Annual Monitoring Report, Ofcom noted "*We remain of the view that postal services are currently affordable for most residential consumers. We note net satisfaction levels from our residential tracker data remain high*".[75] Ofcom's research also shows that the vast majority of consumers (76%) consider that postal services offer value for money. Over eight in ten residential consumers are satisfied with Royal Mail (83%), with dissatisfaction at just 4%.[76]

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73 Ofcom, Residential Postal Tracker Q1 2020 to Q4 2020. Question QF3 and OF2

74 CPI from ONS (D7BT): April 2018 - 105.4; Mar 2021 (Latest available data) – 109.4. This represents a 3.8% increase.

75 Ofcom, Annual Monitoring Update on Postal Services, 2019-20, Para 7.25

76 Ofcom, Residential Postal Tracker Q1 2020 to Q4 2020. Question QG2 and OG5

5.7 Modelling, shared with Ofcom in early 2021, showed that providing a significant uplift in the current Second Class safeguard letter cap could generate revenue yield of up to £[✂]m cumulative over the five-year expected duration of the next regulatory framework. We would not necessarily use this additional commercial flexibility. We will continue to maintain our prudent letters pricing policy ensuring that USO pricing remains affordable for consumers while also making pricing decisions that help to support a market-funded Universal Service. We recognise that a significant uplift (or removal) of the Second Class letter safeguard cap will not in itself restore the Reported Business to financial sustainability. However, it remains an important regulatory lever within Ofcom's control. It can form an important component of a wider overall regulatory framework to support financial sustainability.

Large letter and parcels Second Class cap

5.8 The basket cap for large letters and parcels currently has sufficient headroom to allow moderate price increases, assuming the current volume mix for the expected regulatory period. However, the commercial flexibility remaining in the cap would be significantly narrowed in the event of mix changes. For example, the Second Class large letter and parcel cap could become a binding constraint if there were a shift towards large letters within the cap. This could occur as a result of parcel competitors winning volume from Royal Mail. Maintaining the cap may also limit our ability to evolve our product set to adapt to changing market dynamics. The basket cap contains a mix of two very different types of posting - correspondence and fulfilment. We may need to respond differently to each in a way that the current cap structure may restrict.

5.9 The UK has the most competitive and dynamic parcels sector in Europe. As set out in our response to questions 6.1 and 6.2, competition has been growing in the provision of C2X parcel services. This has been driven by a number of factors. For example, the growth in parcel management services - including online reselling and price-comparison websites - offers consumers access to greater choice and service options. These factors have led to strong pricing pressures driven by competition.

5.10 Given the highly competitive parcels sector and our track record on pricing affordably, we do not believe that a cap on large letters and parcels is necessary. As noted above, consumers would continue to have significant affordability protections through the PSA and Ofcom's Designated Universal Service Provider Condition.

Challenges with introducing a concessionary rate for vulnerable consumers

5.11 In its Call for Inputs (CFI), Ofcom considered whether it could be more proportionate to focus the safeguard cap on consumers who are particularly vulnerable, such as those who are in receipt of certain benefits. While we firmly agree that the current approach is sub-optimal, we also think that a targeted discount would be complex to administer.

5.12 To ensure customers are charged the right amount, the customer's eligibility for a discount would need to be verified every time they made a purchase. Setting up the necessary processes and infrastructure would require material IT development of any channel through which Royal Mail sells stamps. Also, stamps tend to be bought by consumers in relatively small quantities - often in stamp books - and on an irregular basis. Unlike regular payments, such as utility bills or council tax, it is not possible for a discount scheme to be applied for a period of time based on a single eligibility verification. The additional cost involved in an "every-time check" of eligibility would drive a disproportionate level of ongoing overhead. Further, this is unlikely to be practicable in a number of locations where stamps are bought, such as supermarkets or card shops.

5.13 The process would potentially prove onerous for the targeted customers, driving down take-up and further reducing any benefit from such a scheme. [✂]. Following the stamp price rises in March 2012, customers in receipt of certain benefits were able to buy up to 36 stamps at the previous year's prices.[77] [78] The scheme was well publicised, with a leaflet explaining the scheme and containing the required voucher delivered to every UK address. Leaflets were also stocked at Post Offices and Age UK offices throughout the UK. [✂].

Regulatory ask

5.14 Ofcom's regulatory framework must provide the foundation for the Universal Service to remain sustainable into the future. We need greater commercial flexibility to react quickly to changes in market conditions which affect our financial sustainability. Our commercial flexibility is constrained despite the vast majority of Second Class stamp customers not facing any affordability concerns.

5.15 We therefore request that the caps be removed. Consumers would continue to have significant affordability protections through the PSA and Ofcom's Designated Universal Service Provider Condition. If Ofcom is not minded to remove the caps, we request - at a minimum - a significant uplift in both caps.

[77] To be eligible, customers had to be in receipt of one of four benefits. These were: (1) Pension Credit; (2) Employment and Support Allowance; (3) Incapacity Benefit; (4) Unemployability Supplement.

[78] The prices of both First Class and Second Class Stamps went up by 14p, from 46p to 60p and from 36p to 50p respectively. This meant the potential saving to customers was £5.04.

5.2 Redirections services

Ofcom question 5.2: Do you consider Ofcom's approach to the regulation of residential and business redirections services will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence

Overview

Royal Mail has been redirecting mail for its customers for more than 180 years. Despite the structural decline in letters in recent years, the Redirection service remains popular with customers as an efficient and cost-effective way to gain peace of mind when moving home or business.

Our Redirection service is built around the needs of our customers. We routinely review and seek to improve the service. We have taken a number of steps to ensure that our most vulnerable customers can access it, with initiatives such as a four-year price freeze for consumers on a three-month Redirection; a 20% concessionary rate for those on low incomes who are frequent movers; a free Redirection for those under the age of 16 to support families; a free Redirection for victims of scams targeted through the post; and a free Redirection for people affected by widespread exceptional events such as fire or flooding (eg Grenfell).

The Covid pandemic created a set of unique challenges - not least the closure of many businesses across the UK. We listened to our customers and made a number of changes to our Business Redirection product at pace to support UK businesses. These included a new online application to create greater convenience; a free Mail Hold facility for customers applying for a Redirection; a pro-rata refund policy to give businesses flexibility when their premises reopened; and a Small Business Diversion product for business customers who were unable to take out a Business Redirection.

We believe that all our Redirection products offer good value for money. A one-year Redirection for a family of four costs less than 30p/day. This is less than the annual cost of a TV licence and less than other moving costs (such as a removal van). We do, however, recognise that some customers may have affordability concerns. This has been a key driver behind many of the initiatives that we have introduced. **To inform future developments, we will commission research to ensure that the Redirection products remain fit for purpose, including reviewing our existing concessionary scheme. We aim to implement any feasible new initiatives as soon as is practical.**

In summary, Ofcom's current approach to the regulation of Redirection products has worked well for many years. Customers are satisfied with the products offered by Royal Mail. We have taken proactive steps to address any ongoing affordability concerns, and will continue to do so. **There is no need for Ofcom to intervene any further in this area.**

Context

5.16 Royal Mail has been offering a Redirection service since at least 1840.[79] The service allows customers who are moving home or business to have mail that is addressed to their old address delivered to their new address. A Redirection can be put in place for up to four years, and provides peace of mind when moving, as well as helping to prevent identity fraud.

5.17 We offer a range of Redirection products to meet the needs of both businesses and residential users. Customers can choose the length of time they wish to redirect mail for and can apply for a Redirection for up to six months before or after the moving date. This gives customers complete control over their mail delivery. A customer can redirect mail to any address in the world, so our customers can ensure that their mail moves with them. There is no upper limit on the volume of mail sent using Royal Mail Redirection. Users of a domestic Redirection are charged the same price for locations anywhere in the UK, and for any volume of mail they receive.

[79] Post Office (Duties) Act 1840 (3 & 4 Vict c.96) An Act for the Regulation of the Duties of Postage

5.18 Other redirection options are also available in the market. For example, "iammoving"[80] provides a service that updates the address for important mail senders such as the DVLA, utility providers and local councils for free. Movemy[81] offers a similar service which is fee-based.

Redirections - a constant focus on user needs

5.19 We regularly review and develop the Redirection product to meet the needs of our customers. To provide our residential customers with the best possible service, we have invested in a number of initiatives over recent years:

- A four-year price freeze since 2017 on the three-month Consumer Redirection service. This is the "entry-level" product for residential customers.
- **Root and branch overhaul of the pricing structure** to make it fit for purpose for the modern family by charging on a per-person basis rather than per surname, as a reflection of societal changes.
- Making it **free for those under the age of 16** to be added to a Redirection, to support families.
- Introducing a **20% concessionary discount** for those who are on low incomes and renting their property and are therefore subject to more frequent moves.[82]
- A **secure ring-fenced process for victims of domestic abuse** to ensure that details of a new address are kept confidential and secure.
- **A free Redirection for victims of scams** who are targeted by fraudsters through mail.
- A free-of-charge Redirection for those affected by widespread exceptional events such as fire or flooding (see box).
- Ongoing investment in **barcoding**, which will support:
  - Greater automation of Redirection items.
  - Improved accuracy in recording volumes of redirected mail.
  - Monitoring service quality.

Support for victims of exceptional events

In 2017, a catastrophic fire at Grenfell Tower in North Kensington claimed 72 lives. Hundreds of residents escaped, many having seen all of their belongings destroyed. Royal Mail worked with the Police and Rescue Centre team as well as the local council to ensure that residents were quickly able to access their post, which amongst other things would help them to obtain new identification documents and bank cards. This included giving residents a free Redirection to their temporary accommodation with the offer of an additional Redirection once more permanent accommodation had been arranged.

We invested significantly during the pandemic

5.20 Covid had a dramatic impact on many businesses and individuals. We focused on ensuring that our customers received the best possible service and that their needs were addressed. We listened to our customers and made a number of changes to our Redirection products. On Business Redirection, we undertook the following urgent actions:

- Opened an **online application process for business customers** within two weeks of lockdown. Some business customers were unable to submit paper-based applications when they were unable to enter their business properties or access Post Offices.
- Introduced a **pro-rata refund policy** that allows businesses to claim a refund on a Redirection when the business reopens. Many businesses were forced to close without any clarity on when they

80 https://www.iammoving.com/

81 https://www.movemy.co.uk/

82 Available to those in rented accommodation and in receipt of Pension Credit or Jobseeker's Allowance. Unlike any concessionary scheme for Second Class stamps - which would be complex to administer, as noted under our response to 5.1 - Redirection volumes and sales channels make this concessionary scheme relatively straightforward to operate.

would reopen. This has helped many businesses to cope with this uncertainty, in giving them flexibility to access the Redirection service.

- Introduced a **free Mail Hold facility** for customers applying for a Redirection.
- **Introduced a Small Business Diversion product for business** customers (with fewer than 50 employees) that were unable to take out a Business Redirection.
- Agreed a **new process with the Post Office** to promote our online application process.

More generally, we also:

- **Increased the amount of resource in our Customer Experience team** to help our customers apply for a Redirection in a timely manner.
- **Proactively wrote to domestic abuse charities** at the start of the pandemic to ensure that they were aware of our secure application process.

Redirection is a highly manual and labour-intensive process

5.21 When a customer applies for a Redirection, there are a number of tasks that must be completed by our Customer Experience team before a Redirection can be put in place. Security checks must be carried out before we can accept the application; details of the Redirection must be entered into the appropriate Royal Mail systems; Redirection labels must be printed and sent to the relevant Delivery Offices (DOs); and customers will often need ongoing support through the application process.

5.22 Mail that is to be redirected travels through the Royal Mail pipeline from the point of posting to the addressed location. Redirecting mail can be a complicated process given the nature of the service, and requires human intervention. [✂]. Royal Mail requires c.[✂] hours of manual intervention in DOs per year to ensure that customers' redirections are delivered to specification.[83] This process is shown in the figure below.

Figure 5.5: The Redirection process [✂]

5.23 The volume of redirected mail in our pipeline is a big driver of the operational cost. Larger households with more people are likely to receive more mail, which in turn increases the cost to Royal Mail. In 2019, we introduced a price structure to take into account the number of adults at the address to reflect the increased cost to run a Redirection service whilst maintaining a reasonable balancing of prices.

A Redirection offers good value for money

5.24 Despite the level of human intervention required to process a Redirection, a Redirection for a family of four costs £78.99 - less than 30p per day.[84] This puts the price of a Redirection in line with or lower than other annual communication costs, such as:

- The cost of a TV licence: £159.[85]
- The average household spend on telecoms: £930.[86]

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83 Based on the Royal Mail's costing model fixed workload, excluding time for setting up and closing a Redirection.

84 Based on two adults and two children under the age of 16.

85 Gov.uk, TV Licence application, May 2021

86 Ofcom, Communication Markets Report, September 2020

- The average price of basic fixed broadband and landline bundles: £360.60.[87]
- The cheapest available mobile SIM-only deal: £60, or £240 for a family of four.[88]
- The average mobile contract spend: £483.[89]

5.25 A Redirection can also be considered alongside other costs associated with moving, such as:

- The average cost of hiring a van for a one-bedroom house move: £100 for a day;[90]
- The cost of a removal company for a three-bedroom house move: £800.[91]

5.26 Some customers who do not complete their online application for a Redirection are invited to complete a short survey that asks why they abandoned the application. Of more than 16,000 responses received between 1 January and 26 March 2021, nine in every ten respondents did not cite pricing as a concern.[92]

5.27 Moreover, Royal Mail has taken several steps in recent years to ensure that the Redirection service remains affordable. The price of a three-month consumer Redirection has been frozen since 2017. We have undertaken a significant restructuring of the product pricing to ensure that it reflects the nature of the modern family. We have introduced a concessionary rate for individuals or families who are renting accommodation and are in receipt of Jobseeker's Allowance or Pension Credits. To help larger households, we made it free for those under the age of 16 to be added to a Redirection.

Customers are very satisfied with Redirections

5.28 At Royal Mail, we put the customer at the heart of our decision-making. A key component of this is understanding the views and needs of our customers. Independent research carried out by Citizens Advice confirms our view that customers are very satisfied with the Redirection products. In its report *A New Redirection*,[93] Citizens Advice stated: "*Consumers taking out mail redirection are very satisfied with the service they receive.*"

5.29 We also undertake our own market research to ensure that our customers' views are considered. This shows that customers are satisfied with our Redirection products, with 89% of customers reporting that they are Satisfied with their Redirection service.[94] More recently, Ofcom has set out in its Review of postal users' needs[95] that consumers felt that a Redirection offered "*reasonable value for money*".

The future of Redirections

5.30 Royal Mail believes that a Redirection offers both residential and business customers moving to a new address a safe and secure solution which gives them peace of mind that their mail will be protected and safely sent on to them. We will continue to develop the product and enhance the customer journey to ensure that it remains contemporary and good value for customers who wish to use it.

5.31 While we believe that all our Redirection products offer good value for money, we also recognise that some customers may experience affordability concerns. To inform future developments, we will be commissioning research to ensure that the Redirection products remain fit for purpose. This includes reviewing our existing residential concessionary scheme and the structure of our Business Redirection

87 Ofcom, International Broadband Scorecard, December 2020
88 Which?, Cheapest 5G Sim-only deals 2021, March 2021
89 Ofcom, 4.7 million UK homes have struggled to afford their telecoms bills this year, December 2020
90 Which?, How to choose the best removals company, November 2020
91 Which?, How to choose the best removals company, November 2020
92 Royal Mail, Abandon Basket survey, April 2018
93 Citizens Advice, A New Redirection, August 2018
94 Royal Mail research, Consumer Insights – Redirections, Q3 2020-21
95 Ofcom, Review of postal users' needs, November 2020

product. This research will help us to gain a better understanding of what customers want from a modern and contemporary Redirection service. We aim to implement any feasible new initiatives as soon as is practical.

5.32 We will continue to routinely review and enhance the online journey for customers applying for a Redirection. Most customers already apply online,[96] and we intend to make the journey even easier for customers who wish to use this channel. All customers can now renew and pay online to extend their Redirection service. We are also exploring extending payment to the online setup process for new business customers. We will also raise awareness of the concessionary rate by promoting it with local authorities (housing departments) and by making it more prominent on our website.

Quality of Redirections

5.33 Royal Mail has focused on reducing the number of complaints received in relation to a Redirection service. We have been on a journey of continuous improvement as we aim to better understand the root causes of issues and resolve them. Between 2014-15 and 2019-20, through a range of operational initiatives, we reduced the number of complaints received by 19.3%.[97] For example, internal analysis of "[✂]" complaints showed that a high proportion of Redirections were taken out where the original address and new address were within [✂].

5.34 The pandemic presented an unprecedented challenge to our operation. We recognise that, in some instances, these operational challenges have had an impact on our service, including Redirection. To mitigate this, in March 2021, we undertook an internal campaign to promote the importance of Redirection services to our frontline staff. In particular, we highlighted the importance of customers being able to trust us to ensure that they did not miss important mail. We will continue our drive to improve how the product is handled in 2021 by extending the barcoding of Redirection items to improve monitoring of the service.

Our regulatory ask

5.35 Ofcom's current approach to the regulation of Redirection products has worked well for many years. Customers are satisfied with the product offered by Royal Mail. We have taken proactive steps to address any ongoing affordability concerns, and will continue to do so. As such, there is no need for Ofcom to intervene any further in this area.

[96] 80% of consumers currently apply online.

[97] Based on published Royal Mail Annual Complaints reports for 2014-15 and 2019-20.

5.3 Quality of Service targets

Ofcom question 5.3: Do you consider Ofcom's approach to regulating quality of service for key USO services remains appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence

Overview

Royal Mail takes Quality of Service (QoS) very seriously. It is central to the trust that consumers place in the Universal Service, and it is an important factor in retaining and attracting new customers. Consumers have told us that they want certainty and reliability from their postal services. We therefore continue to support all the main QoS targets that lie at the heart of the current regulatory framework.

It is, however, important that the targets are internally consistent and fit for purpose. Unlike many parts of the regulatory framework, they were excluded from Ofcom's last review - which concluded in 2017 - and were broadly copied across by Ofcom when it took over from Postcomm in 2011. As such, they have not been subject to scrutiny for well over a decade. With this in mind, there are some minor technical changes that we would welcome Ofcom addressing:

1. **Update the 99.9% Delivery Route target to accurately reflect the impact of part-route failures.** The current Universal Service Obligation (USO) Delivery Route target does not reflect Royal Mail's actual delivery performance. A more appropriate measure is the number of delivery points successfully delivered to as a proportion of the total delivery points.
2. **Revise the Postcode Area (PCA) target from 91.5% to 90% to statistically align with the First Class 93% target.** Royal Mail would need to achieve a national performance of around 94.5% to be statistically confident of achieving the 91.5% target in 118 PCAs. This would require significant overachievement at a time when we are trying to be as efficient as possible.
3. **Review the Special Delivery Guaranteed by 1pm 99% target to reflect any changes to the product specification.** Royal Mail is requesting the removal of the prescriptive 1pm deadline from the Special Delivery product in favour of letting consumers decide when they want delivery (see response to Q 5.4 below). We would welcome Ofcom reviewing the target in light of product changes to ensure that it remains achievable.

Context

Importance of high USO Quality of Service

5.36 Royal Mail takes QoS very seriously, as it is central to retaining our customers' trust. There are also strong commercial incentives to do so, as it is an important factor in retaining and attracting new customers. Moreover, delivering on our USO quality commitments has read-through to services for all our customers - residential, SMEs, access and Corporates.

5.37 We invest significant resources to ensure that we maintain the best possible QoS. Performance against targets is measured by a specialist independent consultancy (Kantar). This provides added assurance about our record to management and other stakeholders. We also maintain a dedicated quality team and scanning and RFID network infrastructure to provide better data to make more informed decisions on how best to improve QoS.

5.38 More recently, Covid has presented a significant challenge for our QoS performance. Absence levels and social distancing measures have significantly affected our ability to maintain the high standards that our customers expect. Despite this, our postmen and postwomen have continued to deliver for the country throughout the pandemic - connecting consumers, communities and businesses across the UK. We are now focused on recovery. In Q4, we spent an additional £[✂]m on improving QoS after Christmas.[98] This significantly improved our performance to levels last seen in Summer 2020. We plan to continue this trajectory as absence levels decrease and social distancing measures are relaxed. [✂] will continue to invest in temporary vans (we expect to spend c£[✂]m on temporary vans between January and October 2021). Our aim is to achieve normal performance levels as soon as possible.[99]

Market dynamics

5.39 The current QoS regime has not been comprehensively reviewed since the current targets were introduced by Postcomm in 2006. Since then, the postal sector has changed profoundly. Letter volumes have fallen while parcel volumes have grown as consumers shop more online. The pandemic has accelerated these trends. Further, there has been a shift in UK demographics, with a significant increase in the number of UK addresses to 31 million in 2020.[100] Innovation and market developments have also led to evolving customer preferences and needs.

5.40 In 2017, Ofcom committed to reviewing QoS targets following its Review of the Regulation of Royal Mail.[101] However, Ofcom decided not to review QoS targets at this time, and instead opted to include QoS targets in its user needs review.

5.41 In November 2020, Ofcom published its "Review of postal user needs".[102] Its research found that the current 93% First Class target meets the needs of 98% of residential residents and 97% of SMEs. Both residential and SME consumers valued certainty and reliability, and were generally not prepared to accept lower QoS requirements. This supported Royal Mail's own research that certainty and reliability are important for postal users. This is consistent with high quality of service standards.

Regulatory ask

5.42 Royal Mail recognises the important role that QoS plays in the trust that our customers place in us. We do not want material changes to the headline QoS targets, as they are currently working well and are meeting the needs of consumers. We request, however, that Ofcom uses its regulatory review as an opportunity to fix some technical anomalies within the current targets.

Update the 99.9% Delivery Route target to accurately reflect the impact of part-route failures.

5.43 Royal Mail is required to complete 99.9% of delivery routes every day. We remain fully committed to this obligation. We would strive to achieve it irrespective of regulation, as it forms an important part of the trust that all our customers place in us to deliver USO and non-USO products. However, we urge Ofcom to review the current measurement, which does not accurately reflect Royal Mail's actual performance or the consumer experience in delivery.

5.44 Under the current regulatory methodology, partially completed routes are counted as total failures. To meet the target, there can be no more than 58 incomplete routes each day out of c.58,000 delivery routes to c. 31 million addresses. A route is only classed as complete if every single delivery point has been achieved. This means that if just one delivery point is not completed on a route, the route is classed as failed for that day. The current measure treats the part-route failure with the same severity as a full-route failure, even though only a few delivery points may have been missed.

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98 Royal Mail, Q3 Ofcom QoS presentation, February 2021, p2

99 Royal Mail, QoS presentation to Ofcom, March 2021, p2

100 Royal Mail. Postal Address File, March 2021. https://www.poweredbypaf.com/the-march-2021-statistics-for-the-postcode-address-file-paf-are-now-available/

101 Ofcom, Review of the regulation of Royal Mail Statement, March 2017

102 Ofcom, Review of postal users' needs, Nov 2020, Page 4.

5.45 Despite this misleading methodology, Royal Mail's delivery route performance is already very high. Our performance in 2018-19 was 99.55% - only 0.45% below the 99.9% target.[103] However, due to its very high specification, and its calculation methodology, we have never met the 99.9% target since it was put in place in 2006.

5.46 In a network of our size, 99.9% is not a realistic target based on the current methodology. It has become harder to achieve following the modernisation of Royal Mail's delivery operation. We have implemented new - more efficient - delivery methods. These have enabled us to reduce the number of routes by increasing the average number of delivery points covered by each route. We have moved from around 66,000 delivery routes to about 58,000 today.[104] In effect, as the number of routes has reduced, so too has the number of permissible failures, in absolute terms. This has made the target more difficult for Royal Mail to achieve.

5.47 As we continue to adapt our network to carry more parcels and fewer letters, we expect there to be fewer delivery routes in the future, making the target even more difficult to achieve. New parcel routes will also cover a much wider geographic area, with more delivery points than traditional letter routes. This means that the current misleading measure will only become more difficult to achieve as new parcel delivery routes go live.

5.48 This delivery route methodology also creates an incentive to prioritise resources on routes that are capable of being completed. For example, if there are two routes in an office that are at risk of part failure, from a target perspective it would be better to focus the available resources on just one route and ensure it completes, rather than split resources over two walks that then both have a part failure (which are recorded as total failures). Doing this would result in better performance against the target, but customers would not actually have received a better service. As our USO delivery point performance shows that the vast majority of USO failures are part walks, it is clear that Royal Mail does not do this. We are focused on providing the best possible service for customers. When a route fails it leads to delays, which affects QoS and reduces customer satisfaction and trust, which we do not want. However, the methodology should reflect Royal Mail's actual performance, rather than a misleading view of performance.

5.49 A more appropriate measure would be to calculate the number of delivery points successfully delivered to as a proportion of the total delivery points. This would recognise routes that are partially complete and not count them as a 100% fails. This approach better reflects the consumer impact of incomplete routes. Changing the methodology will not affect customers and the service they receive. Royal Mail is highly committed to ensuring that all routes are complete every day. We merely ask that the USO delivery performance target reflects our actual performance. This new approach would also be consistent with how we calculate the Collection USO target. As demonstrated in the table below, Royal Mail would have achieved 99.9% delivery points target in 2019-20 under a delivery point methodology.

Figure 5.6: Royal Mail USO Delivery Route performance in 2019-20

Financial year	Performance under current route methodology	New delivery point methodology
2019-20	99.52%[105]	99.94%[106]

[103] Royal Mail, QoS report 2018-19, https://www.royalmailgroup.com/media/10811/quarterly-quality-of-service-report-2018-19-q4-republished-28-june-2019.pdf

[104] Royal Mail internal analysis.

[105] Period 12 removed due to the impact of Covid

[106] Excludes weeks 51-52 due to the impact of Covid

Revise the Postcode Area (PCA) target from 91.5% to 90% to statistically align with the First Class 93% target.

PCA confidence intervals

5.50 From a commercial perspective, Royal Mail must already ensure high QoS in all local areas of the UK. This is what our customers want and need. However, the PCA target does not statistically align with the 93% national target. Both the PCA target and the national target monitor the same thing - First Class delivery performance - one at a national level, and one at PCA level. As such, they should be internally consistent and statistically aligned.

5.51 The current regulatory framework requires Royal Mail to achieve a next-day service at 91.5% performance across 118 of its 121 PCAs[107] in the UK. Aggregated across all 118 postcodes, Royal Mail must achieve a 93% national next-day target. Given that it is not possible to measure every single piece of mail to see whether it met the required target, the measurement is carried out by a series of sample surveys. These surveys are designed by Royal Mail in compliance with European Standard (EN13850),[108] and are conducted by a market research agency (Kantar). This provides an independent, representative and unbiased set of figures.

5.52 The survey data allows us to calculate exactly the percentage of test mail that met the targets. We then apply statistical methods to estimate - based on the survey result - the percentage of all First Class and Second Class letters and parcels meeting the targets. We do this by calculating a "confidence interval". The confidence interval gives a range of values around the survey result. It is within these results that the true percentage of real-world letters and parcels complying with the standard is likely to fall. All sample surveys have an associated confidence interval.

The PCA target does not align to the national target

5.53 The current PCA performance target of 91.5% does not statistically align with the national target of 93%. Royal Mail would need to achieve a national performance of around 94.5% to be statistically confident of achieving the current 91.5% PCA target in each one of the 118 PCAs. The QoS data is broadly normally distributed, with a standard deviation of c.1%, and statistical theory states that close to 100% of values within such a distribution will be found within three standard deviations of the mean value. If the mean (national) QoS achieved is 93.0%, we would be confident that all 118 PCAs would lie in the range of 3% above and 3% below 93.0%, a range of 90.0%-96.0%. The minimum PCA standard therefore needs to be set at 90.0%. Royal Mail's and Ofcom's statisticians appeared to agree on this point when we discussed it in 2017.[109]

5.54 To demonstrate this alignment point, in 2014-15, the 93% national First Class target was achieved. However, nine PCAs fell below the minimum 91.5% standard.[110] In 2013-14, Royal Mail exceeded the 93% target, achieving 93.2%, although four PCAs fell below the minimum 91.5% standard.[111]

5.55 Royal Mail will fail PCAs when we achieve the national target. To be assured of meeting the 91.5% target for all 118 PCAs, we would have to put additional cost into our operation. We would have to surpass the national target of 93% by 1.5% to be confident of meeting the target in every PCA - this would be a considerable over-achievement at a time when we are pushing to be as efficient as possible. Nor would it be proportionate, given that the current 93% First Class target meets the needs of 98% of residential residents and 97% of SMEs.[112]

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107 There are 121 Postcode Areas nationwide. All but three are set a minimum standard for First Class stamped and meter franked mail of 91.5%. The three exceptions are Shetland, Orkney and the Hebrides because their remote location makes it impossible to deliver every day (eg there is a ferry sailing every other day).

108 EN13850 is the mandatory European standard for the measurement of the end-to-end transit time of First Class mail.

109 Letter from [✂]of Royal Mail to [✂] of Ofcom, 16 November 2017

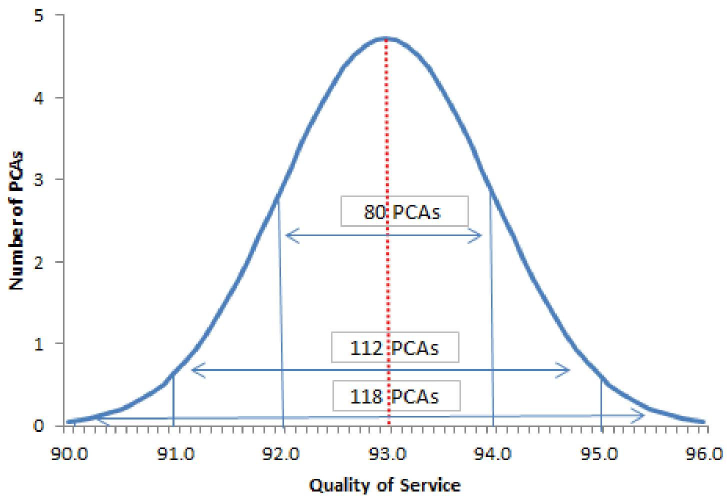
110 Royal Mail, Full Year QoS Results, 2014-15

111 Royal Mail, Full Year QoS Results, 2013-14

112 Ofcom, Review of postal users' needs, Nov 2020

5.56 The impact of the normal distribution on our First Class performance in shown in Figure 5.7 below.

Figure 5.7: Distribution of PCA performance when national QoS is 93.0% (Source - Royal Mail)



5.57 This chart shows an average national QoS of 93% (the red line). The data is normally distributed in a "bell-shaped" curve. The standard deviation (SD) of the data was 1% in 2019-20. The properties of the normal distribution state that:

- 68% of the data lies within 1 SD of the average.
- 95% of the data lies within 2 SD of the average.
- 99.8% of the data lies within 3 SD of the average.

5.58 Translating this into PCA performance means that we would expect:

- 80 PCAs to fall within 1 SD, i.e. between 92% and 94%.
- 112 PCAs to fall within 2 SD, i.e. between 91% and 95%.
- 118 PCAs to fall within 3 SD, i.e. between 90% and 96%.

5.59 This illustrates why the national target of 93% and the PCA target of 91.5% are not compatible. At 93.0% national performance, we would expect PCA QoS to be as low as 90% (and as high as 96.0%) to cover all 118 PCAs. In the last ten years, we have achieved 93.0% for First Class four times. The table below shows that, in three of the four years, all 118 PCAs achieved 90.0%, but never the 91.5% target.

5.60 Even when we recorded our highest-ever First Class QoS of 94.1% in 2005/06, one PCA still failed the 91.5% target. There may be the odd anomaly such as in 2016/17, when national performance was 93.2% but one PCA missed the 90.0% target. This is because, even with the lower target of 90%, it does not necessarily guarantee that all PCAs will achieve the target when 93% is achieved nationally. Some PCAs may perform below 90% if they have encountered significant operational disruption.

5.61 Amending the PCA target to 90% means that it would statistically align with the 93% national target. Royal Mail suggests that Ofcom amends its regulatory drafting to realign the PCA target with the national 93% target.

Review the Special Delivery Guaranteed by 1pm 99% target to reflect any changes to the product specification.

5.62 Special Delivery Guaranteed by 1pm is a flagship Royal Mail service. It operates in a highly competitive market, with numerous options now available for consumers in the tracked and insured single piece market. Many major operators offer similar services - for example, DPS Local and UPS both offer a range of timed delivery parcels which include customer collection (see Annex).

5.63 As such, there is a strong commercial incentive for Royal Mail to achieve the best possible SD 1pm QoS. In 2018-19 and 2019-20, average[113] SD 1pm QoS performance was 98.44%. On the rare occasions where items are delayed, customers can claim a full refund for the cost of postage. This is in comparison with other operators, which often do not publish performance figures or provide any service guarantee or resultant compensation (see Annex B).

5.64 In our response to Question 5.4, Royal Mail requests the removal of the prescriptive 1pm deadline from the Special Delivery product in favour of letting consumers decide when they want delivery. We believe that this is the best way to innovate and adapt the USO SD product to evolving consumer needs. We would welcome Ofcom reviewing the SD target in light of any product changes to ensure that it remains achievable.

5.65 Should Ofcom decide not to allow flexibility to the SD 1pm product specification, it should consider that, in a network of the size and complexity of Royal Mail's, a 99% 1pm target is very challenging and not consistently achievable. This is because, with a 1% margin of error, SD performance has a high exposure to network connectivity delays. As with any network, there are critical cut-off times to collect, process, transport and deliver mail from one point to anywhere else in the country the following day. While we go to great lengths to minimise quality delay, inevitably, this does occur. If any of the elements of our pipeline fail to connect, we have very limited options available to hit the 1pm target. This represents the biggest challenge to SD QoS performance. It is particularly the case when serving the harder-to-reach areas of the UK, which rely far more heavily on the air network – such as south-west England or northern Scotland, where items are more susceptible to delay if flights are cancelled, delayed or diverted. Further, as the Post Office network becomes increasingly open to competitors, there is the enhanced risk of Royal Mail items falling into other operators' networks. Given the limited options available when a connection is missed, Special Delivery Guaranteed by 1pm (SDG) items are more exposed to this risk. We consider that the QoS framework should discount factors that are outside Royal Mail's control, such as miss-sorting in Post Office Ltd (POL).

5.66 In recent years, we have made significant investments to improve performance. For example, we have completed the rollout of 76,000 next-generation PDA devices and focused on improving our operational processes and training to prevent mis-sorts and delays. This focus on performance has meant that SD performance has shown an improving trend in recent years. There has been an increase in performance from 97.6% in 2009-10 to 98.5% in 2019-20 (98.6% adjusted for Covid). Despite these best efforts, Royal Mail has not met the SD 99% target since 2006/07.[114] For regulation to be effective, it should be stretching but achievable. Otherwise the target becomes meaningless.

5.67 We are calling for greater flexibility in the SD product specification to offer a range of delivery time options to customers. We would welcome Ofcom reviewing the target in light of any changes to ensure that it remains achievable.

113 Excluding Period 9 from 2018-19 and Period 12 from 2019-20 due to the onset of the Covid pandemic.

114 Royal Mail QoS reports 2006-07 to 2020-21 https://www.royalmailgroup.com/en/about-us/regulation/quality-of-service/

Annex B - Examples of competitors' premium product information

DOOR 2 DOOR - BY 12

Delivery to United Kingdom within 1 working day

More Info | Printer | Collection

SERVICE DETAILS

- Parcel delivery before noon the next working day, Monday - Friday
- We will advise you in advance of the one hour collection timeslot
- Your customer receives a one hour delivery timeslot, notified in advance by SMS or email
- Your receiver can track their parcel all the way to them on a live map with a countdown to the final 15 minute timeslot
- A range of 'in-flight' options are available, if delivery is not convenient. Including: leave in a safe place or deliver to neighbour

Collection and delivery are not guaranteed but currently enjoy a very high success rate.

KEY FEATURES

- Fully tracked service
- Protect your parcel up to the value of £5,000.00

RESTRICTIONS

- Check the prohibited items list
- Maximum Weight 30 kg
- Maximum Length 1 m
- Maximum Height 0.6 m
- Maximum Width 0.7 m

We ship with UPS

UPS Express® by 10.30am

Collection tomorrow if you book in the next 20 hours

Delivery within 1 working day.

More Info | Printer | Collection | Protection

Service Details

Serviced by UPS Express® - by 10.30 am is one of the fastest services you can book through Parcel2Go, one of a wide variety of UPS expresss delivery services we offer. UPS express delivery is one of our most efficient services, allowing you to get your goods safely and on time, without the hassle. Serviced by UPS Next Day provides parcel delivery by 10.30am the next working day throughout most of UK's mainland. Collection and Delivery are not guaranteed.

Collections are between 9am – 5.30pm.

Same day collection available until noon (Monday to Friday not in all areas).

Volumetric weight is charged on this service. Please click the link below for more information.

Volume Calculator

Key Features

- £20.00 inclusive protection
- Fully tracked service
- SMS alert optional
- Protect your parcel up to the value of £10,000.00

Restrictions

- Check the prohibited items list
- Maximum Weight 70 kg
- Maximum Length 1.5 m
- A maximum of 30 parcels per order
- Maximum Width 0.76 m
- Max Length+Girth 3 m
- Volumetric weight is charged on this service. Discover more.

5.4 Regulating USO services

Ofcom question 5.4: Do you consider Ofcom's approach to regulating USO services, including access requirements, Special Delivery Guaranteed by 1pm, Signed For and Meter mail will remain appropriate going forward? If not, please explain what changes you think should be made, with supporting evidence.

Overview

In 2012, Ofcom took the major step of introducing greater commercial freedom for Royal Mail by moving away from the traditional price control model. It concluded that: "*In our view Royal Mail is necessarily better positioned than the regulator to take commercial decisions that are in its interests*." This was an important starting point but did not go far enough. There is considerable prescription on the non-price terms of Universal Services. These detailed service and feature specifications - set out in the Postal Order and Designated Universal Service Provider (DUSP) conditions - act as a barrier to innovation and prevent us from bringing new products to market quickly. This year, Royal Mail will simplify and improve its product offerings under a "good", "better", "best" approach. We therefore request that the prescription is stripped back and Ofcom relies on the existing "fair and reasonable" principle.

We have reviewed the framework and our asks in this area include:

- **Ability to offer tracking in the Universal Service Obligation (USO)** - Royal Mail supports the removal of the prohibition of tracking on First and Second Class letter, large letter and parcel services within the Universal Service by removing the prohibition on a "tracking facility" - see Section 6.4 for more details.
- **Special Delivery 1pm** - Remove unnecessary prescription from the Special Delivery product - including the 1pm deadline - to allow consumers to decide when they want delivery. The requirement to offer registered and insured services together should also be separated so that they can be offered as separate products.
- **Recorded Signed For** - A signature may have historically been the only way to confirm delivery, but there are now a range of options including scans, photos, etc. We need flexibility to offer products that better meet consumer needs.
- **International** - Remove services that are not aligned with customer needs, such as the International Economy (72 day) service. We also request greater flexibility to offer a range of confirmation of delivery options for international products in line with options available in receiving countries.

We believe that Ofcom's current approach to regulating Meters is working well. Among SMEs that use metered/franked mail, 85% consider this method of sending mail to be "important" or "very important" to their business.[115] It is an important component of a wider regulatory framework to support the financial sustainability of the Universal Service. Ofcom should maintain its approach in this area and keep meters within the Universal Service.

Royal Mail is proud to support the current DUSP conditions on accessibility. The UK is already well provisioned on access points, with 115,000 postboxes and over 11,500 post offices across the country. We continue to work with the Consumer Advocacy Bodies to improve accessibility for vulnerable consumers.

[115] Ofcom, Review of postal users' needs, Nov 2020

Context

5.68 The postal industry has undergone significant change in recent years. Parcel volumes - driven by e-commerce - have grown exponentially as letter volumes have declined. This rise in demand for parcels has created a new type of postal user. They want more flexible options which go beyond the current Universal Service offering. More recently, new operators have increased their supply of parcels services to consumers and SMEs, offering new and innovative customer products and features. This has raised the bar in terms of what the Universal Service needs to provide in order to attract and retain customers.

5.69 Royal Mail has begun to respond to these changes. Over the last year, we have started collecting parcels from the customer's doorstep, delivering on Sundays, providing prescriptions to those in urgent need of medication, and introducing barcoded stamps. None of this was required by regulation.

5.70 To stay relevant and sustainable, the Universal Service must also adapt to life in the 21st century. The Universal Service framework needs much greater built-in flexibility to futureproof the service as user preferences evolve beyond what is predictable today. The current regulations were written for a different generation of postal users and are too prescriptive. In 2012, Ofcom started the journey of introducing greater commercial freedom for Royal Mail by moving away from the traditional price control model. It concluded that: "*In our view Royal Mail is necessarily better positioned than the regulator to take commercial decisions that are in its interests*." The framework still contains detailed non-price service and feature specifications. These act as barriers to innovation and prevent us from bringing new products to market quickly.

5.71 This risks preventing good consumer outcomes and slows down innovation and change. This year, Royal Mail will simplify and improve its product offerings under a "good", "better", "best" approach. In a period of ever-evolving innovation, it is important that the Universal Service takes into account the changes in the postal industry and provides solutions for the needs of a new customer base, whilst maintaining services that cater for more traditional needs. The regulatory framework should allow Royal Mail to be more fleet of foot and react quickly to the changing needs of all customers. Otherwise, customers of Universal Postal Services are in danger of being increasingly left behind.

Regulatory ask

5.72 The regulatory review is an ideal opportunity for Ofcom to continue the journey started in 2012 to introduce more commercial freedoms to meet evolving consumers and SME needs. Royal Mail's market research has indicated that Universal Service products are not always fully tailored to customers' needs, either because there are too many features bundled into products, such as Special Delivery Guaranteed by 1pm (SDG), or certain basic services are missing, such as Tracking on some items. Consumers and SMEs should have the flexibility to choose the features that match their needs. We believe that the existing "fair and reasonable" principle provides sufficient protection to consumers without the need for this additional service prescription.

5.73 Below we set out examples of changes that we have identified that require review by Ofcom. Please note that we address tracking in the USO in our response to question 6.4.

Special Delivery Guaranteed by 1pm

5.74 Special Delivery Guaranteed (SDG) is a flagship Royal Mail service which faces significant competition from other time-guaranteed express services from other operators. It guarantees next-day delivery by 1pm, meaning that customers can claim a full refund when this is not met. Consumer satisfaction is high. Last year, 98.6%[116] of SDG items were delivered on time against a 99% target.

[116] Adjusted for Covid impact. Adjustments are calculated by excluding performance in Weeks 51 and 52.

1pm Guarantee

5.75 In 2020, Royal Mail undertook detailed consumer research on the Special Delivery product.[117] It showed that customers value the certainty of end-of-day delivery but are not wedded to 1pm. The 1pm deadline is not a driving factor in selecting the product for the majority of consumers, but acts as further reassurance that the item will arrive the next day.[118] [✂]. Businesses attach more importance to specific delivery time than individual consumers do, [✂][119]

Figure 5.8: Royal Mail SDG variant research [✂]

5.76 The main reasons cited by consumers and businesses for using SDG are the need for proof of safe delivery, consequences if lost or damaged in transit, and the need for the item to arrive as soon as possible/the next day. Delivery by 1pm the next day was the least important reason cited by consumers.[120] This is supported by Ofcom's 2020 user needs research, which found that, while users saw special delivery as essential, many were unclear about all of the service's features, and typically used it for the guarantee of next-day delivery, rather than the 1pm delivery deadline, insurance or tracking components of the service.[121]

5.77 These findings are important, as SDG 1pm now operates in a highly competitive environment. Choice exists in this area. Competitors now offer a range of next-day options - from morning deliveries to end of day. For example, UPS, TNT and DPD Local all offer next-day timed consumer single-piece services with a range of delivery times between 09.00, 10.30, 12.00 and end of day (see Annex C). These operators offer a wide range of services because customers want flexibility. To stay relevant, our Universal Service offering needs to be able to compete. SDG should also be able to provide customers with the flexibility to choose the services that they want.

5.78 The current SDG 1pm guaranteed service also drives inefficiency in our operation at a time when Ofcom is pushing Royal Mail to be as efficient as possible. This is because the 1pm target means that the product must be prioritised through the network. This can often lead to costly route diversions when there are delays in order to ensure that the product meets its time guarantee. When items are received late into a delivery office, a separate van is often sent out to deliver just a handful of items. This is costly and affects the delivery of other USO items. Were the USO structured so as to allow us to offer a range of SDG delivery options, the impact of meeting the 1pm target would be lessened as SDG items would be distributed across other SDG services throughout the day.

5.79 Finally, having 1pm as the only delivery option means that SDG items are often delivered when the recipient is not at home because they are at work, school or university. As SDG cannot be left in a safe place or with a neighbour, this often means that the receiver must go through the inconvenience of collecting the item from their local Delivery Office (DO). Having the flexibility to offer a range of SDG delivery times that fit with how people live their lives, including an end-of-day or morning delivery, would make the product more convenient and would better meet the needs of modern consumers.

5.80 Royal Mail urges Ofcom to review the 1pm time prescription from the SDG product, with a view to removing it as part of its regulatory review. Customers should have greater choice of a range of delivery times throughout the day. The current 1pm specification is an unsatisfactory "one-size-fits-all" approach.

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[117] Royal Mail, SDG Variant Research, March 2020 – Quantitative: 3,000 online panel interviews with consumers, 700 online panel interviews with SMEs, 150 panel interviews with businesses with 250+ employees. Qualitative: four focus groups and four in-depth interviews with marketplace sellers.

[118] Royal Mail, Special Delivery Guaranteed: Qualitative research debrief, 2020

[119] Royal Mail, Special Delivery Guaranteed: Variant Research, 2020

[120] Royal Mail, Special Delivery Guaranteed: Variant Research 2020, Page 3

[121] Ofcom, Review of postal users' needs, November 2020

Registered and insured

5.81 The current regulatory framework requires Royal Mail to offer a domestic USO registered and insured service together. We do this through our SDG 1pm product. We believe that a time-guaranteed, registered and insured product all in one may provide additional services that go beyond what some customers require. Royal Mail requests the flexibility to offer consumers the services that they want without having to bundle them all into one.

5.82 Ofcom's User Needs review found that many consumers are unsure about some of the service features for SDG.[122] For example, many were unclear about all the SDG features, and typically used it for the guarantee of next-day delivery, rather than the 1pm delivery deadline, insurance or tracking components of the service. This is supported by Royal Mail's qualitative research, which indicates that some USO products are over-specified for what our customers need.[123] For example, some people buy SDG for speed, but the security/insurance elements are not vital. Others need the safety/security/tracking features but not necessarily the 1pm element.

5.83 We believe that there is an opportunity to disaggregate the service offering in order to empower users to choose the features that they require at the time. This would make Royal Mail products easier to understand, and also provide more power to the user to select the products and services that best meet their needs. It would also bring the domestic product into line with the international product, where both registered and insured can be offered to customers as separate products.

Signed For

5.84 Under the current regulatory framework, Royal Mail is required to offer the "*provision of proof of delivery on application by the sender*"[124] on First and Second Class items. Royal Mail meets this requirement through its Royal Mail Signed For service, which can be bought as an add-on when sending a First or Second Class item.

5.85 Ofcom's User Needs Review found that consumers value a signature on delivery and see it as an essential Universal Service. This supports Royal Mail's findings. We do not want to remove the option of a signature. We do, however, believe that customers should have the flexibility of a range of separate delivery confirmation options. A signature may have historically been the only way to confirm delivery, but there are now other options available, including scans (and the accompanying Delivery Confirmation information), GPS coordinates and photos, which may more suitably meet customers' needs.

5.86 These alternative options have already been shown to work well. Competitors to Royal Mail offer a range of delivery confirmation options. For example, DPD[125] and Hermes[126] offer photo evidence of delivery. UPS offers delivery confirmation, Signature and ID confirmation.[127] Our research shows that customers want the flexibility of a range of delivery options that may better their sending needs. We ask that Ofcom update the definition of "proof of delivery" to remove the requirement for evidence to be provided by the recipient. This will provide the flexibility to offer users alternative proof of delivery options that might better meet their needs.

International

5.87 Since the regulatory framework was put in place, worldwide global logistics and linehaul has changed significantly. The lead times for global freight have fallen as air travel has expanded. Customer expectations have also changed. Customers expect parcels to arrive in a matter of days - not months - even on the other side of the world. With that in mind, we request that Ofcom make changes to the

[122] Ofcom, Review of postal users' needs, November 2020
[123] Royal Mail, Special Delivery Guaranteed: Qualitative research debrief, 2020
[124] DUSP 1.6.1(a) (b)
[125] https://www.dpd.co.uk/content/how-can-we-help/parcel-delivery-during-covid-19.jsp
[126] https://www.myhermes.co.uk/terms-and-conditions
[127] https://www.ups.com/gb/en/shipping/services/value-added/delivery-confirmation.page

international products falling within the Universal Service in order to bring them into line with modern consumer demands for international mailing.

- **Remove the requirement to provide a slow Economy service (DUSP 1.6.1 (f) and (h)).** Operating a product with a 72-day target routing does not align with modern customer needs. This is reflected in the declining use of the product. Volumes being shipped via the service [✂]in 2019-20 on 2018-19 volumes, and the product now represents [✂] of total international USO product revenue. It is now much quicker and more cost-effective to send items across the world. Consumers are already well serviced by the International Standard USO product, which is priced comparatively to International Economy. Further, no other competitors to Royal Mail offer similar slow services. For example, the slowest service to Australia offered by UPS and FedEx takes six days. DHL's takes two weeks. We therefore encourage Ofcom to review International Economy, with a view to removing it as part of its review.
- For international products, update the definition of "registered" to allow Royal Mail to offer a range of confirmation of delivery options. Royal Mail is currently required to offer a registered service on all its international USO products. In line with the domestic product (see above), Ofcom should update the definition of proof of delivery to allow Royal Mail to offer customers the most appropriate delivery confirmation option in the country that they are sending to. Given the wide range of approaches in receiving countries, it is not always possible to offer customers a signature.

Maintain meters in the Universal Service

5.88 Lastly, we consider that Ofcom's current approach of allowing Universal Services to be paid for via Meters is still appropriate and is welcomed by customers. It is an important component of a wider regulatory framework to support the financial sustainability of the Universal Service. As such, Ofcom should retain meters as a means of payment for Universal Postal Services.

5.89 Nearly [✂]of SMEs with 10-49 employees and [✂] of those with 50-249 employees use meters when sending letters, with [✂]% using it for parcels.[128] Among those that use metered/franked mail, Ofcom's User Needs research found that 85% of SMEs considered this method of sending mail to be "important" or "very important" to their business.[129] It also highlighted that businesses value the flexibility of being able to receive a discount on the standard stamp mail price, without having to commit to a bulk contract. Customers also value the key Universal Service characteristics that meters provide - namely, universality, reliability, affordability and weekday deliveries. Removing meter from the Universal Service would make many customers worse off. Customers who cannot reclaim VAT - in particular, charities and the health and financial services sectors - would experience a 20% increase in their prices. Many senders would be likely to re-evaluate whether they should continue to use postal services altogether. Given that e-substitution has already had a dramatic effect on postal volumes and will continue to do so, removing meters as a means of payment for Universal Postal Services would hasten this decline.

5.90 Meters is important in supporting the financial sustainability of the Universal Service. It accounts for £[✂]m of revenue in 2019-20. Indicative modelling on the impact of removing meters as a means of paying for Universal Postal Services suggests that this would lead to a c.£[✂]m profit reduction per annum. The price increase faced by customers who cannot reclaim VAT would result in an indicative £[✂]m revenue reduction, partially offset by a £[✂]m reduction in cost and an increase in VAT recovery.

5.91 There is no obvious alternative affordable UK-wide service available to meter customers. Access operators would be unlikely to serve many small and medium-sized meter customers, given their low volumes. These customers would therefore be unable to switch to access services if prices increased.

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[128] Royal Mail, User Needs Research (Illumines), SME, 2019 Pages 14-15

[129] Ofcom, Review of postal users' needs, 2020, Para 6.50, Page 77

For example, Whistl's unsorted bulk mail services require businesses to commit to a minimum volume of at least 250 items per collection.[130] They would therefore have to resort to paying for Universal Services via stamps or buying postage online.

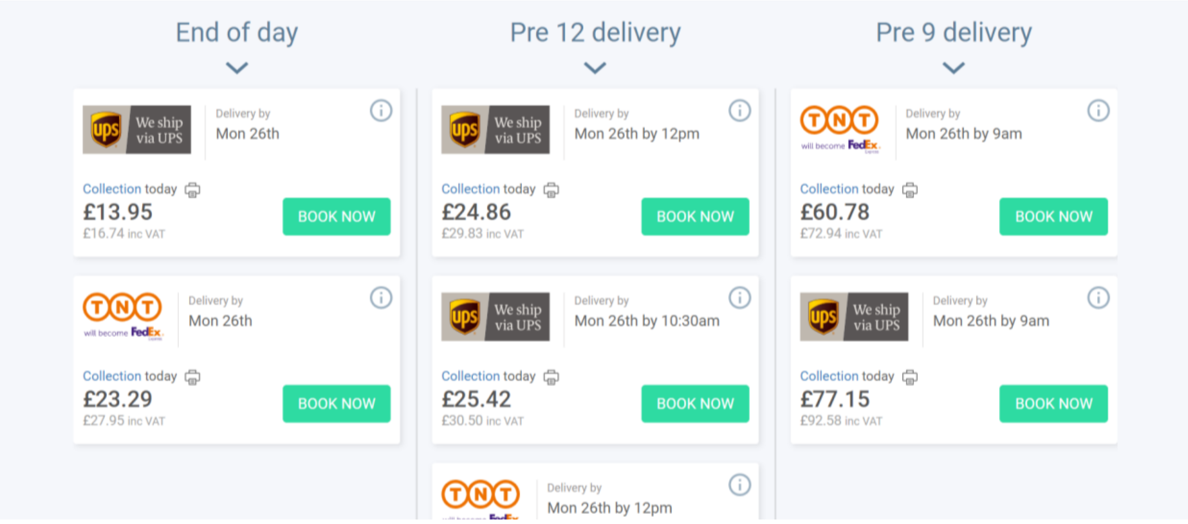
Accessibility requirements

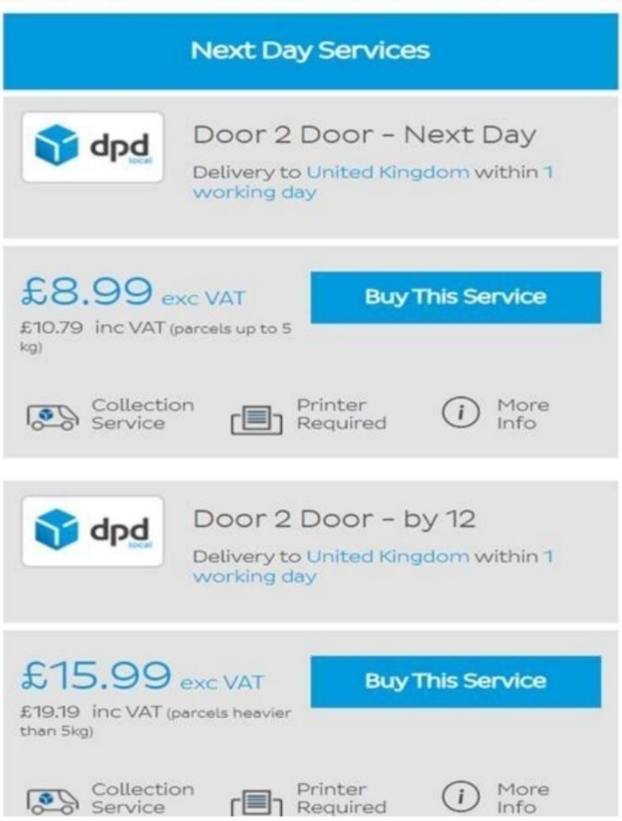
5.92 Royal Mail is proud to support the current DUSP conditions on accessibility. The access needs of consumers and SMEs are incredibly important and form a key feature of the Universal Service - connecting people, communities and businesses. The UK is already well provisioned on access points, with 115,000 postboxes and over 11,500 post offices across the country. We rarely remove a postbox, and the number of boxes in the UK overall - in both rural and urban areas - has remained stable for the past decade.

5.93 We are continually looking at ways to improve access for vulnerable customers. We recently launched a new 'Parcel Collect' service, offering customers who might struggle to leave the house the ability to have items collected from their door via their postmen and women. We will continue to work with the Consumer Advocacy Bodies to improve accessibility for vulnerable consumers.

[130] https://www.whistl.co.uk/mail/unsorted-mail/premiersort-flex

Annex C - Operators offering a range of delivery times





6. Parcels regulation

6.1/6.2 Parcels market

Ofcom question 6.1: Do you think the parcels market is working well for all senders and receivers of parcels (such as online shoppers, marketplace sellers and/or small retailers)? If not, please explain what changes you think should be made, with supporting evidence.

Ofcom question 6.2: What is the nature and extent of detriment (if any) that consumers may suffer in the C2X or B2C segments of the parcels market? Please provide your views with supporting evidence.

Please note, we provide our feedback to questions 6.1 and 6.2 in this section.

Overview

The parcels sector is functioning well. It is delivering good outcomes for senders and receivers of parcels (Question 6.1). We have not observed any major systemic consumer detriment in the supply of Business-to-Consumer (B2C) or Consumer-to-Business/Consumer (C2X) parcels that requires regulatory intervention from Ofcom (Question 6.2).

The UK has the most competitive and dynamic parcels sector in Europe. As the sector has become more competitive, customers' expectations have increased. All carriers - including Royal Mail - have invested and innovated in order to develop features that customers want, provide a great experience, and deliver greater convenience. Customers are benefiting from increased flexibility, speed and choice.

At the same time, across the parcel sector in the UK prices have declined in real terms. This is despite a significant shift to higher-value next-day and tracked products. This indicates strong pricing pressures driven by competition, and that efficiency gains are being passed on to consumers in the form of lower prices.

Royal Mail commissioned Oxera to undertake a market analysis of the parcels delivery sector in the UK, with the primary focus on B2X deliveries (see Appendix "Parcels market analysis and implications for the scope of the access regime" for the report's Executive Summary). The report presents evidence of a highly competitive sector where numerous operators have challenged and continue to challenge Royal Mail. In particular:

- **In B2X,** competition is strong across all types of deliveries, including premium B2C services (where DPD is a key player); economy B2C services (where Hermes and Yodel are key players alongside Royal Mail); and B2B (where Royal Mail has not been traditionally as strong). In addition, Amazon Logistics has disrupted the industry economics significantly.
- **In C2X,** there is growing competition (key players are Royal Mail, Hermes and Yodel).

Ofcom should not increase regulation in this area. We request that Ofcom allow end-to-end parcel competition - and all the benefits that this brings to customers - to thrive.

In addition, Oxera's parcel sector analysis shows no evidence of market failures that would justify (a) mandating access for lightweight parcels services; or (b) retaining access conditions for fulfilment large letters. Indeed, the evidence indicates that neither of these two measures would be needed to promote effective competition or efficiency, or confer significant benefits on users of postal services. For more details on the implications of Oxera's analysis for the scope of the access regime, please see the responses to Questions 7.1 and 7.2.

Context

6.1 The UK has the most competitive and dynamic parcels sector in Europe. According to Apex Insight's European Parcels Market Report, total internet retail sales in Europe reached €424bn in 2019, having grown at 15% per year since 2014.[131] The leading country is the UK, where average spend per head was approximately €1,900 in 2019. France and Germany combined are similar in size to the UK, with the three countries representing two-thirds of the European total.

6.2 In terms of UK-specific dynamics, there has been a rapid increase in demand for fulfilment services, which has been further accelerated by the pandemic. The ONS has reported that internet sales made up 28% of total UK retail sales in 2020, up from 19% in 2019 and 18% in 2018.[132] This acceleration is driven by the extensive periods of mandated closures of bricks-and-mortar retail outlets in lockdowns. However, high street demand is not expected to return to pre-pandemic levels, as indicated by a number of permanent exits from the retail environment. A range of consumers have discovered the ease and convenience of online shopping and home delivery. Demand has increased across the board. In fact, 33% of consumers do not plan to resume normal shopping habits immediately, and 55% say they plan to slowly return to shopping in stores.[133]

Innovation continues at pace across the sector

6.3 As the sector has become more competitive over time and customers' expectations have increased, carriers have innovated in order to remain competitive. Products that were initially viewed as premium have become the norm. This has resulted in ever-increasing service quality and falling prices (average unit revenues). Innovations across the sector include:

- **Improved parcel handling** - All carriers have evolved handling processes to reduce unit costs and be able to deliver any type of parcel to the final consumer at a competitive price. This has resulted in increasing sortation efficiency and innovative strategies to reduce the cost of the final mile. Examples include route optimisation software and the use of apps to reduce the risk of failed deliveries.

- **New business models** - New business models have emerged to offer ever more convenient alternatives to home deliveries. This has enabled volume consolidation and lower unit costs, and an increasing range of options. Examples include an increased number of aggregators and a growing network of parcel shops and lockers.

- **Increased flexibility, speed and choice for customers** - As the large retailers have become more sophisticated and demanding, with Amazon leading the way, parcel senders have required carriers to guarantee increasing levels of flexibility, speed and choice to their customers. The result is that all parcel operators offer a wide range of options for delivery, and that products that were traditionally viewed as premium have now become the norm, such as next-day and tracked, with increased Inflight Redirection options available.

6.4 Royal Mail has invested in a range of innovative parcel service features and service options - see Figure 6.1. We are making our services simpler and more flexible in order to remain competitive. This is as part of our commitment to deliver what customers want and to provide a great experience. Our key innovations include:

- **Parcel postboxes** - Our c.1,400 parcel postboxes are ideally suited to a fast, easy and convenient local parcel drop-off. They allow consumers, marketplace sellers and SMEs to post pre-paid parcels or return items, 24/7.

- **Parcel Collect** - We collect direct from a customer's door or a nominated safe place. Customers pay for their postage and collection online or via the Royal Mail app. Royal Mail will then collect up to five parcels per address, six days a week.

- **Royal Mail app** - We continue to improve our Royal Mail app. Features that are available now include the capability to track items, buy postage, book a collection, find local drop-off locations,

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131 Apex Insight, UK Parcels Market Insight Report, December 2020

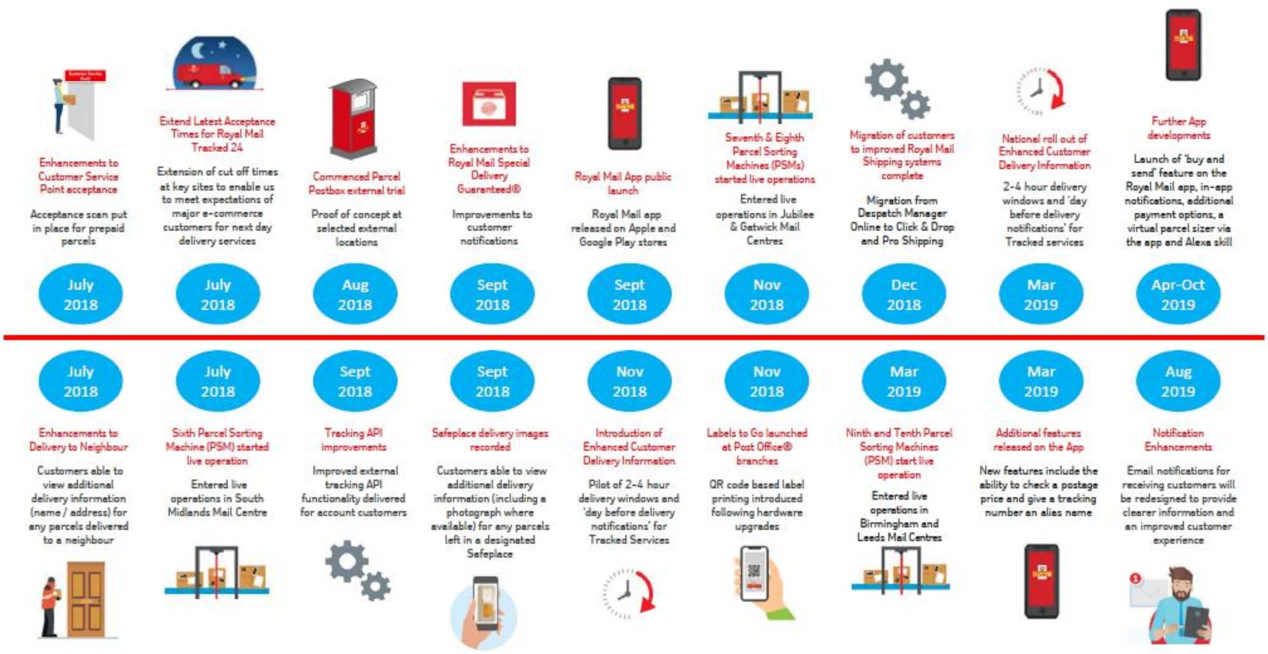
132 Office for National Statistics, 26 March 2021. Internet sales as a percentage of total retail sales (ratio) (%).

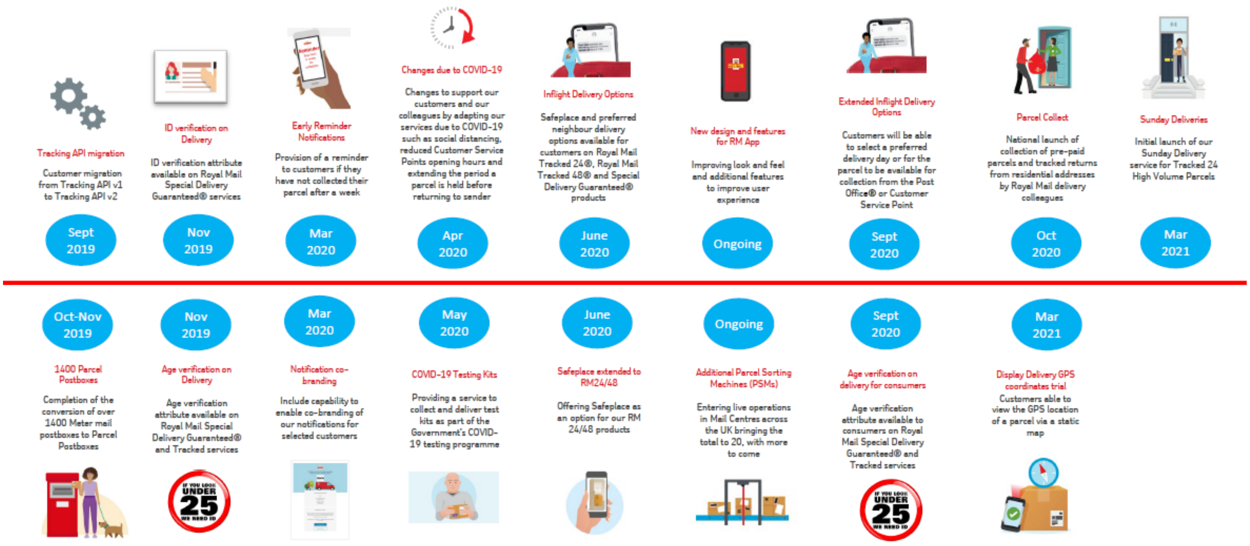
133 Forrester Analytics Consumer Technographics® COVID-19 Survey.

and measure the size of a customer's parcels. We also maintain a major customer service presence (via our Customer Services Points and Post Office Ltd (POL) to cater for over-the-counter customers.

- **Estimated Delivery Windows** - We provide predicted day and estimated time of delivery by SMS and/or email for tracked parcels. Tracked delivery notifications help customers to plan their day. They are sent an email or text message the night before and on the morning of delivery with an estimated two-, three- or four-hour delivery window.
- **Delivery confirmation** - Barcoded Royal Mail 24/48 parcels receive free delivery confirmation online. This was introduced to meet marketplace seller standards and reduce fraud with a proof of delivery.
- **Sunday parcel deliveries** - We have recently introduced a Sunday parcel delivery service for major retailers using our Royal Mail Tracked 24 (high-volume) service. An increasing number of consumers expect Sunday deliveries as part of their online shopping experience.
- **Later Acceptance Times** - This is available on Royal Mail Tracked 24 to support next-day delivery. Our network is now open later to allow shoppers to buy items in the evening for next-day delivery.
- **Inflight Delivery Options** - Our Inflight Delivery Options allow customers to change their delivery after it has been sent. This means that customers no longer have to worry about not being at home to receive a parcel. Customers are also able to change the delivery day or location to a Post Office or Royal Mail Customer Service Point. The Options also enable Royal Mail Tracked 24 and Royal Mail Tracked 48 customers to opt for delivery to a neighbour or SafePlace.
- **Local Collect** - Customers can have parcels delivered directly to their local Post Office branch or Royal Mail Customer Service Point to collect at their convenience. We send them an SMS/email notification when their parcel is ready to collect. This ensures that customers receive their delivery first time, every time.
- **Age Verification** - Our Age Verification service allows all business customers - large and small - to send goods that require age verification on the doorstep.

Figure 6.1: Royal Mail's Parcels Transformation Journey





6.5 On top of product innovations, we are investing significantly in parcel automation to support our offering in parcels and to improve efficiency. A total of 20 parcel sort machines have now been installed (see response to question 4.1 for further detail), with 33% of business parcels now automated. We have invested considerably in parcel automation through our parcel hubs. Our second hub in the Midlands will have the capacity to sort over one million parcels a day when it is fully operational in 2023.

Prices continue to fall across the sector

6.6 At the same time, there is also consistent evidence from a range of sources pointing to long-running and persistent reductions in prices across the sector, as well as modest (and declining) levels of profitability. Figure 6.2 summarises data from Ofcom's Annual Monitoring Reports. It shows that average revenues for next-day products have fallen by 29% in real terms, while later than next day average revenues have remained broadly flat. This indicates strong pricing pressures driven by competition, and that efficiency gains are being passed on to consumers in the form of lower prices.

Figure 6.2: Average Unit Revenue for domestic next day and later than next day services (£, real)[134]

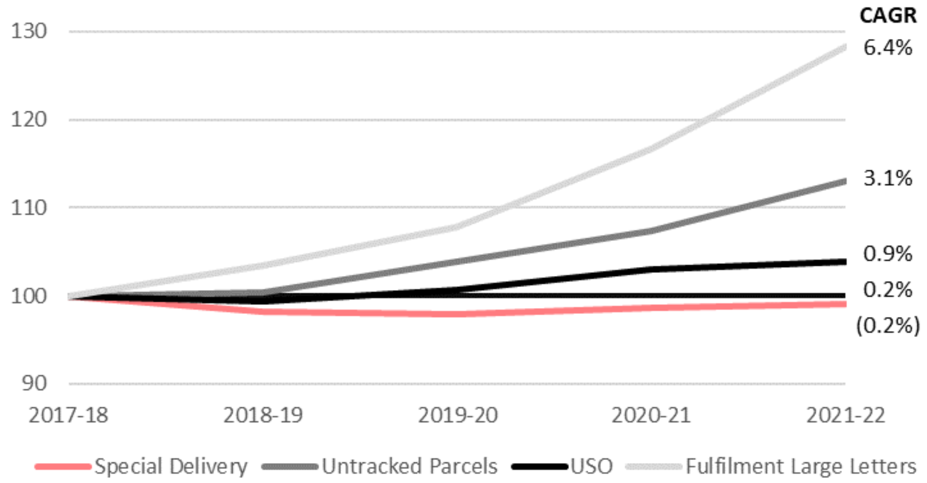
[✂]

6.7 Royal Mail does not face price controls for the vast majority of our parcel product portfolio.[135] However, our prices are materially constrained by competition and the market. Our pricing strategies over the course of this regulatory framework have been limited, [✂].

[134] Source: Oxera, Parcels Market Report, Figure 3.1 converted into real terms. Price increases based on list price with the exception of Tracked. Tracked based on AUR.

[135] Direct price regulation is limited to the Second Class Safeguard basket cap for large letters and parcels.

Figure 6.3: Index of real Royal Mail parcel price increases (real)



Deflated by CPI

Findings from an independent analysis of the parcel sector

6.8 To supplement our assessment of the UK parcel sector, Royal Mail commissioned Oxera to conduct a review and prepare a report (see Appendix "Parcels market analysis and implications for the scope of the access regime" for the report's Executive Summary). Oxera's report presents evidence of a highly competitive industry where numerous end-to-end operators have challenged and continue to challenge Royal Mail across the full spectrum of services. There are also several other parcel operators with a more limited geographic coverage or without their own final mile delivery network. These operators can and do access other end-to-end operators' networks (not only Royal Mail, but also end-to-end operators such as Hermes, Yodel and DPD) to carry their parcels in areas in which they do not operate.

6.9 Oxera applied standard tools and criteria used by competition authorities for assessing the level of competition. Below, we set out some headlines from Oxera's analysis, covering B2X deliveries (which was the primary focus of the report) followed by additional considerations on C2X deliveries.

6.10 **Business-to-Business/Consumer (B2X)** - Oxera found that increased demand has brought entry and expansion opportunities to providers of delivery services. Investment levels are high as carriers continue to take advantage of opportunities to expand across segments. Competition occurs across the full spectrum of deliveries, including premium B2C services (where DPD is the key player); economy B2C services (where Hermes and Yodel are key players alongside Royal Mail, and where Amazon Logistics is disrupting the market); and B2B (where Royal Mail has not been traditionally as strong).

- **National carriers** - There are currently 13 carriers operating national networks in the UK. Carriers offer the full spectrum of deliveries, including: B2X and C2X; next day and later than next day; premium and economy; small and light; and large and heavy.
- **Countervailing buyer power** - This refers to the relative bargaining positions of consumers and suppliers. Competitive pressure will be stronger if customers have high buyer power. There is significant evidence to show that large retailers are able to exercise significant buyer power.
- **Barriers to entry and expansion** - This indicates how easily new operators can enter the sector or expand across segments. Crucially, barriers to expansion for the 13 carriers operating national networks are low. There has been significant expansion and supply-side substitution across segments, as carriers look to offer a more complete range of products and profitable opportunities to increase utilisation of their shared facilities. Many operators also have flexible employment models, which implies that capacity - particularly in delivery - can be scaled up or down to

accommodate demand relatively quickly and easily. The pandemic has demonstrated how responsive carriers have been to an unexpected surge in demand. There is also evidence of competitive pressure and contestability affecting all segments of B2X deliveries, including the lightest and smallest letter-boxable items.

- **Entry of Amazon Logistics** - Since 2013, the entry of Amazon Logistics has disrupted the sector dramatically. It poses a direct challenge to all traditional parcel operators. The total volume of parcels delivered by Amazon Logistics has increased at a rate of [✂]% year on year, making it the second-largest B2X carrier within a short time, and achieving a volume share of [✂]% in 2019.

6.11 **Consumer-to-business/consumer (C2X)** - The C2X segment is influenced by ongoing changes in consumer habits (more parcels and gifts being sent to other individuals), trends in e-commerce (increasing volumes of returns) and the evolution of online marketplaces (online platforms such as eBay or Gumtree providing routes to market for smaller businesses and spurring the growth of online transactions).[136] Oxera found growing competition in the provision of C2X services (again, led primarily by Royal Mail, Hermes and Yodel):

- **Business model convergence** - Operators such as DPD, DHL, UPS and FedEx/TNT historically focused on international parcels, with the UK being a key hub within their air networks. More recently, all except TNT have invested in UK parcel shops to take advantage of the growth in the B2C and C2X segments. As a result, the differences between B2X and C2X have diminished over time. Consumers are sending fewer items to each other directly, and are sending more often via online retail platforms. The volumes of returns have also increased, driven by the growth in internet sales and higher return rates as options have improved - and retailers more often offer these to customers for free.[137]

- **Networks of pick-up and drop-off locations (PUDO networks)** - There has been a significant expansion of the networks of PUDO locations over recent years. Multiple alternative networks now rival the Post Office in terms of size and reach, which has altered the competitive dynamics in the C2X segment. Consumers and SMEs have a wide set of drop-off options, facilitating more C2X deliveries and returns.

- **Parcel management services** - The growth in parcel management services - including online reselling and price-comparison websites - offers consumers access to operator choice and a range of service options. Websites offering price comparisons and convenient access to parcel services - such as Parcels2Go - make it easier for customers to shop around and identify alternatives.

Consumer research shows increasing customer expectations

6.12 As carriers have innovated and improved services to remain competitive, Ofcom's own consumer research shows that customer expectations have increased. The sector is working well. Ofcom's Annual Monitoring Report for 2019-20 found that "*high proportions of residential consumers are satisfied with Royal Mail (82%) and postal services overall (85%), with dissatisfaction levels remaining at 4% and 3% respectively.*"[138]

6.13 An almost identical picture emerges for SMEs.[139] When consumers were asked what factors were important when sending parcels, the importance ratings associated with every single factor tested increased relative to the previous year's results. In particular, "ability to track the delivery" increased from 70% to 83%, "fast delivery" increased from 71% to 84%, and "Convenient options for the recipient to accept the delivery" increased from 62% to 79%.[140]

[136] Ofcom, 'Review of postal user needs', 2020, Para 3.23, Page 15

[137] Apex Insight estimates that the returns rate increased from 14% in 2010 to 20.8% in 2019. Apex Insight (2020), 'UK Parcels, Market Insight Report 2020', December, Page 53

[138] Ofcom, Annual Monitoring Update on Postal Services 2019-20, Para 4.6

[139] Ofcom, Annual Monitoring Update on Postal Services 2019-20, Para 4.22

[140] Ofcom, Annual Monitoring Update on Postal Services 2019-20, Figure 4.7

Consumers experience in the parcels sector

6.14 Ofcom's Call for Inputs (CFI) sought views from stakeholders on possible issues and detriment that consumers may face in the parcels sector. Royal Mail goes to great lengths to ensure that our customers get a positive doorstep experience. Royal Mail's mission is to own trust at the doorstep. As noted above, Ofcom's Postal Tracker shows that customer satisfaction with Royal Mail remains high.

6.15 We have comprehensive policies on all aspects of the customer delivery experience. Our resource-planning approach ensures that staff have sufficient time to complete their round, including time for customers to answer the door when we knock. New delivery staff receive a week of training under the guidance of a workplace coach before they are allowed to deliver mail on their own. They are taught that part of "*treating every customer and their mail with respect*" includes allowing enough time for customers to answer the door.[141] Our permanent postmen and postwomen visit homes and premises every day, and they therefore know their customers' needs well. They benefit from significant local knowledge. Our best-in-class terms and conditions mean that staff have the ability to focus on quality and not just speed, which is the key factor in gig economy (pence per item) business models of other couriers. We also monitor customer feedback to identify rounds or individuals that need extra support.

6.16 We know that mistakes can and do occur. We have a strong and robust complaints process to help resolve customers' issues. The Consumer Council of Northern Ireland (CCNI) considered that both Royal Mail and Parcelforce's complaints procedures were easy to find, transparent and simple for customers.[142] We continuously seek ways to improve the customer journey. For example, we have developed our online claims[143] process so that [✂]% of online claims are now fully automated with no need for any human intervention. This ensures that claims are handled as efficiently as possible. It has reduced the time it takes for a customer to make a claim, and minimises the stress associated with doing so.

6.17 We recognise that it is vitally important that all customers - including disabled customers - are able to access postal services. Citizens Advice has set out the challenges that some disabled customers experience.[144] As the Universal Service provider, our network is set up to be able to visit every address every day. As noted above, our postmen and postwomen deliver the same round every day. This means that they get to know their customers' needs and take into account where a customer is likely to take longer to respond. A number of the parcel service improvements also benefit disabled and vulnerable customers in particular. For example, estimated delivery windows give more visibility of when an item will be delivered and help customers to plan their day. Inflight Redirections and the expanded SafePlace give customers more control over their delivery. Parcel Collect means that customers can have their parcels collected from their door.

Regulatory ask

6.18 The evidence on the parcels sector shows that it is a sector that is functioning well and delivering good outcomes for both senders and receivers of parcels (Question 6.1). We have not observed any major systemic consumer detriment in the B2C or C2X parcels markets that requires regulatory intervention from Ofcom (Question 6.2).

6.19 End-to-end competition is already well developed and continues to evolve and grow. Carriers across the sector - including Royal Mail - have innovated to deliver increasing quality and range to customers in order to remain competitive. Efficiency gains that carriers have made from improving handling processes have been passed back to customers. The sector has seen long-running and persistent

141 Royal Mail, WPC Guide for New Entrant Induction

142 Consumer Council Northern Ireland (CCNI), Stamp Out Complaints, December 2018, Page 14, Table 3. Please note that we have been informed separately that Royal Mail and Parcelforce are operators 8 and 3 respectively.

143 Claims are a sub-set of complaints about items that are lost, damaged or delayed.

144 Citizens Advice, The Missing Link: Why parcel companies must delivery for disabled people, December 2019.

reductions in prices. All this has occurred as a result of competitive market forces delivering good outcomes.

6.20 Ofcom should not increase regulation in this area. We request that Ofcom allow end-to-end parcel competition - and all the customer benefits that this brings – to thrive.

6.3 Consumer protections

Ofcom question 6.3: How effective are the existing consumer protection measures for users of parcel services, in particular CP 3? Is a change in regulation needed to protect users of postal services (as senders and recipients) and if so, what measures? Please provide your views with supporting evidence.

Overview

Royal Mail is proud to be the Universal Service Provider for the UK. We take this responsibility very seriously. We understand the unique position that this puts us in with regard to contact with consumers, particularly those in vulnerable situations. As such, we fully accept the additional complaints-handling requirements that come with this special status under Consumer Protection Condition 3 (CP3).

Good customer service and treating customers fairly are embedded within our DNA. Royal Mail has a strong and robust complaints-handling process which is prominently displayed on our website and has been recognised as being clear, transparent and easy to find. We also survey our customers at the end of calls and the vast majority of customers (86%) are satisfied with how their complaint has been handled.

The competitive and dynamic nature of the UK parcels sector, and a new generation of users of post, have changed customer expectations. **As parcel volumes have increased, we have evolved our complaints-handling processes to meet this need.** This includes automating the customer journey where possible, introducing new customer messaging, and driving operational improvements. Last year, [✂]% of claims were made through our new online channel, with the vast majority requiring no manual intervention.

We believe that CP3 works well, as it balances sufficient clarity over complaints and redress without over-prescription. It enables our Customer Experience team to handle each case in the way that suits the individual needs of the customer most effectively. In fact, in 2019, when the Consumer Council of Northern Ireland (CCNI) looked into how postal operators comply with the basic complaints requirement, only Royal Mail and Parcelforce Worldwide received a clean bill of health out of the 11 operators assessed.

We do not see the need for any changes to the current Consumer Protection requirements. Instead, we suggest that Ofcom should focus on enhancing its monitoring of the existing Consumer Protection regulations across the industry. If Ofcom believes that there is a need to widen the scope of CP3, so that other parcel operators become subject to more detailed rules, it is vital that there is consistency in reporting definitions and oversight. Otherwise, there will be a risk of undermining competition as customers are misled into making spurious and inaccurate comparisons between operators on the basis of inconsistent statistics.

Background

6.21 Royal Mail has a unique position in the postal sector as the Universal Service provider. We take our commitment to our customers very seriously. We understand the importance of ensuring that customers should have access to a robust and transparent complaints and redress process. Treating our customers fairly is embedded in our DNA.

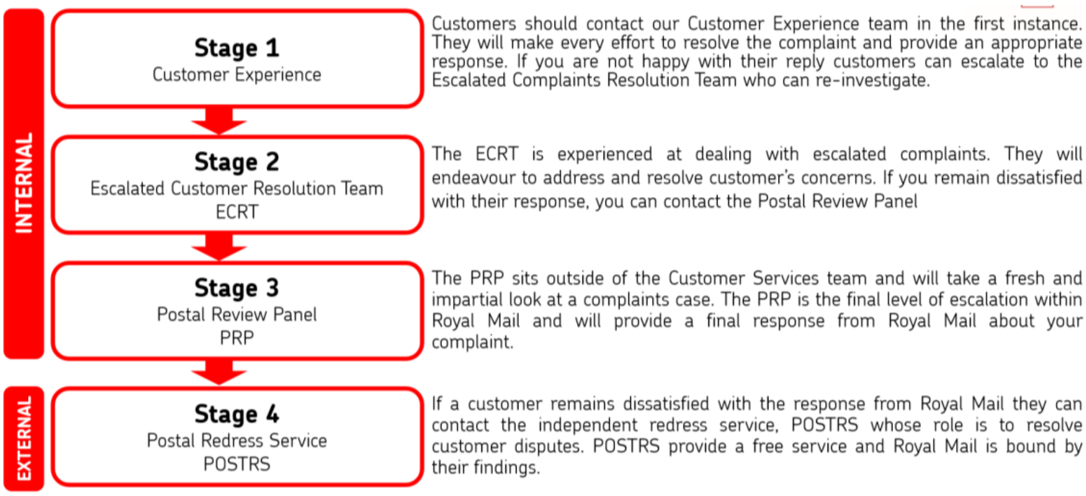
6.22 Royal Mail faces sector-specific regulation standards on complaints. For example, under CP3.3,[145] there are rules governing how Royal Mail should set up its complaints-handling process, how a complaint should be handled, how records should be kept, how and when customers should be

[145] Ofcom, Consumer Protection Condition 3.3, March 2017

contacted, how vulnerable customers should be treated, and how complaints data should be published. By contrast, Ofcom's requirement on other Postal Operators is much more limited - requiring them to have a "*transparent, simple and inexpensive*"[146] complaints procedure.

6.23 Royal Mail's complaints process was originally agreed with Postcomm in 2008, and for more than a decade has set the benchmark for the industry. The process - published on our website[147] - has three internal stages of escalation, with a further option of resolution via the Postal Redress Service (POSTRS), an external body set up via the Centre for Effective Dispute Resolution (CEDR). When customers purchase an item that requires a home delivery, we help to ensure that they know whether to contact us or the retailer with clear signposting on our website.[148]

Figure 6.4: The Royal Mail Complaints Handling process



Complaints process performance

6.24 Our complaints process is robust and performs effectively, as demonstrated by our data on complaint resolution in 2020-21:

- We received a total of 1.17m consumer complaints.[149]
- 99.2% were resolved at the first stage of the process.
- 99.98% of complaints are handled internally by Royal Mail. Of the very low numbers of complaints that are referred for external redress, the vast majority are not upheld. Of the 290 cases referred to POSTRS in 2020-21, only 31 (11%) were wholly or partially upheld.

Figure 6.5: Complaints resolution in 2020-21

		Number of complaints	
Tier 1	Total consumer complaints received	1,170,628	
Tier 2	Escalated to Escalated Complaints Resolution Team	9962	0.85%
Tier 3	Escalated to Postal Review Panel	3450	0.29%
Tier 4	POSTRS adjudication requested	290	0.02%
Tier 4	Decision fully or partly overturned	31	0.003%

146 Ofcom, Consumer Protection Condition 3.2, March 2017
147 https://www.royalmail.com/sites/default/files/Complaint_Handling_Process_AUG_2019.pdf
148 https://www.royalmail.com/help/buying-items-online
149 Defined in Consumer Protection Condition 3.1.2(d) "any expression of dissatisfaction made to a postal operator".

6.25 This is substantially lower than other communications providers. By comparison, CEDR also runs the Communication & Internet Services Adjudication Scheme (CISAS)[150] to resolve disputes between customers and providers of communication services such as broadband and mobile phone services. In 2020, CISAS handled 399 redress cases relating to broadband provision on behalf of BT.[151] Of these, 245 (61%) were partly or wholly upheld.

6.26 Another example of the performance of our complaints process relates to repeat complaints. We have a strong track record of resolving complaints at the first time of asking. In 97% of cases, we resolve them the first time they are raised with us.

Investing in improving the complaints process

6.27 A new generation of mail users has led to changes in how customers complain and the types of complaint that are raised. This is driven in part by the growth in parcels traffic and the increasing move to online engagement. To manage these changes, we have invested in a series of improvements to our complaints process.

6.28 First, we have invested in improving our online claims[152] journey to make life easier for our customers and help them receive swift resolution. We have updated our website to allow customers to upload digital copies of evidence to support a claim. 86% of customers now use this channel to make a claim - an increase of 21% on the previous year.[153] Of those customers seeking to make a claim online, [✂]% are fully automated.[154] This means that, if the customer supplies all of the required information to us and the information is validated, they will not need to contact us again. The remaining 38% still require some level of human intervention to ensure that the customer issue is resolved.

6.29 As new complaint types have emerged, we have analysed the data to drive new processes and innovations to improve the customer experience. For example, an increase in barcoded and tracked parcels led to an increase in Denial of Receipt[155] complaints. Through root-cause analysis, we identified opportunities to improve our customer messaging and operational compliance. We introduced new customer notifications with enhanced information when items were delivered to a neighbour or to a SafePlace. Our operation also focused on operational compliance with the delivery processes on the doorstep. For example, we made sure that our staff understand which items can be left in a SafePlace, and ensured consistent use of the “sorry you were out” card.

6.30 More generally, our parcel customers expect greater transparency and convenience. To address this, we have invested in a wide range of initiatives including Estimated Delivery Window, Delivery Confirmation, expanded SafePlace, Inflight Redirections, Parcel Collect, Parcel Postboxes and free Local Collect – see our response to question 6.1 for more details. These have helped to improve the customer experience, and the additional flexibility should have had a beneficial impact on complaints.

Positive external feedback on Royal Mail’s complaints-handling process

6.31 Complaints are one of the key performance indicators, and this plays a key role in how we manage our business given their visibility to senior management. They are reviewed by the Royal Mail Executive Board on a monthly basis as part of the Board’s focus on the Customer, and key actions are tracked and managed between the Customer Experience and Operations teams. On a weekly basis, overall complaint volumes are reviewed by the Customer Experience team, and daily data relating to complaints is communicated directly to Delivery Offices (DOs).

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150 https://www.cedr.com/consumer/cisas/
151 CISAS, Complaints Case Outcome data 2020
152 Claims are a sub-set of complaints about items that are lost, damaged or delayed.
153 86% of consumers who claimed submitted a claim online in 2020-21, up from 65% in 2019-20.
154 For all business and consumer claims.
155 In these cases, our Track and Trace system shows an item as delivered but the customer hadn’t received it.

6.32 In its report Stamp Out Complaints,[156] the CCNI investigated how postal operators comply with this basic requirement, explaining: "*it is vital to understand if consumers have access to the right information so it is easy to make and pursue a complaint*". Both Royal Mail and Parcelforce Worldwide received a clean bill of health - being assessed as green against each category.

Figure 6.6: CCNI report (Table 3)

Postal operator	Easy to find	Transparent	Simple
Operator 1			
Operator 2			
Parcelforce Worldwide			
Operator 4			
Operator 5			
Operator 6			
Operator 7			
Royal Mail			
Operator 9			
Operator 10			
Operator 11			

6.33 Citizens Advice Scotland has also carried out its own research into postal complaints.[157] It interviewed nine operators and identified that only seven had any complaints policy on their website. It also found that some postal operators did not have a dedicated phoneline, or deliberately made it difficult for customers to contact them via telephone. Royal Mail is the exception to this, noted for promoting the telephone as a key method of contact.

6.34 We also check in with our customers directly. In our latest internal research,[158] consumer satisfaction with Royal Mail Customer Services was found to be very high at [✂]%. In August 2020, we also introduced a new feedback mechanism to gain further insight into our customers' opinions on how we handled their complaint calls. Every customer that calls us to lodge a complaint is offered the opportunity to complete an automated survey of their experience of Royal Mail's complaints handling.[159] We ask the caller to rate the politeness of the call handler, the handler's understanding of the problem, and the customer's satisfaction with the action that we took. Of the c. 8,000 customers surveyed last year, 93% thought our Customer Service call handler dealt with their complaint politely, 91% thought the call handler understood the complaint, and 86% of complainants told us they were satisfied with the actions we had taken.

Regulatory asks

6.35 We do not believe there is a case for change in the current Consumer Protection requirements. We believe that CP3 works well, as it balances sufficient clarity over expectations around complaints and redress without over-prescription. It enables our Customer Experience team to handle each case in the way that best suits the individual needs of the customer.

6.36 Instead, we suggest that Ofcom should focus on enhancing its monitoring of the existing Consumer Protection regulations across the industry. In situations where things go wrong with a delivery, it is crucial for the integrity of the industry that customers are able to contact postal operators and follow clear, transparent and easy-to-find complaints processes.

6.37 If Ofcom does extend parts or all of CP3 to other Postal Operators, it is vital that there is consistency in reporting definitions and oversight. A subjective approach to complaints reporting could lead to a wide discrepancy in the numbers reported by different operators and have a material commercial

156 The Consumer Council for Northern Ireland, Stamp Out Complaints, December 2018, Please note that we have been informed separately that Royal Mail and Parcelforce are operators 8 and 3 respectively.

157 Citizens Advice Scotland, Postal Complaints: improving the complaints experience for consumers, December 2019

158 Royal Mail, Consumer Brand & Satisfaction Survey, full year 2020-21

159 Prior to the call, the customer is offered the opportunity to complete the survey.

impact on postal operators. It could undermine competition if customers are misled into making spurious and inaccurate comparisons between different operators.

6.4 Tracking in the USO

Ofcom question 6.4: Are there any changes to the universal service obligations required for parcels, such as including tracking for First/Second Class services? If so, please provide your views with supporting evidence.

Overview

Royal Mail supports the removal of the prohibition of tracking on First and Second Class letters, large letters and parcel services within the Universal Service. The postal industry has undergone significant change. The rise of e-commerce and online shopping has seen a significant rise in parcel volumes, which has shifted customer expectations. In the face of a rapidly changing market, we need a flexible regulatory framework that supports innovation and enables Royal Mail to bring new products and services to market quickly. This includes the flexibility for customers to choose services that meet their needs, such as tracking.

Tracking is now seen as a hygiene factor for many consumers and SMEs. They need the guarantee of an affordable, high-quality, UK-wide tracking service. In 2020, The Consumer Council for Northern Ireland found that nine in ten consumers believe tracking should be included as standard for parcels. Our own independent research conducted by Illuminas in 2019 backs this up. It found that nearly two-thirds (63%) of residential customers would find being able to track large letters or parcels they send First or Second Class very or fairly appealing.

Tracking also has significant appeal amongst businesses, with two-thirds (66%) being in favour. Just 4% found it unappealing. Marketplace platforms - a major revenue source contributing to the financial sustainability of the Universal Service Obligation (USO) - are recommending parcel operators based on performance and service options, including whether tracking is available.

Current modelling indicates a long-term c.£[✂]m revenue and c.£[✂]m profit risk to Royal Mail's finances if tracking is not able to be provided on USO parcel products and marketplace sellers require a tracked service. This is a material risk to the ongoing financial sustainability of the Universal Service.

Background

Changing market dynamics

6.38 In recent years, the postal industry has undergone unprecedented change. While letter volumes have fallen, the rise of e-commerce and online shopping has seen a significant rise in parcel volumes. Even before Covid further increased demand, the ONS reported that online sales made up 19.2% of total UK retail sales in 2019, up from 18.0% in 2018 and 16.3% in 2017. In 2020, following the onset of the pandemic, online sales grew by 46%, the largest increase since 2008, and made up 27.9% of total retail sales.[160] Royal Mail is now handling many more universal service parcels, and the senders of those parcels are changing. Q3 2020-21 saw a [✂]% year-on-year increase alone,[161] with an increasing proportion of Universal Service parcels being sent by marketplace sellers.

6.39 In the letters market we remain committed to constantly evolving our products and services in line with the ever-changing needs of our customers. In March 2021, we began adding unique barcodes to Second Class stamps, which pave the way for innovative customer services and features to be added to letter products in the future. This forms part of Royal Mail's ongoing modernisation drive aimed at bringing even greater convenience to its customers.

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160 ONS. Internet sales as a percentage of total retail sales April 2021. https://www.ons.gov.uk/businessindustryandtrade/retailindustry/timeseries/j4mc/drsi

161 Royal Mail, Consumer Research Tracker, Q3 2020-21

6.40 To stay relevant and sustainable, the Universal Service must also adapt to life in the 21st century. This year, Royal Mail will simplify and improve its product offerings under a “good”, “better”, “best” approach. The Universal Service framework needs much greater built-in flexibility to futureproof it as user preferences evolve beyond what is predictable today. The inability to offer tracking on Universal Service products acts as a barrier to innovation and prevents us from bringing new products that customers may want in the future to market quickly.

Residential user needs

6.41 In the face of a rapidly changing market, the Universal Postal Service also needs to adapt. While technology has led to unprecedented growth in e-commerce and parcel volumes, it has also led to the ability to offer new services, including the option of tracking on parcels. As a result, consumer expectations are increasing; for many, tracking is now seen as a hygiene factor. The regulatory framework must also respond to these changes. The current definitions are too prescriptive and get in the way of good consumer outcomes. Customers should be empowered to choose their preferred product by allowing a more flexible approach to defining the services that make up the Universal Postal Service, including the option of a tracking facility.

6.42 For residential users, this is clearly supported by independent third-party research and by research commissioned by Royal Mail:

- **Illuminas (2019):** Found that nearly two-thirds (63%)[162] of residential users would find being able to track large letters or parcels they send First or Second Class very or fairly appealing.
- **Consumer Council for Northern Ireland (2020):** Found that nine in ten consumers believe tracking should be included as standard for parcels.[163]
- **Royal Mail Covid research (2020):** Found that tracking is the most preferred change amongst consumers and SMEs (selected by [✂]% of consumers and [✂]% of SMEs).

6.43 Ofcom further underlined these findings in its own User Needs Research in November 2020, which found that around three-quarters of residential postal users believed end-to-end tracking was important for parcels, in terms of either sending (74%) or receiving (78%).[164]

6.44 For letters, our quantitative research[165] suggests that consumers want to be able to track letters and large letters when sending important documents. [✂]% of customers sending letters or documents via Special Delivery Guaranteed (SDG) do so primarily because they want regular updates on the progress of their item through the postal network. In addition, [✂]% of all SDG items sent are either in a letter or large letter format.[166]

Small and medium-sized enterprise (SME) user needs

6.45 Tracking for Universal Services is also needed by SMEs. Independent research commissioned by Royal Mail shows that 66%[167] of SMEs would find being able to track large letters or parcels they send First or Second Class very or fairly appealing, while tracking is the most preferred change to the USO amongst SMEs ([✂]).[168] Just 4% of all SMEs found it unappealing.

6.46 The SME users of Universal Services are also changing. The advent of online marketplaces means more people than ever are selling online either as a supplement to their income or as a small business. Even

[162] Royal Mail, User Needs Research (Illuminas) Residential Report, 2019, Page 5
[163] CCNI “The Universal Postal Service and Northern Ireland consumers”, September 2020, p2
[164] Ofcom, UK Postal Users Research: Quantitative Research Report, 2020, Page 77
[165] Royal Mail, Special Delivery Guaranteed Variant Research, March 2020
[166] 15% standard letter (100g); 28% document (250g); and 13% small thin item (750g).
[167] Royal Mail, User Needs Research (Illuminas), SME Report, 2019, Page 44
[168] Royal Mail, User Needs updated Research, SME, 2020

before the impact of Covid, sales via online marketplaces were forecast to grow from £26.2bn in 2019 to £39.3bn in 2024 the UK.[169] Covid has accelerated this trend.

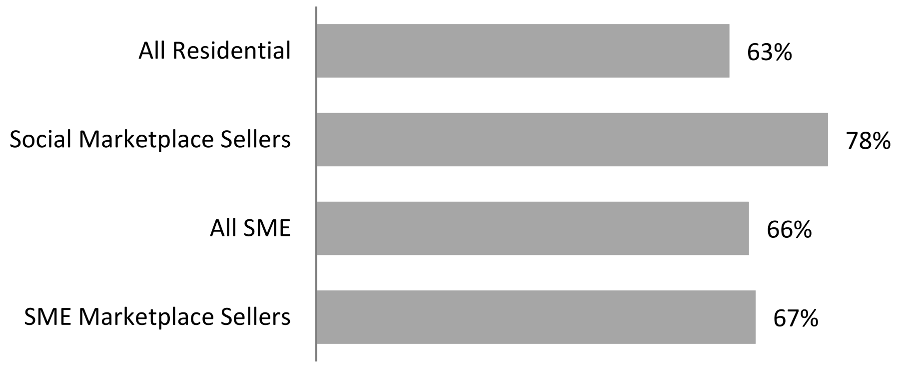
Marketplace sellers

6.47 Royal Mail is seeing this growth in marketplace selling translate into Universal Service parcel volumes. The Royal Mail Consumer Research Tracker found that, in Q2 20/21, marketplace sellers made up [✂]% of total Post Office Ltd (POL) parcel volume,[170] up from [✂]% in Q2 19/20.[171] This represented an overall [✂]% year-on-year increase in Universal Postal Service parcels sent in Post Offices for marketplace selling. Across the whole market in Q2 20/21, [✂]% of overall parcels and large letters sent as a result of marketplace selling were sent via the Post Office as Universal Postal Service items.[172] The increase in marketplace selling is particularly strong among young users. In Q1 20/21, 36% of 16-34-year-olds reported having sold an item on an online marketplace in the last month, compared with 26% in Q1 14/15.[173] In Q1 20/21, 74% of 16-24-year-olds reported ever having sold an item on an online marketplace, compared with 58% in Q1 14/15.

Figure 6.7: Volumes of marketplace seller parcels sent via the Post Office[174] [✂]

6.48 Marketplace sellers expect a lot more transparency when posting items regarding tracking and alert notifications. They are increasingly aware of advanced technology offered by competitors, and they have come to expect proactive communication from services such as Amazon, which send user-centric notifications at prime points of the user journey and offer real-time tracking. This allows them to have better visibility of parcels in the network, and to keep their customers updated on when they can receive their items.[175] Royal Mail research indicates that 78% of social marketplace sellers[176] and 67% of SME marketplace sellers would be very or fairly appealing to have the option of tracking large letters or parcels sent First or Second Class in the UK with Royal Mail.[177]

Figure 6.8: How appealing would it be to have the option of tracking large letters or parcels that you send First or Second Class in the UK with Royal Mail? (% Very/Fairly Appealing)



6.49 Further, marketplace platforms are moving towards tracking as standard in order to improve customer satisfaction. We are under continual pressure from [✂], to offer more and more granular tracking

169 Global Data report, Retail Channel Series: UK Online Marketplace Retailing 2019-2024. https://www.globaldata.com/uk-online-marketplace-spend-set-to-rise-50-1-to-39-3bn-by-2024/
170 Excluding returns.
171 Royal Mail, Consumer Research Tracker Q2 2020-21
172 Royal Mail, Consumer Research Tracker Q2 2020-21
173 Royal Mail, Consumer CSAT: Q1 14/15; Q1 2020-21
174 Royal Mail, Consumer Research Trackers Q2 2019-20 – Q3 2020-21
175 Royal Mail, Special Delivery Guaranteed: Qualitative research debrief, 2020
176 Defined as “Primarily not selling as a primary source of income”.
177 Royal Mail, User Needs Research (Illuminas) Residential and SME Report, 2019

information on our services. There is a risk that they and other marketplace platforms set terms and conditions that are aimed at discouraging sellers from using USO products if we cannot keep pace with tracking requirements. This would result in a significant loss of marketplace sellers. Platforms are already recommending parcel operators based on performance and service options, including whether tracking is available (see Annex D). If we do not have the ability to offer tracking, we will be excluded from an important and growing part of the market, which will make it increasingly challenging to generate sufficient revenue to cover the high fixed costs of providing the Universal Service.

The rest of the market does not meet the need for an affordable, UK-wide tracked service

6.50 All other providers of consumer parcel services offer tracking as standard and have done so for many years. However, no operators other than Royal Mail offer a UK-wide next-day service, at comparatively prices to standard USO products. Hermes applies a variable delivery timeframe dependent on where the item is being sent from and to in the UK. For some UK locations, it applies surcharging. Yodel and DPD also apply surcharges in some circumstances. This means that consumers who want a next-day delivery tracked service in remote locations, such as the Scottish Islands or Northern Ireland, have the option of either paying a premium price for an Express Delivery Courier or using Royal Mail's Special Delivery 1pm service. Ofcom's current approach therefore excludes some UK consumers from an affordable next-day Tracked service. Consumers most disadvantaged by the current regulatory framework are generally in remote locations and are most reliant on the Universal Service. Continuing to exclude Tracking from USO parcels will deprive these consumers from accessing affordable contemporary postal services.

6.51 Royal Mail is also facing increasing competition in the consumer parcels space. In December 2020, Royal Mail signed a new commercial agreement with the Post Office offering both parties greater flexibility to adapt to changing consumer demands and market trends. The Post Office has already begun to leverage this greater commercial flexibility, launching a click and collect trial with Amazon in March 2020.[178] If the Post Office does decide to sell other operators' products alongside Royal Mail's, it is even more essential that USO products remain competitive. Given that any future regulatory settlement is likely to be in place for at least five years, Ofcom must futureproof the regulatory framework to ensure that Royal Mail is able to offer USP products which are able to compete with other parcel services sold alongside them in the future.

Financial impact on the Universal Service

6.52 Revenue growth is key to the financial sustainability of the Universal Service. For the Universal Service to continue to be financially sustainable it must evolve with changing consumer needs, so it continues to be an attractive option in a competitive market. Continuing to prohibit tracking will result in the Universal Services becoming increasingly irrelevant in a contemporary parcel sector. This will significantly impact the financial sustainability of the Universal Postal Service.

6.53 For business planning purposes we have assumed [✂]. Currently marketplace platforms require this information for sellers to benefit from seller protection cover. Our SF product provides this through a higher level of visibility than the delivery confirmation service. However, with technological advances there is an ever increasing risk that marketplace platforms no longer view either delivery confirmation or SF as fit for purpose and require a fully tracked product.

6.54 We do not know when this change might happen, hence [✂]. However, given we expect it is likely, there is a significant risk to the future finances of the Universal Service. For the purposes of modelling we have assumed [✂]. Current modelling indicates a long term c£[✂]m revenue and c£[✂]m profit risk to Royal Mail's finances if tracking is not able to be provided on Universal Service parcel products and marketplace sellers require a tracked service. Up to [✂]% of Royal Mail parcel SF traffic, [✂]%

178 The Grocer, March 2021: https://www.thegrocer.co.uk/convenience/post-office-partners-with-amazon-in-click-and-collect-trial/653741.article

of large letter SF and [✂]% of letter SF traffic could be lost. Given the high fixed cost nature of the Universal Postal Service, it would not be possible to reduce our costs in line with this decrease in volume. The network relies on economies of scope and scale. A significant reduction in network volumes would have a material impact on the ongoing finances of the Universal Postal Service.

6.55 Ofcom has previously argued that "*there is nothing preventing Royal Mail from offering tracked First and Second Class parcels outside of the universal service*". While Royal Mail does offer a consumer Tracked service via its online channel that has VAT applied, it would not make commercial sense to offer a tracked parcel service outside of the USO in the Post Office. Above all, it would increase the cost of a Tracked service to consumers, as there would be a 20% price increase for customers who cannot reclaim VAT. Given the high fixed costs of the Universal Service, it would not be possible for Royal Mail to absorb the VAT increase. Further, our product portfolio would become too complicated for customers to understand and for our channels to sell. For example, we would be offering two similar products at different price points, one of which does not fully meet our customers' needs. Rather than add more products, Royal Mail needs the flexibility to provide a more streamlined product offering where consumers have a choice over the features that they need within the Universal Service product.

VAT exemption on Universal Postal Services

6.56 Offering tracking on Universal Service parcels would not distort the market. In 2017, Ofcom noted that "there is a risk that allowing Royal Mail to offer tracking in the universal service could give it an unfair advantage over its competitors since universal service products are currently exempt from VAT." Universal Services are VAT-exempt because they are in the public interest and must be provided as part of a policy obligation. Consumers benefit through a lower-priced high-quality product.

6.57 It is also widely recognised that Universal Postal Services should be VAT-exempt. Almost all European postal services have the same exemption for Universal Services. Many EU postal services offer tracking on standard Universal Services (for example, PostNL has USO Parcel up to 10kg - delivered to a home address, with Track and Trace VAT exempt). Any "advantage" that is gained from the VAT position on Universal Services is outweighed by the large network and high fixed costs of being the Designated Universal Service Provider.

6.58 Our competitors are not constrained by having to deliver to the whole of the UK at a uniform tariff and service. For example, Ofcom's 2020 Geographic Variations in B2C Parcel Delivery Services Report found that the median surcharge that other operators charge to deliver to Northern Ireland is £9.17. The average additional charge to Aberdeenshire is £9.00.[179] This suggests that there is a significant cost for other operators in delivering to harder-to-reach and remote areas of the UK.

6.59 The parcel industry is highly competitive. The vast majority of consumers and SMEs have a much wider choice than they did in the past. Many rivals have prices that are competitive to Royal Mail's and carry volumes at all weights. These services offer tracking and are in direct competition with the Universal Service parcel offerings. Many consumers expect the ability to track their parcels. If we are not allowed the option of including tracking, our Universal Services will increasingly become less attractive to consumers and retailers who purchase parcel delivery services on their behalf. This will place Universal Services at a competitive disadvantage to other parcel services over time. Having the ability to offer tracking on Universal Service parcels would also not restrict competitors' ability to grow. Royal Mail has offered a fully tracked Special Delivery product for many years now, which has not hindered growth in the premium consumer next-day delivery market.

Regulatory ask

6.60 Royal Mail believes that customers of Universal Services should have the flexibility to choose tracking as an option should they require it at a fair, reasonable and affordable price. We urge Ofcom to

179 Ofcom, "Geographic variations in B2C parcel delivery services report", December 2020

remove the prescriptive regulation which prohibits offering tracking on letter, large letter and parcels services within the Universal Service.

Annex D - eBay delivery operators

Printer required DETAILS

24 Hours ESTIMATED

drop-off at UPS - Next day delivery

DROP-OFF POINT
See map
Drop off your parcel from today

DELIVERY
Mon, April 26
Delivered to home/office

£3.98 + VAT

BOOK NOW

Printer required DETAILS

Details

Service details	Packlink information
- Drop off at drop-off point	- Tracking available
- Estimated delivery within 24/48 hours	- Check the prohibited items list
- Maximum weight 10kg	
- Max. Length 80cm, Max. Length + circumference 180cm	

24 Hours ESTIMATED

drop-off at DPD - Next day delivery

DROP-OFF POINT
See map
Drop off your parcel from today

DELIVERY
Mon, April 26
Delivered to home/office

£5.99 + VAT

BOOK NOW

Printer required DETAILS

Details

Service details	Packlink information
- Drop off at drop-off point	- Tracking available
- Estimated delivery within 2 business days	- Check the prohibited items list
- Maximum weight 15kg	
- Max. 60cm x 60cm x 60cm	

24 Hours ESTIMATED

collection by DHL Parcel - Next day delivery

COLLECTION
Fri, April 23
At home/office if you book in the next 11 hours

DELIVERY
Mon, April 26
Delivered to home/office

£6.18 + VAT

BOOK NOW

Printer required DETAILS

Details

6.5 Approach to regulating parcels

Ofcom question 6.5: Do you have any other comments on Ofcom's approach to regulating parcels? If so, please provide your views with supporting evidence.

Overview

The minimum Postal Services Act 2011 (PSA) standards require us to deliver parcel services five days a week (Monday to Friday) to every address across the UK. In practice, we already deliver parcels six days a week (Monday to Saturday). This reflects consumer demand and market dynamics in the parcels sector. As such, we see no immediate need to add Saturday parcel deliveries to existing USO requirements. We do, however, welcome dialogue with Ofcom and the Government to ensure that the Universal Service regains relevance and is sustainable.

The current USO parcel weight limit should be retained. Reducing the limit to below 20kg could be detrimental to customers. There are some areas of the country where the market is not providing a reliable, affordable collection and delivery service at these parcel sizes.

Delivery days for USO parcels

6.61 The postal sector is changing at an unprecedented rate, and parcel volumes are growing rapidly. Royal Mail is a major physical delivery arm of the UK's flourishing e-commerce industry. Conversely, letters face ongoing and increasing structural decline. The arrival of the global Covid pandemic has only accelerated these trends.

6.62 Given the significant changes we have seen in the market, we continue to believe that the best way to ensure that the Universal Postal Service continues to meet our customers' needs is to rebalance our business model more towards parcels and deliver more of what our customers want, when they want it. This is borne out by our own research and research conducted by our regulator, Ofcom.

Regulatory ask

6.63 The minimum requirements set out in section 31 of the PSA 2011 require Royal Mail to deliver specified parcel services five days a week (Monday to Friday) to every address across the UK. When making the Universal Service Order in March 2012, Ofcom did not add to these delivery requirements. In practice, we already deliver parcels across the UK six days a week (Monday to Saturday), including Universal Service parcels. This reflects the consumer demand and market dynamics in the parcels sector. In March 2021, we started trialling Sunday parcel delivery for major retailers.[180] As such, we see no immediate need to add Saturday (or indeed Sunday) parcel deliveries to the Universal Postal Service requirements (by modifying the Universal Services Order). We do, however, welcome an ongoing dialogue with Ofcom and the Government to ensure that the Universal Service regains relevance and is sustainable.

Weight limit for USO

6.64 The USO requirements on Royal Mail apply to parcels up to 20kg. We consider that these weight requirements are working well. USO parcels up to 20kg provides an essential service for users who need it. As noted in response to question 6.1, while there is evidence of growing competition in Consumer-to-Business/Consumer (C2X) services, the market does not currently provide a reliable, affordable collection and delivery service to all parts of the UK at these parcel sizes, especially above 15kg.

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[180] See https://www.royalmailgroup.com/en/press-centre/press-releases/royal-mail/royal-mail-taps-into-sunday-parcel-deliveries-for-major-retailers/

6.65 No operator other than Royal Mail offers a UK-wide next-day service at comparative prices to standard USO products. Hermes applies a variable delivery timeframe depending on where the item is being sent from and to in the UK. For some UK locations, it applies surcharging. Yodel and DPD also apply surcharges in some circumstances. A reduction in the weight limit could therefore disadvantage customers in remote locations.

Regulatory ask

6.66 The current USO requirements on Royal Mail up to 20kg should be retained.

7. Access regulation

7.1 Scope of access regulation

Ofcom question 7.1: Does the current scope of access regulation remain appropriate or should this be changed and, if so, how and why? Please provide your views with supporting evidence.

Overview

The UK has both the most vibrant access market and the most competitive end-to-end parcels market in Europe. As Ofcom notes in its CFI, "*…access-based competition has remained strong, with access operators' share of addressed letter volumes sitting above 60%*". It is considerably higher for bulk mail contracts with the largest senders. Both retail and access bulk mail customers have benefited from low upstream retail margins resulting from the intense upstream competition. Royal Mail has continued to price in a fair and reasonable manner over the past five years. Customers have also benefited from innovations such as the introduction of Mailmark and greater choice through the recently launched access Economy service. There is also vibrant end-to-end competition in the bulk parcels market. Multiple parcel operators compete for customers. We (and other operators) continue to offer a parcels access service on a commercial basis. In addition, the growth of Amazon Logistics has added, and will continue to add, further disruption to the market.

Given the market environment, there is no case for any extension to the access regime to include lightweight parcels. We request early confirmation that this policy option is off the table to remove unnecessary regulatory uncertainty. The three statutory tests required under the PSA to mandate access for lightweight parcels are not met. Ofcom has considered the scope of the access regime on a number of occasions. In its 2012 and 2017 reviews, Ofcom concluded that there was insufficient evidence to support the imposition of any additional forms of access. Since then, the parcels market has become even more competitive and Royal Mail's market share has reduced. A mandated service could in fact have a detrimental impact on competition and innovation in the parcels market. Moreover, growth in end-to-end parcels volumes and revenues is vital to the future financial sustainability of the Universal Service. We are investing significantly in parcel automation, including parcel hubs. These investments require certainty that our upstream volumes will not be adversely affected by unnecessary regulatory changes. Any potential expansion of the mandated access regime to include parcels would have a material impact on the parcel hub business case outcomes.

We request that Ofcom actively considers removing Fulfilment Large Letters (also known as General Large Letters) from the access mandation regime. The three statutory tests are not met for requiring access for Fulfilment Large Letters. They have a different competitive dynamic and economics to "paper" large letters. They are small packets that typically fit through a letter box. We sell, handle and deliver these items as parcels, as do our competitors. There is sufficient competition for these services from other end-to-end parcel operators. Competition in this area allows customers to send small letterboxable parcels at low prices and high quality with a range of providers. Fulfilment Large Letters should therefore be removed from the access regime.

Finally, we believe that the current regulation of mandating D+2 and D+5 access at the Inward Mail Centre (IMC) remains the most appropriate form of access competition and should not be widened. Access mandation should also not be widened to include D+1 "premium" items. Royal Mail currently provides an access premium service which provides for a late access window (22:30-00:30) for next day delivery on a commercial basis. Demand for the service has been limited and volumes remain low as they have been since the service was introduced.

Access mandation should not be extended to include lightweight parcels.

Background

7.1 Royal Mail commissioned external consultants, Oxera, to provide an independent view of the parcels sector. This included undertaking a detailed economic market analysis, applying the standard tools and criteria used by competition authorities for defining relevant markets and for assessing the level of competition. Oxera's report presents evidence of a highly competitive market where numerous end-to-end operators have challenged, and continue to challenge, Royal Mail across the full spectrum of segments (see Appendix "Parcels market analysis and implications for the scope of the access regime" for the report's Executive Summary). Below is a summary of the key evidence and conclusions. They key points can be summarised as follows:

- **Countervailing buyer power.** There is considerable evidence that the parcels market features many large senders who hold and are able to exercise significant buyer power. Multi-sourcing is prevalent indicating customer's procurement strategies are sophisticated and able to take full advantage of the wide range of available options. The evidence also highlights switching is common and churn rates are high. Survey data indicates [✂]% of B2C senders have switched at least once in the last three years, and [✂]% have switched in the last year. Analysis of our own customer base identifies a link between larger senders and lower prices, providing further evidence of buyer power.

- **Barriers to expansion are low and incentives to expand are high.** There are currently 13 parcel carriers that operate national networks in the UK, covering all customer segments and with an ability to switch the use of those networks to meet changes in demand. Many parcel carriers have flexible labour models. This means capacity to process and deliver parcels can be scaled up or down to accommodate demand relatively quickly (as demonstrated by the Covid pandemic). The evidence also shows that parcel operators have invested heavily and innovated to keep up with growth in demand (eg sortation capacity, networks of parcel shops).

- **Amazon Logistics' entry**. Amazon Logistics entering the market exemplifies the vibrancy and challenge of the competitive environment in which Royal Mail and other parcel carriers are operating. Since 2013, Amazon Logistics has disrupted the industry dramatically. The total volume of parcels delivered by Amazon Logistics has increased at a rate of [✂]% year-on-year, making it the [✂] within a short space of time, achieving a volume share of [✂]% in 2019-2020. This is a result of Amazon's leadership in technology and innovation, alongside economies of scale and density facilitated by vertical integration with the largest online retailer in the UK (estimated to represent at least a third of all e-commerce volumes). Amazon Logistics is now starting to compete head-to-head with Royal Mail and other UK carriers for profitable opportunities to deliver parcels and Fulfilment Large Letters on behalf of third-party sellers, for example, with its "Ship with Amazon" offering.

- **Market shares.** Royal Mail's share in B2C volumes declined by [✂] percentage points over 2016-17 to 2019-20 ([✂]pp over 2013-14 to 2019-20). Across the parcels sector, B2C losses have been partially compensated by B2B gains. In 2019-20, Royal Mail's volume share in B2X was c.[✂]% (and only c. [✂]% in revenues).

7.2 In terms of **market outcomes**, the evidence indicates the parcel market is working to the benefit of consumers:

- All carriers have been innovating to reduce unit costs (sortation, last-mile).

- New business models have emerged (eg aggregators, parcel shops).

- Carriers offer a growing range of high-quality delivery options, as large retailers become more sophisticated and demanding (higher speed, greater flexibility and choice).

- Margins are low and average revenues across the market have been falling.

“Lightweight” items

7.3 We note that Ofcom has not defined “lightweight” items. Instead, it notes that different stakeholders have different views - for instance, “letter-boxable parcels, sub 1 kg parcels and sub 2 kg parcels”.[181] The evidence demonstrates that it is difficult to define a separate market for “lightweight” items as competition in the parcels industry is broad and typical segmentations are increasingly blurred.

7.4 In any competitive market, we would expect to find that parcel operators have different strengths and weaknesses, and different areas in which they have competitive advantages. For instance, Hermes has a lower cost labour model that confers a cost advantage in van delivery operations. Amazon has a flexible and highly efficient operating structure, is a leader in technology and innovation, and enjoys economies of scale and density due to its vertical integration with the largest online retailer in the UK. We can use our foot delivery network to deliver certain smaller parcels at the same time as letters. However, the way our network is configured, the USO provider processing and delivering both letters and parcels, also gives us some disadvantages. One major difference in the configuration of our network is the number of nodes (eg in Royal Mail’s case, delivery offices and mail centres). The standard ‘parcel’ model involves one or 2 major sorting hubs with depots (maybe 50 or 100) from which routes start. This means 2 to 3 sorts of a parcel, each with their own cost. Because of our combined letter and parcel network – our volume, item size, letters and geographic coverage - we have well over 1200 nodes, and [✂]. This leads to [✂].

7.5 To the extent that bulk B2X deliveries can be segmented across different types of items, Oxera’s analysis found that volumetrics rather than weight would be a more appropriate segmentation. [✂]. Segmentations by weight steps (eg 0-1kg, 1-2kg) would be artificial.

7.6 Different parcel network configurations will result in different advantages and disadvantages. In the **van deliverable segment** (in which most items are 1-2kg), [✂].

Figure 7.1a: York with small number of large parcels

Figure 7.1b:York with multiple trays and high number of paper-based large letter items

7.7 Other carriers, on the other hand, are able to “loose load” vehicles for large items. In some cases, they will tip entire trailers onto conveyor belts to unload.

[181] Ofcom, Review of postal regulation - Call for inputs. March 2021, footnote 206, Page 63

7.8 Our total share in the van deliverable segment is estimated to be [✂]% in 2019-20. As such, the van delivery segment is highly competitive, and [✂].

7.9 In the **foot deliverable segment,** the data shows that Royal Mail has [✂]against its closest competitor (Hermes) for bulk B2X senders, irrespective of weight (most foot deliverable items are 0-1kg). Evidence from bulk 0-1kg contracts currently under negotiation indicates that Royal Mail would have to [✂]. Our total market share is estimated to be c.[✂]% (down from c. [✂]% in 2016). This demonstrates that the segment is highly competitive, and increasingly so, with [✂].

7.10 In the **Letterboxable segment** (which in Oxera's analysis includes Fulfilment Large Letters), [✂] due to its role as the Universal Service provider, which enables our customers to benefit from economies of scale and scope. However, there is no evidence that we are able to exercise any pricing power for bulk deliveries due to:

a. Countervailing buyer power (eg [✂]% of all of Royal Mail 24 Fulfilment Large Letters are sent on behalf of Amazon).

b. Contestability/low barriers to expansion - other operators deliver letterboxable items and are enhancing their offering (eg Hermes recently introduced new "postable" rates for bulk senders for items under 1kg[182]).

c. Amazon in-sourcing significant volumes, indicating that Royal Mail's cost position is replicable.

d. No clear Royal Mail cost advantage when items are sold as aggregated consignments (i.e. letterboxable items sent with larger items).

7.11 As a result, Royal Mail's market shares have declined by over [✂]pp between 2016-17 and 2019-20. We face market pressures that constrain our prices and margins, including for Fulfilment Large Letters and the smallest/lightest parcels. This analysis demonstrates that the letterboxable segment is highly contestable and Royal Mail is facing growing pressure despite some degree of cost advantage. Competition is expected to intensify further as the trends identified in (a) to (d) above continue. Importantly, the evidence also indicates there are no significant demand- or supply- side differences between letter-boxable parcels and fulfilment large letters. As a result, the latter were included in Oxera's parcels market analysis and the conclusions above on the letterboxable segment therefore apply to both letterboxable parcels and Fulfilment Large Letters. This has implications for the current scope of access mandation regime, since it indicates that Fulfilment Large Letters (i.e. General Large Letters) should be removed from access mandation (see below).

Statutory tests to mandate access

7.12 Under Section 38(4) of the Postal Services Act (PSA) 2011, in order to impose an access condition, Ofcom must demonstrate that the access obligation is appropriate for each of the following purposes:

- Promoting efficiency.
- Promoting effective competition.
- Conferring significant benefits on the users of postal services.

7.13 The Oxera report demonstrates that the statutory conditions for mandating access for lightweight parcels and retaining access for Fulfilment Large Letters are not met (note this has direct readthrough to our regulatory ask on Fulfilment Large Letters):

- **Promoting effective competition.** In its 2017 Review of Regulation, Ofcom concluded that there was no need to mandate access in parcels given the bulk parcels sector was becoming increasingly competitive.[183] The current evidence indicates that competition has intensified further. Current

[182] https://www.myhermes.co.uk/our-services/our-prices

[183] Ofcom, Review of Regulation of Royal Mail, Statement, March 2017, para 5.68

E2E players already provide effective competition and alternative services to Royal Mail's delivery for all types of parcels/Fulfilment Large Letters. Therefore, no access mandation requirements are needed to promote competition for these products.

- **Promoting efficiency.** In 2017, Ofcom concluded that market conditions faced by Royal Mail incentivised it to improve its efficiency. Current evidence indicates that competition provides sufficient incentives for us to pursue cost efficiencies within a reasonable timeframe. Incentives are likely to become even stronger as competition further intensifies, and Amazon Logistics continues to disrupt the market. When Ofcom stated in 2017 that there was no evidence to warrant mandating parcels, it provided us with the certainty required to invest in parcels sorting machines and parcel hubs. As a result, we have invested significantly to improve our parcel sortation efficiency (eg super hubs). Mandating access to parcels would affect any such future incentive to invest and would create a risk of stranded assets if we were to lose parcel volumes upstream.

- **Conferring significant benefits on end users.** Current evidence indicates that further access regulation would not confer additional benefits. End-to-end competition provides powerful incentives to offer the required level of quality and service. It is a more effective form of competition compared with access competition. Widening access mandation could, in reality, be detrimental to end users due to the adverse effects it could have on:

    1. **Innovation.** There has been significant innovation in parcels as we describe in more detail in our response to Questions 6.1 and 6.2. This has been driven by the intense competition between end-to-end operators. Access mandation could dampen incentives to innovate by damaging incentives to invest in those end-to-end networks.

    2. **Recovery of investment costs.** If a significant volume of our retail parcels moved to access, this could lead to Royal Mail being unable to recover the investment made in our parcels hubs from our retail parcels. Alternatively, there may need to be a significant increase in access prices to cover the investment costs that have already been sunk into upstream parcel automation. Consequently, this could result in price rises for end-consumers.

    3. **Financial Sustainability of Universal Service network.** If access is targeted at areas where we still have some position of relative (but declining) strength, it risks structurally undermining our ability to recover the fixed costs of the Universal Service network. Ultimately, as letter volumes decline, the future financial sustainability of the Universal Service network increasingly depends on our ability to drive sufficient revenues and margins from our parcels business.

Regulatory ask

7.14 As concluded by Ofcom in 2017, there is no need for any extension to the mandated regime to include parcels and we request that Ofcom reconfirms this position early in the review process. In its 2012 and 2017 reviews of the postal regulatory framework, Ofcom concluded that there was insufficient evidence to support the imposition of any additional forms of access. Since then, the parcels industry has become even more competitive. In 2019-20, Royal Mail's volume share in Business-to-Business/Consumer (B2X) was c.[✂]% (and only c[✂]% in revenues).

7.15 Royal Mail has commissioned Oxera to undertake a market analysis of the parcels delivery industry in the UK. It finds a competitive, vibrant industry where numerous end-to-end operators have challenged and continue to challenge Royal Mail across the full spectrum of segments. A mandated parcel service could have a detrimental impact on competition and innovation in the parcels market. Moreover, growth in parcels is vital to the future financial sustainability of the Universal Service. We are investing significantly in parcel automation, including parcel hubs. These investments require certainty that our upstream volumes will not be adversely affected by unnecessary regulatory changes. Any potential changes to the access regime to include parcels would have a material impact on the business case outcomes.

7.16 We have undertaken initial financial modelling to understand the potential implications if Ofcom were to require Royal Mail to widen the access mandation to parcels (see Annex E for more details on our modelling assumptions and analysis). Indicative modelling [✂] suggests that, over the medium term, mandation is likely to reduce revenue by somewhere in the range of £([✂])m to £([✂])m.

Remove Fulfilment (ie General) Large Letters from the access mandation

Background

7.17 Under the current regulatory regime, Ofcom requires us to provide access for D+2 and later letters and large letters and D+5 letters. Large letters are defined by dimensions - up to 353mm in length, 250 mm in width and 25 mm in thickness, with a maximum weight of 750g. The definition of large letters covers any item which falls within these dimensions, irrespective of content. This definition is out of date. It does not reflect the very significant differences in how consumers use paper-based Large Letters and fulfilment Large Letters. Moreover, it does not reflect how we handle these items in our network.

7.18 Fulfilment Large Letters - also known by the access operators as General Large Letters[184] - are small parcels (eg phone cases etc) that typically fit through a letter box. Some examples of a Fulfilment Large Letter >10mm are shown below.

Figure 7.2: Rigid Box >10mm

Figure 7.3: Floppy LL >10mm

Figure 7.4: Small jiffy bag <10mm

7.19 These thick, Fulfilment Large Letters (eg >10mm thick) typically are not sorted through our large letter sorting machines for a number of reasons. [✂].

[✂]

7.20 [✂] The table below sets out the key differences between paper-based large letters and those used for fulfilment. The table clearly demonstrates that FLL (ie General) are treated in our network more like a parcel.

Figure 7.5: Comparison of Fulfilment Large Letters and Correspondence Large letters

Attribute	Paper-based Large Letter (eg Business Mail Large Letter)	FLL (ie General)

184 They are called General Large Letters in Access as there is no content control, such as there is with Business Mail, Advertising Mail or Subscription Mail.

Content	A4 Paper-based documents (eg legal documents etc).  	Goods with intrinsic value or resale value including goods sent in fulfilment of an order; gifts and unsolicited goods; spares and replacement parts. 
Machine-ability	Generally machined on [✂] address is readily readable, and wrapping is suitable (eg paper or polywrap)  	 Generally sorted in Parcel Sorting Machines or manually sorted in bull rings as thickness varies considerably. Many do not [✂].
Tray-ability	Generally, fit effectively into trays providing an efficient way to move round network. Thin LL (<10mm) - 50-75 items per tray 	Generally, do not use trays as inefficient. They are moved round network with other parcels in parcel containers. Thick LL (>10mm) - 10 items per tray if used  More often moved around in Auto Level Packet Sleeve (ALPS): 

Manual sortation	Sorted into a frame	Sorted with parcels into Auto Level Packet Sleeve (ALPS) or drop bag fittings

7.21 In addition to the way Fulfilment Large Letters are handled in Royal Mail's network, the end-customers using these Fulfilment Large Letters will have different characteristics and many more options of supplier than those customers predominantly sending paper-based large letters. Customers sending fulfilment items via Fulfilment Large Letters have the same characteristics and needs as customers using other parcels to send their fulfilment items. They will be very different to the types of customers generally sending correspondence large letters. If they are a bulk sender, they will also have many more options in the market beyond Royal Mail when choosing a potential supplier. There are many end-to-end operators they can use in addition to Royal Mail and the access operators. This is very different to the options available to those customers sending correspondence large letters who can only use Royal Mail or one of the access operators.

Regulatory ask

7.22 We request that Ofcom actively considers removing Fulfilment Large Letters (also known as General Large Letters) from the access mandation regime. The Oxera analysis demonstrates that there are no substantial demand- or supply-side differences between a fulfilment large letter and a parcel that is small enough to fit through the letterbox. There is sufficient competition for these services from other end-to-end parcel operators. Competition enables customers to send Fulfilment Large Letters at low prices and high quality with a range of providers. On the supply side, Fulfilment Large Letters are handled as parcels in our network. As set out above, the three statutory tests for mandating access in lightweight parcels are not met. Given that Fulfilment Large Letters are in effect small parcels, these should be included in any parcel market analysis and hence the same conclusion applies. Fulfilment Large Letters should therefore be removed from the access mandation regime.

Access mandation should not be widened to include D+1 "premium" items

7.23 As Ofcom note in its Call For Inputs document, Royal Mail currently provides an access premium service which provides for a late access window (22:30-00:30) for next day delivery on a commercial basis. Demand for the service has been limited and volumes remain low as they have been since the service was introduced. We agree with Ofcom that there is no evidence that would support the view that D+1 services should be mandated.

Access mandation should not be widened to any point in our network other than the Inward Mail Centre

Background

7.24 In 2012, Ofcom chose to mandate access at the Inward Mail Centre (IMC) in respect of D+2 Letters and Large Letters. It reaffirmed this decision in its 2017 Review of Regulation.[185] Following a detailed review in 2012, Ofcom concluded that mandating access at points downstream of the IMC would not meet the three statutory tests set out above. Whilst Ofcom does not suggest that access should be extended to anywhere beyond the IMC, it is important to re-iterate that the evidence has not changed.

Regulatory ask

7.25 We request that access mandation is not widened to any point in our network other than the IMC. Access at points downstream of the IMC would introduce additional inefficiency and unnecessary cost into Royal Mail's network:

- The automated processing pipeline begins at Royal Mail's IMC sites where mail is processed into batches and then fed through compact sequencing sorters (CSS) located in the IMC or Mail Processing Units (MPUs). These CSS machines sort mail into exact walk order leaving only very low levels of subsequent manual intervention being required in Delivery Offices (DOs). It would be impractical if an operator were to input mail downstream of the IMC. Access mail can only be walk sequenced if it starts its journey through the Royal Mail network at the IMC.
- The current access resourcing framework was designed to offer access at the IMC sites. Mandating access to additional facilities downstream would significantly increase the number of sites requiring management of access procedures, staff and associated resource.
- There would be a requirement for Revenue Protection (RP) at additional sites, which would require significant investment by Royal Mail in staff training, operational equipment and IT systems. This investment would largely represent a duplication of RP facilities that currently exist within IMCs. Existing IMC RP facilities would still be required as access mail would still arrive at these sites. The volume of work these sites would be responsible for would reduce by a greater proportion than their costs, resulting in an increased unit cost of RP at IMCs.
- There are increasing physical space constraints as sites reduce in size, ie downstream of IMCs. Many DO sites are too small to accommodate the heavy goods vehicles used by the access operators.

7.26 Requiring access at points other than the IMC would not promote effective competition, nor would it confer significant benefits on end users of postal services. There is no evidence or analysis that demonstrates that access to Royal Mail's network at any other point than the IMC would generate sufficient consumer or competitive benefits to outweigh the inefficiencies, including stranded costs that we would face. Whilst access at points other than the IMC may benefit a very small number of customers who use that particular niche service, there will be many smaller customers to whom it would be detrimental if such access caused the cost of delivering the USO to increase overall and impacted overall prices.

[185] Recently, access mandation has been expanded to include D+5 Letters. Ofcom, Modifications of the USP Access Condition for regulating access to Royal Mail's postal network - Regulation of new D+5 Letters access services, March 2021

Annex E – Indicative financial impact if access mandation extended to parcels (up to 1kg)

[✂]

7.2 Access price controls

Ofcom question 7.2: How well is our approach to access price regulation working in supporting access-based competition? Are there any improvements or changes that we should make? If so, please provide your views with supporting evidence

Overview

The current approach to access price regulation has been effective in facilitating access-based competition in letters and "paper" large letters. There is no evidence that this approach needs to materially change. There are, however, some technical modifications to the regulatory margin squeeze control (ie USPA6) that would benefit customers.

There is no need to introduce a direct price control on access products. Replacing the current regulatory margin squeeze control with either a direct price control or price cap on access carries a significant risk of regulatory failure. The evidence does not support the introduction of more draconian, prescriptive regulatory measures. This would be a retrograde step. The challenging conditions we face in the letter industry, including from e-substitution and the risk of tipping points, along with access competition, act as a constraint on Royal Mail's pricing. This is demonstrated by our pricing behaviour - which has been both fair and reasonable - since Ofcom's previous regulatory review in 2017.

The current margin squeeze (USPA6) can be improved through some technical modifications to align it better to market dynamics. The current design acts as a barrier to us competing effectively. Customers are won and lost on small differences in prices, which emphasises the importance of getting it right. Our key proposed change is to **remove the contract level test**. Maintaining the USPA6 contract level test is disproportionate. We believe it should be removed or at the very least set at a level that reflects economic fundamentals (i.e. long-run average incremental costs (LRAIC)).

If Ofcom is not minded to take this step, as a minimum, it should refresh the fully allocated cost (FAC) cost benchmark to align with operational reality. We should be allowed to price in line with the market (i.e. down to upstream LRAIC where market conditions require this). Using a 50% FAC cost benchmark is not a reasonable proxy for LRAIC, it overstates our incremental costs and means that we are priced out of competing for some contracts.

USPA6 should also be amended **to remove Fulfilment (General) Large Letters from the test**. The evidence demonstrates that the statutory tests for retaining access for Fulfilment Large Letters are not met. Fulfilment Large Letters are small parcels. See our response to Q7.1 for more details.

Context

Our prices reflect market dynamics and the need to have a market funded Universal Service

7.27 Royal Mail actively considers market dynamics, including significant competition from e-substitution and the risk of tipping points, when making its pricing decisions. We also consider our cost base and the need to have a market funded Universal Service. The fixed cost nature of our letters business means as volume declines, unit costs will increase despite efficiency initiatives.

7.28 We actively consider the impact of pricing on market demand. There continues to be structural letter decline across all key segments. Recent econometric analysis shows that the key driver explaining the observed decline in business mail volumes is gross domestic product (GDP). We believe the impact of

Access business mail price increases is in line with our business mail price elasticities and in line with historic relationships (see Cazals et al. 2020[186]). [✂].

7.29 Advertising mail volumes are performing considerably worse than our econometric models would imply, possibly by c. [✂]%. Based on current evidence, it is difficult to identify a precise cause. We suspect it is due to a variety of factors, including business closures during lockdown, high levels of business uncertainty and the lower cost of using digital media, both in terms of time and money, with the latter increasing in importance in a post-Covid environment. However, it could also reflect more responsive customer reactions to price increases than our estimated price elasticities suggest. As previously discussed, we adopt a cautious pricing strategy on advertising mail, reflecting its higher price elasticity and competition from other media.

7.30 We have consistently deployed a long-term yield optimising pricing strategy for letters, balancing factors such as the prevailing economic outlook, competing communication channels and uncertain prospects for e-substitution when setting our prices. However, occasionally we have had to make difficult pricing decisions to ensure that we have the resources available to support the Universal Service in the medium to long term and to help ensure the Reported Business has the ability to earn a commercial rate of return.

7.31 We actively consider price elasticities when making decisions on price increases in order to avoid activating tipping points. We do not have long-term pricing power but there are some segments which are more elastic than others over the short to medium term. For example, advertising mail has a higher price elasticity than business mail. Given the price elasticity for advertising mail, any significant price increases is unlikely to be financially beneficial to anyone. We are very conscious that significant price increases on advertising mail could simply encourage customers to use other forms of media or to completely stop using letter mail. Hence our pricing strategy is to apply price increases that are close to inflation for advertising mail.

7.32 However, we also need to consider the appropriate price increases necessary to help support a financially sustainable Universal Service. This led us to deploy higher-than-usual price increases for Business Mail in 2021. This decision that was not made lightly and took into account the potential risk of hitting a tipping point and the financial challenges facing the business.

7.33 When considered over the four-year period as a whole, the real compound annual growth rate (CAGR) since 2017 for Business mail (sorted plus access using CPI deflator) is [✂]%, and for advertising it is only [✂]%. We believe these are fair and reasonable given the market conditions we face and the upward pressure on our unit costs, in part due to volume declines.

7.34 Even in the face of the significant volume declines seen in 2019-20 and 2020-21, we have managed to limit the real price increases for bulk business mail (both bulk retail and access) to under 10%. For bulk advertising, our real price increases have remained much lower, at under [✂]%.[187] It should also be borne in mind that these are headline price changes. We work with customers to help them mitigate any price increases. This means, by working with us, customers can experience price increases lower than these headline rates. Our price increases since the last regulatory review in 2017 are shown below in Figure 7.7.

Figure 7.7: Real price increases for bulk business and advertising mail [✂]

We have also sought to identify ways in which we can work with our customers to help them mitigate parts of the increase and realise the commercial value of mail. For example, the launch of a D+5 access

186 Has the Covid pandemic accelerated the rate of decline in business letters? Some early and preliminary analysis and thoughts. Catherine Cazals and Thierry Magnac, Toulouse School of Economics, Frank Rodriguez, Oxera Consulting LLP. Jonathan Pope and Soterios Soteri, Royal Mail Group. Presented at: 28th Conference on Postal and Delivery Economics – Online, 30 November - 4 December 2020

187 Based on actual list prices (headline price changes) and deflated using CPI. Source: Royal Mail Pricing team.

service; encouraging migration to Mailmark, which enables us to share the cost savings with customers; incentive schemes such as Scheme for Growth or the Back to Business scheme.

No evidence to support the introduction of an alternative form of price control or price cap. It raises significant risk of regulatory failure.

Background

7.35 The current margin squeeze control has been effective in facilitating strong access-based competition in letters and large letters. Access operators' share of addressed letter volumes now sits above 60% and both retail and access bulk mail customers have benefited from low upstream retail margins resulting from the intense upstream competition.

7.36 Under the Postal Services Act 2011 (PSA), Ofcom has the power to impose ex ante controls on access pricing. But there needs to be evidence that Royal Mail would set excessive prices or engage in a margin squeeze between retail and access prices, with adverse consequences for users of postal services. We have not observed any such evidence justifying any alternative price control or direct price cap on access. The extremely competitive retail bulk mail market, and the threat of e-substitution, constrain Royal Mail's pricing. There is no evidence to suggest that the price increases we have put into the market since 2017 could be considered excessive. As our audited regulatory accounts (2019-20) demonstrate, we are making a loss of (4.2)%[188] on access products. Market dynamics are leading to an increase in letter unit costs. Letters are in structural decline; we have a high fixed cost associated with being able to provide a letter delivery service 6 days a week across the UK.

7.37 If Ofcom went down the path of setting a price control, it would require forecasts of volumes, costs, revenues and the relationship between these key variables. As Ofcom is aware, there is significant volatility in volumes. History demonstrates the significant issues associated with forecast volumes in the postal sector. It was the difference between forecast and outturn volumes which contributed to Royal Mail becoming loss making (£(120)m in 2010-11) and which required the 2006 Postcomm price control to be reopened.

7.38 Recent experience demonstrates how difficult it would be to accurately forecast volumes. For example, the impact of Covid has seen inland addressed letter volumes drop by c.21% in 2020-21. This would have been unforeseen at the time of setting a price control. In addition, the parcels market is highly competitive, forecasting volumes in this area would be subject to a high degree of uncertainty. In fact, in its 2012 statement, Ofcom acknowledged that:[189]

- "in a highly uncertain market environment, where the level and pattern of demand is unclear, it is not feasible to predict accurately whether a given price trajectory would be adequate to ensure the provision of the universal service is financially sustainable.
- The mechanism for instilling efficiency incentives under an RPI – X formula does not work effectively in circumstances where Royal Mail is struggling financially, and Ofcom has a primary duty in relation to the continued provision of the universal service.
- A price control reduces Royal Mail's flexibility to adapt to ongoing changes in the market and its operating environment."

7.39 These facts have not changed and demonstrate why a price control is not appropriate for post. In our 2020-21 results, we have not given guidance on volume forecasts due to the significant uncertainties.

188 Royal Mail Regulatory Accounts, 2019-20, EBIT financeability margin.
189 Ofcom, Securing the Universal Postal Service: Decision on the new regulatory framework. March 2012, Para 1.19

Regulatory ask

7.40 There is no need to introduce a direct price control on access. Replacing the current regulatory margin squeeze control with either a direct price control on access carries a significant risk of regulatory failure. The evidence does not support the introduction of more draconian, prescriptive regulatory measures. This would be a retrograde step. The challenging conditions faced in the letters sector including e-substitution and the risk of tipping points, along with access competition, act as a constraint on Royal Mail's pricing. This is demonstrated by our pricing behaviour - which has been both fair and reasonable - since Ofcom's previous regulatory review in 2017.

Customers can benefit from some modifications to the current regulatory margin squeeze control (USPA6)

Background

The contract level test in the regulatory margin squeeze control should now be removed. The market level test is sufficient for Ofcom's purposes.

7.41 Ofcom introduced the contract level test in 2012 as a further safeguard to the market level test. Alongside the market level test, Ofcom decided it was necessary to establish a price point control for individual contracts. It believed this was important "*since relying on the margin squeeze basket alone would enable Royal Mail to price at levels for individual contracts below LRIC whilst maintaining the minimum average price (and thereby meeting its margin squeeze basket obligation). Although Ofcom could investigate this behaviour under ex-post competition law powers, for the reasons set out earlier we are concerned that this leaves a risk of targeted pricing which could result in the permanent exit of competitors from the market.*"[190]

7.42 While regulating the pricing of individual contracts might have made sense when the access market was in its nascent stages, it is now disproportionate and overly prescriptive. Ofcom should remove the contract level test. The regulatory market level test is sufficient to facilitate competition. Notwithstanding this point, Royal Mail would continue to be subject to competition law and would assess contract level pricing with reference to the competition law margin squeeze test.

7.43 Royal Mail has a relatively low and falling proportion of retail bulk letters. Its share of letters sent by large businesses has declined over time. The dynamics of the Access market are now well defined. There are now a number of well-established competitors with larger market shares. For example, Whistl is now by far the biggest single upstream carrier for bulk mail and increasing over time, which may itself distort the bulk letters market. This highlights that access customers have not been prevented from entering the market or expanding.

7.44 While our competitors have complete pricing freedom, we are highly restricted by USPA6. They have the freedom to choose how to price individual contracts according to the demand characteristics of their customers. Some of those prices could theoretically be priced at incremental cost, others above FAC. As we explain below, Royal Mail does not have this commercial flexibility. This is neither in the interests of consumers nor efficient competition.

7.45 Our share of this market is now so low that, for any large deal, the market, not the contract test, constrains Royal Mail's pricing. As long as this trend continues, and the market level test is passed, the case for the individual price point control is weak. For any large volume deal, the market level assessment has effectively become a contract level test. The [✂] tender was a real-world example of where the market level test became a key determinant of the decision whether or not to bid, and the

190 Ofcom, Securing the Universal Postal Service - Proposals for the future framework for economic Regulation, April 2011. Annex 7 – Access. Page 42, Para 7.48

offer price we could make when it came up for tender. [✂].Using a cost standard of 50% of FAC is inconsistent with operational reality. Our variable cost is [✂]% of FAC.

7.46 Ofcom's Call for Inputs (CFI) recognised that the appropriate cost standard for assessing contract level prices is the LRAIC.[191] When it introduced the test in 2012, the 50% of FAC cost standard was intended to approximate LRAIC. Ofcom's 2012 Decision noted that it had "*considered a range of evidence regarding what might be an appropriate proxy for contract LRIC. Furthermore, our analysis indicates that 50% of FAC falls within the middle of the range of these estimates.*"[192]

7.47 We recognise that Ofcom is not minded to rely on Royal Mail's LRAIC model for use in the margin squeeze test. However, if the contract level test is to be retained, its ability to promote efficient competition in the Second Class and Economy pre-sort market is entirely reliant on Ofcom defining a suitable FAC percentage.

7.48 Data from our 2020 LRAIC model shows that the variability of our upstream cost base for products within the margin squeeze test is c. [✂]% of FAC. Continuing to maintain the 50% of FAC cost standard as a proxy for LRAIC is therefore inconsistent with operational reality. This test is creating a competitive distortion, as it forces Royal Mail to use a higher cost standard for setting prices in competitive tenders than our competitors.

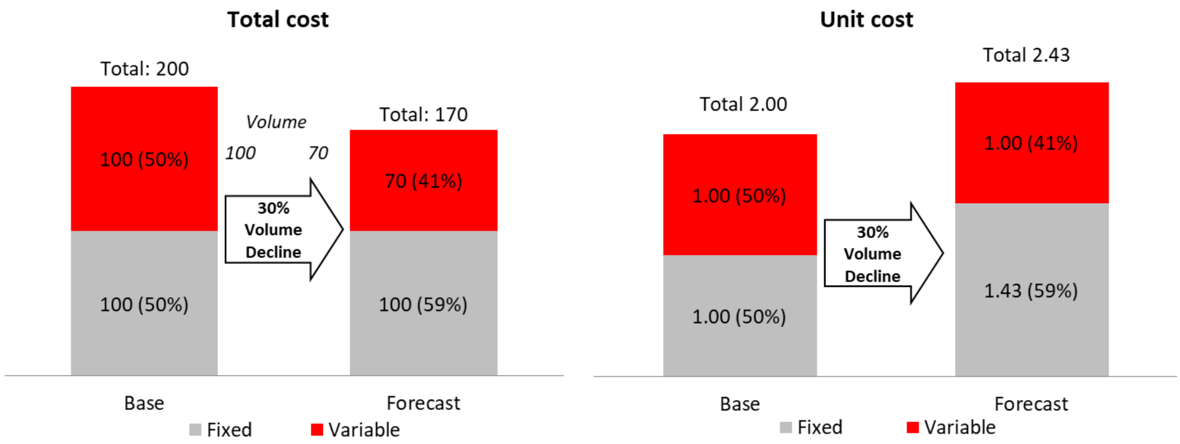
7.49 Analysis shared with Ofcom in our response to the 2017 Regulatory Reporting Consultation indicated a similar level of cost variability.[193] Ofcom did not consider changing the 50% cost standard at that time. Since then, however, Ofcom has developed its own bottom-up cost model of Royal Mail's network. While Ofcom has not shared its view on the level of cost variability within its model, the model allows it to independently assess the level of variability of Royal Mail's cost. This should provide Ofcom with greater confidence to move to a more appropriate, lower cost standard for the margin squeeze test. We would welcome the opportunity to discuss this with Ofcom.

Using a static percentage of FAC is not reflective of incremental cost in an industry which is experiencing structural volume decline.

7.50 FAC includes both fixed and variable costs. If volume decreases - given our high fixed cost network - fixed unit cost, by definition, must increase. By contrast, total variable costs will move in proportion with volume, with variable unit cost therefore remaining the same. In markets with structural volume decline, with time, total unit costs will increase, and the proportion of fixed to variable unit cost will increase. Using an illustrative example where fixed and variable unit costs are both 50%, if volume fell by 30%, absolute fixed cost would remain the same while unit fixed cost would increase by 43%. This would alter the split of fixed and variable cost to 59% and 41% respectively. Continuing to use a static proportion of FAC (i.e. 50% FAC) as a proxy for LRAIC, is therefore flawed.

[191] Ofcom, Review of postal regulation - Call for inputs, March 2021, footnote 186.
[192] Ofcom, Securing the Universal Postal Service: Decision on the new regulatory framework, March 2012, Para 10.135.
[193] Royal Mail, Review of Regulatory Financial Reporting for Royal Mail, June 2017, Para 2.14.

Figure 7.8: Illustrative example of changes in proportion of fixed and variable cost to total cost following volume decline



Impact of the growing misalignment between our variable cost and 50% of FAC over time with volume decline

7.51 Figure 7.9 below sets out the impact on the minimum prices we are required to charge for USPA6 products should Ofcom maintain the 50% of FAC cost standard rather than moving to LRAIC. The analysis is based on our latest USPA6 cost forecast submitted to Ofcom for 2021-22, which had a total unit cost of [✂].

- **Current misalignment ([✂])** – Applying the [✂]% of FAC to the 2021-22 total unit cost forecast leads to a unit cost [✂]. By contrast, applying the 50% of FAC cost standard leads to a unit cost of [✂]. This means that the minimum price Royal Mail must charge today is [✂] higher than the variable cost we observe in our network.
- **Volume impact (a further** [✂]**)** – Ofcom's next regulatory framework is expected to last for five years. Assuming letter volume decline is 7% per annum the total volume decline over the regulatory period would be around 30%. This would cause total unit cost to increase from [✂] today to [✂] with only 70% of volume remaining, as variable cost remains the same but fixed costs increase.[194] Applying Ofcom's 50% of FAC cost standard would lead to a minimum price of [✂] [✂] higher than the variable cost we face in reality.

Figure 7.9: Growing misalignment of 50% FAC to variable cost over time with volume decline

[✂]

The misalignment created by Ofcom's "proxy LRAIC" has been a significant contributing factor to our declining volume and share of Second Class pre-sort letters.

7.52 The misalignment created by Ofcom's proxy LRAIC has stopped Royal Mail competing fairly with access operators. It has been a significant contributing factor driving our volume decline and share of Second Class pre-sort letters. There is a significant downward trend in volumes across all Royal Mail retail bulk letter products, which on average have declined by [✂]% per annum since 2012. This contrasts to an average decline of under [✂]% per annum in Network Access over the same time period. However,

194 Total unit cost ([✂]) – Variable unit cost ([✂]) = Fixed unit cost ([✂]).
Fixed unit cost @ 100% volume = [✂]. Fixed unit cost @ 70% volume = [✂].
Fixed unit cost @ 70% volume (3.77p) + Variable unit cost ([✂]) = Total unit cost @70% volume ([✂])

declines in Second Class pre-sorted traffic have been materially worse, at [✂]% per annum. This is [✂] percentage points per annum higher than retail bulk letters as a whole and [✂] percentage points per annum higher than network access.[195]

Figure 7.10: Volume compound average growth rate - 2012-13 to 2020-21 [✂]

7.53 The faster decline in USPA6 volumes, relative to other bulk letter products with similar cost profiles, suggests the decline is not the result of cost-based competition. Tenders by companies for these products are extremely competitive, with contracts being won and lost on margins of [✂]per item. For non-USPA6 products, we can compete with the other access operators using a measure of incremental cost. However, for the USPA6 products, Royal Mail is required to use a higher cost standard - 50% FAC.

7.54 Royal Mail's Retail Economy product has just been brought into the margin squeeze test. There is therefore a pressing urgency to update the rules to allow Royal Mail to compete for this traffic over the next regulatory period, without artificial regulatory constraints.

Regulatory ask

7.55 Regulation has not kept pace with the maturity of the market. Maintaining the contract level test is disproportionate. It does not allow Royal Mail to compete fairly for the revenue we need to sustain the Universal Service. The basket level test is sufficient for Ofcom to achieve its purposes. The contract level test should therefore be removed.

7.56 If Ofcom does decide to retain the contract level test, then it should update the cost standard, so it is in line with variable costs Royal Mail faces in practice. Ofcom should set the cost standard at [✂]% of FAC. This would allow Royal Mail to compete for traffic on the merits - based on our variable cost - rather than being constrained by a regulatory safeguard that is no longer required in a mature market. Updating the cost standard is in the interests of fair competition and customers. This is even more important now, given that the Retail Economy product has been brought into the margin squeeze control increasing the volume subject to the test.

[195] Note within this analysis the 2c pre-sort (USPA6) definition does not include pre-sorted RM48 Sort Plus LL volumes. This is to ensure consistency of data across the years since RM48 Sort Plus LL was not included in the test until 2014.

7.3 Approach to access regulation

Ofcom question 7.3: Is our current approach to access regulation working well in delivering fair, reasonable and not unduly discriminatory terms of access, and are there any changes we should make? If so, please provide your views with supporting evidence.

Overview

Overall, we consider that Ofcom's **existing approach to access regulation is working well in** delivering terms of access that are fair, reasonable and not unduly discriminatory:

- It is important that Royal Mail **retains the commercial flexibility** to negotiate the terms of access with our access customers, to ensure all parties can respond agilely to industry developments and ultimately generate the **best outcomes for our access customers and the users of mail services, while supporting the financial sustainability of the Universal Service**.
- This flexibility has allowed Royal Mail to develop a range of **innovative services** and solutions in recent years, which have resulted in **clear benefits for access customers and the mail industry**. These services were developed through close engagement with access customers, allowing them time to provide input and prepare for the changes to be implemented.

We believe that the existing safeguards are adequate and that there is no need (or basis) for Ofcom to materially expand access regulation.

However, we do consider that there are **areas where Ofcom could provide additional clarification** in the access condition without compromising its preference for less interventionist regulation:

- First, remove the requirement at USPA 8.1A for Royal Mail to publish the fall to earth volumes of D+2, D+3 and D+4 for the new D+5 service would be consistent with Ofcom's stated intention of allowing Royal Mail and access customers to retain the flexibility of commercial negotiations.
- Second, there would be merit in explicitly permitting Royal Mail's Wholesale team, under USPA5.3, to use access information for purposes that benefit access customers and/or the mail industry as a whole.

Context

Importance of Royal Mail's commercial and operational flexibility to set terms and conditions of access

7.57 Ofcom's current approach, whereby Royal Mail retains the commercial and operational flexibility to negotiate the terms, conditions and charges of its access products and services, remains appropriate. On the whole, the access market is working well for all types of access customer (i.e. carriers, producers/intermediaries and end brands). The access market in the UK is bigger than in any EU country. In fact, no EU country has more than 25% of upstream letters volumes handled by access competitors.[196] As Ofcom acknowledges, access-based competition has remained strong – access customers' share of addressed inland letter volumes exceeds 60% and competition has resulted in benefits to mail users through low retail margins and increased innovation.[197]

7.58 It is important that Royal Mail retains this flexibility to work with access customers to meet the ongoing challenges of maintaining and improving trends in mail volumes, against the backdrop of a structural decline in letter volumes. Both Royal Mail and our access customers need to have the ability

[196] See Para 11 of the Post Sector Report - https://www.parliament.uk/globalassets/documents/commons-committees/Exiting-the-European-Union/17-19/Sectoral-Analyses/27-Post-Report.pdf

[197] Ofcom, Review of postal regulation – Call for inputs, March 2021, Summary box .

to adapt as quickly as possible to ensure our products and services remain appropriate and relevant for the modern communications sector. Being able to respond to customer needs and develop new products supports our wider efforts to simplify and transform, and ultimately generates efficiencies for the industry.

7.59 As set out in more detail below, we consider that this approach generates the best outcome both for Royal Mail and our access customers. Our proposals and negotiations to amend terms and conditions are conducted in a manner that takes account of our overriding obligation to ensure that changes are fair, reasonable and not unduly discriminatory. At the same time, the current regulatory framework allows Royal Mail and access customers to agree changes in a more agile manner, in response to industry developments.

7.60 We therefore welcome Ofcom's statement[198] that any further regulation in this area would need to be proportionate.

No case for significant additional regulation

7.61 There is no evidence to conclude that the current approach to access regulation is resulting in unfair, unreasonable or unduly discriminatory terms of access. As a result, any material expansion of access regulation would be disproportionate.

7.62 We note that access customers have raised concerns that the existing approach allows Royal Mail to act unreasonably (which we disagree with) and that it does not support the development of new services (with reference to the new service request process).[199] We do not consider that to be an accurate representation of the innovation that has taken place in the industry in recent years, primarily driven by Royal Mail. Further details are set out in the section below.

7.63 Separately, we support Ofcom's decision to modify the access condition to bring the new D+5 letters service within the scope of regulation. However, we continue to be concerned that the introduction of an additional regulatory requirement for Royal Mail to report Quality of Service (QoS) data for items delivered on D+2, D+3 and D+4, as well as D+5 is too prescriptive. We consider that it would be proportionate for Ofcom to use the regulatory review to amend the access condition to remove the publication requirement on the fall to earth of volumes on D+2, D+3 and D+4 (i.e. USPA 8.1A). The current approach is unnecessary when we will be providing this information voluntarily to access customers.

7.64 We also consider that there are a number of areas in which it would be beneficial for Ofcom to clarify the terminology in the access condition. We therefore ask Ofcom:

- To confirm that the definition of "Access Operator" in USPA 1.3(ba) should be interpreted as meaning all access customers (i.e. all entities enter into an access letters contract with Royal Mail);
- To confirm that the concepts of "D+2 Access" and "D+5 Access" (as defined in USPA 1.3(f) and (fa)) assume that items are handed over to Royal Mail on D+1. Royal Mail has no control over an access customer's upstream operations – an access customer may hold mail upstream before handing it over to Royal Mail, resulting in a longer delivery time for the posting customer (eg a D+3 or a D+6 service); and
- To bring the descriptions and dates of the publication requirements in USPA 8 into alignment with other areas of regulation - please see our more detailed comments in our response to question 3.1.

198 Ofcom, Review of postal regulation – Call for inputs, March 202, Para 7.53
199 Ofcom, Review of postal regulation – Call for inputs, March 2021, Para 7.51-7.53

Royal Mail has worked well with access customers to develop innovative solutions

7.65 Ofcom's current regulatory framework has enabled Royal Mail to develop a range of innovative new services and solutions in recent years, aimed at addressing particular challenges facing access customers and the mail industry. This includes:

- **48-way sort** (launched 2018) for mech letters to allow customers to present machinable letters to a lower sortation level, resulting in efficiency improvements across the supply chain. Examples of efficiency include maximising container fills, fewer containers being used, less segregation at Mail Centres (MCs) and lower pipeline costs between mailing house and carrier, and between carrier and Royal Mail handover. We now have approximately [✂] of machine-readable letters presented as 48-way sort;

- **JICMAIL** (The Joint Industry Currency for Mail) (launched January 2018) is the industry standard audience measurement data for advertising mail, which serves the marketing services community. It covers business mail, addressed advertising mail and door drops. Royal Mail is the major funder of JICMAIL and was instrumental in establishing JICMAIL in order to benefit the industry. We continue to work closely with them on various initiatives and most recently we have driven the introduction of the JICMAIL levy to open up access to JICMAIL data[200] across the industry. This is used to measure the effectiveness of mail campaigns by providing mail with the same metrics on reach and frequency of the advertising as is available for other media channels;

- **Partially Addressed services** (trial launched November 2018) for advertising/direct mail customers, to help them target and acquire new customers. This was developed and launched by Royal Mail in response to the new GDPR regulations, which threatened some traditional streams of advertising mail. By using a partially addressed service, customers are able to send mail in a highly targeted and responsible way to reach potential customers, without requiring their personal data. To date, despite the impact of the Covid pandemic, these new services have been successful and c. [✂] million items have already been sent using them;

- **Magazine subscription services** (launched January 2019). Magazine publishers, especially those who produce consumer titles such as Cosmopolitan, are facing a number of headwinds. Available space in retail outlets (where c.75% of consumer titles are sold) is reducing, advertising revenue is migrating to digital platforms, and consumers have an unlimited amount of content available for free online. Such publishers are keen to grow their subscription base as it protects print volume and gives them a platform from which they can cross sell other titles or products to consumers who have an affinity with the brand. Our magazine subscription service supports customers with that ambition, through providing 12 months' notification of price changes. The customer dynamics specific to the magazine subscription sector require certainty on postal prices. Through engagement and commercial negotiation with magazine customers, we have agreed a longer price notification period. This gives publishers greater confidence to invest in subscription models where a lower price is offered to readers in return for commitment to buy all editions, and enables publishers to set their subscription rates with full knowledge of what the postal charges will be for the duration of the subscription sold;

- **Mailmark Direct Data** (launched December 2020). As part of upgrades to our Mailmark data warehouse systems and software we introduced new Mailmark reporting functionality and the new Mailmark Direct Data transfer service that automatically supplies customers with item data on all Mailmark items. This was initially introduced on a trial basis, but all participants have now moved to permanent contracts. These contracts were developed on an iterative basis through customer negotiations, taking on board concerns that were raised during the trial; and

200 JICMAIL (through a process managed by Kantar) uses a nationally representative panel of UK households to measure the reach and frequency across different mail types. These JICMAIL metrics provide the same level of data for evaluating the audiences and impact of direct mail that has been available for TV, radio and press for a number of years, and is now giving planners a common currency for advertising mail in the wider mix.

- **New Economy service** (launched January 2021) for up to D+5 Mailmark letters, to provide customers with more choice by offering a lower priced service with slower delivery than the standard access service.

7.66 We adopt a transparent approach with customers when we are considering changes to access products. The above solutions have been developed through close engagement with access customers. For example, we have discussed updates at customer groups - such as the Wholesale Access Group (WAG), Mail Competition Forum (MCF), Mail Users Association (MUA) and Strategic Mailing Partnership (SMP) - prior to final changes being notified. Access customers can, and do, provide input into Royal Mail's proposals via these customer groups, as well as through their regular one-to-one meetings with their Royal Mail Account Directors.

Case study: Inverness Trunking Solution

In January 2019, we opened a new Inward Mail Centre (IMC) in Scotland to better serve the Inverness, Outer Hebrides and Kirkwall postcode areas. From 25 March 2019, this meant that we changed the circulation of access mail for the IV, HS and KW postcode areas from Aberdeen Mail Centre to our new Inverness Mail Centre.

Some access customers raised concerns about the logistical challenges and costs of trunking mail to Inverness. The [✂] raised concerns about having to lay on additional vehicles to attend Inverness and, hence, increased cost of their logistics with no perceived benefit. Additionally, due to the remote location of Inverness relative to the overall national network, there were concerns raised around achieving the Access Window slot times for handover. Initially, our Account Directors held informal discussions with carriers to gauge their thoughts and ideas. From this exercise, a suggestion was made that Royal Mail may be best placed to carry out the logistics and the carriers who wished to participate would share the cost, rather than having to absorb the full cost of laying on another vehicle and driving time.

We therefore introduced a 12-month trial of a trunking service whereby carriers hand over their Inverness labelled containers at Edinburgh Mail Centre and Royal Mail then transits those items to Inverness Mail Centre, in return for a fee.

Following the success of the trial, in March 2020 we introduced a new Trunking Services optional schedule to the Access Letters Contract and the Wholesale Parcels Contract (with effect from 16 September 2020).

7.67 As a result of our transparent approach, access customers also have time to prepare for the launch of new services and solutions in advance of formal notice being given for changes to the terms and conditions.

7.68 The changes considered above demonstrate both how Royal Mail actively engages with customers and also how our proposals are driving innovation in the industry. The flexibility permitted by the current regulatory approach is a key enabler of this.

Formal requests for mandated products for our access customers

7.69 Whilst Royal Mail works closely with access customers on the development of new products, services and operational changes (as set out above), we also have a formal process for responding to customer requests for mandated products.

7.70 Royal Mail first began engaging with customers in 2017 on making changes to this process as a result of customer feedback. We issued the first consultation in November 2017 and subsequently met with all responders individually, held two workshops and engaged with Ofcom. We then issued a second consultation in January 2019.

7.71 We consulted on two main areas - our process and our cost recovery mechanism - and made significant changes as a result of customer concerns about affordability.[201] In order to encourage new ideas from access customers and to support them in putting together their business case for a potential new service without having to commit to any financial outlay, Royal Mail's revised process includes:

- A £500k annual scoping fund to cover the first £500k of external scoping costs up to the end of stage 5 each financial year; and
- A commitment that we will fund all internal costs throughout the entire scoping and development process. The only cost that Royal Mail may seek to recover is external cost during the product development stage. Whether we would seek to recover this cost - and the mechanism used – will be influenced by the six cost recovery principles.

7.72 The updated process[202] came into effect on 20 June 2019. [✂]. In addition, as Ofcom notes, it is "*able to provide guidance on issues such as these, but access operators have not raised a dispute on this particular matter with Ofcom, particularly since Royal Mail has updated its process and principles for determining how costs for new access services should be recovered*".[203]

7.73 It is therefore not clear that the current approach to regulation is somehow stifling innovation on the part of access customers. We do not see how any further regulation in this area would improve access customers' ability to propose new solutions that could be implemented in an efficient manner. As Ofcom acknowledges, with the structural decline in letters, the scope for further investment and innovation in the market will likely diminish.[204] Consequently, we do not see how further regulation in this area would be effective or proportionate.

Royal Mail's use of data under USPA5

7.74 Whilst we believe that the existing safeguards are adequate and that the current approach is working well to deliver fair, reasonable and not unduly discriminatory terms of access, there are a number of areas where both Royal Mail and access customers would benefit from minor amendments to the access condition (without altering Ofcom's overarching approach). This is primarily around clarifying how Royal Mail may use information to benefit the wider mail industry without infringing USPA5.

7.75 Currently, USPA5.3 prohibits Royal Mail from disclosing or using any information it has as a result of providing access (namely, data received from, or about, access customers) for the benefit of our trading business (i.e. Royal Mail Retail), unless consent has been obtained either from Ofcom or from all relevant access customers.

7.76 Royal Mail has robust "ring-fencing" processes in place to ensure that any access information remains within the Wholesale business and is not shared with Royal Mail Retail. Specifically, we:

- Ensure that Wholesale and Retail employees work in separate areas;
- Have system controls in place to ensure that access information cannot be accessed by anyone in Royal Mail Retail, including separate data storage systems; and
- Apply restrictions on how staff can transfer to or from roles in our Wholesale team, such as a waiting period before an employee can move to a role within the Royal Mail Retail team.

7.77 Royal Mail's Wholesale team can see value for our customers and Royal Mail Group if we are permitted to use certain data sets from access customers to drive better industry interventions (i.e. not for the benefit of Royal Mail Retail but to benefit the industry as a whole to maintain and improve trends in

[201] See https://www.royalmailwholesale.com/news/our-decision-on-changes-to-the-access-service-request-process.
[202] See https://www.royalmailwholesale.com/new-service-development.
[203] Ofcom, Review of postal regulation – Call for inputs, March 2021, para 7.53
[204] Ofcom, Review of postal regulation – Call for inputs, March 2021, para 7.53

mail volumes). However, access customers have raised concerns that such use could be contrary to USPA5 and that this data would be used solely for Royal Mail's benefit.

7.78 For example, as part of the Wholesale team's review of the Access Letters Contract (ALC), Royal Mail has engaged with access customers to explore proposals to use access market information, including that available via Supply Chain Identifiers (SCID) and Unique Customer Identifiers (UCID), to capture market insight to support activities that would benefit access customers. The potential benefits of allowing the Wholesale team to access this data include enhancing our understanding of market trends by sector/segment such that we could develop sales propositions, incentives and even products that better meet prevailing market conditions. We do not believe that insight only at access customer level is sufficient to fulfil this important requirement. We could also share best practice using end brand case studies, and Royal Mail would of course continue to observe the existing USPA5 compliance processes.

7.79 At a more granular level, our access customers had, for some time, been asking Royal Mail to make the Media Specialist resource available to them, to put them in a better position to influence their customers and therefore to retain and grow their mail volumes. In 2020 this became a reality. However, as things currently stand, the Media Specialists do not have access to the underlying posting data for any brand and are therefore unable to target their efforts as effectively as would be possible with access to such data. We believe that access to this data would enable the Media Specialists (who are channel agnostic) to work more proactively with access customers and end brands, helping them to identify where customer trends are changing, and facilitating interventions to address the underlying issues.

7.80 The purpose of USPA5.3 is to ensure that Royal Mail does not use access information to obtain a commercial advantage for its trading business, primarily Royal Mail's Retail business where it competes with access customers. In circumstances where the Wholesale team wishes to use access information for the benefit of the mail industry as a whole, or to support the efforts of a Media Specialist to identify brands whose mail volumes were significantly down to then drive a tailored 'case for mail' pitch, we do not believe that such use is contrary to the spirit of USPA5 nor that such use would adversely affect the ability of access customers to compete with Royal Mail Retail. All such endeavours are predicated on protecting and, where possible, growing mail volumes for carriers to carry and producers to produce.

7.81 We therefore consider that it would be helpful for Ofcom to amend USPA5 to explicitly permit Royal Mail's Wholesale team to use access information for specified purposes that benefit access customers and/or the mail industry as a whole. This could be achieved by adding wording to USPA 5.4 to make it clear that USPA 5.3 will not apply where:

> "(f) the information is used by the Royal Mail Wholesale team for purposes which benefit access customers and/or the mail industry as a whole, provided that no disclosure of information shall be made to persons within the Royal Mail Retail trading business conducted by the universal service provider."

Regulatory ask

7.82 We consider that there are areas where Ofcom could provide additional clarification in the access condition without compromising its preference for less interventionist regulation, as follows.

- Removing the requirement at USPA 8.1A for Royal Mail to publish the fall to earth volumes of D+2, D+3 and D+4 for the new D+5 service would be consistent with Ofcom's stated intention of allowing Royal Mail and access customers to retain the flexibility of commercial negotiations.
- There would be merit in explicitly permitting Royal Mail's Wholesale team, under USPA5.3, to use access information for purposes that benefit access customers and/or the mail industry as a whole.