

13<sup>th</sup> February 2020

## **Mail Competition Forum response to consultation on Ofcom's proposed Plan of Work 2020/21**

### **Introduction**

The Mail Competition Forum (MCF) is a group which represents the interests of many of the UK's leading mail and parcel operators, who compete both with one another and with the incumbent Designated Universal Service Provider, Royal Mail (RM). The objective of the MCF is to support the development of conditions in the UK for fair, vibrant and sustainable competition to Royal Mail within a stable and undistorted market.

RM has a near monopoly in the delivery of mail and a high market share in parcel services, especially for items below 2kg in weight. This gives RM high market power while subject to little competitive pressure. The MCF believes it is therefore vital for a healthy postal market and to ensure the continuing, sustainable provision of the Universal Postal Service that there is effective regulation of RM to mitigate its market power and apply constraints in the absence of market competition.

In this context, Ofcom has statutory regulatory duties:

- In the Communications Act 2003 "*to further the interests of consumers ....., where appropriate by promoting competition*"; and
- In the Postal Services Act 2011 "*to secure the provision of a universal postal service ... for the provision of a universal postal service to be financially sustainable ... for the provision of a universal postal service to be efficient .... and for its provision to continue to be efficient*"

The MCF welcomes the opportunity to comment on Ofcom's proposed Plan of Work for 2020/21, which we have considered in the context of Ofcom's 2019 Annual Monitoring Report and Ofcom's continuing work to understand the needs of mail users and consider the future regulatory framework for post.

### **Annual Monitoring Report (AMR)**

Ofcom's latest AMR (covering 2018/19) found that:

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- *There was a downward trend across RM's efficiency metrics, with a slight increase in real costs and negative overall efficiency. RM failed to achieve its target productivity improvement of 2-3%.*
- *The profitability of the part of RM that provides the universal service declined, with EBIT of 1.6%*

Ofcom says that "We continue to believe that efficiency gains are crucial in ensuring the sustainability of the universal service", but "though the financial position and financial health metrics of the Royal Mail Group do not indicate any short-term financial health issues.... The longer term sustainability depends on a range of factors, including the extent to which the revenue growth and Royal Mail's transformation programme, set out in its five-year strategy, can be delivered," adding "We note that the strategy is subject to some risks... In its half-year results announcement, Royal Mail noted that transformation is running behind... Therefore, we believe that uncertainty remains about the longer-term sustainability of the universal service."

It hence seems clear to the MCF that Ofcom has concerns about the sustainability of RM's provision of the Universal Service.

The MCF also saw as some key findings of the AMR:

- Mail volumes declined by 8% in 2018/19 and have now declined by 20% since 2014/15. Over that same period, RM's prices for bulk business mail services have increased in real terms by around 7% for both Retail and Access.
- RM's costs increased marginally in real terms and have reduced by less than 5% since 2014/15 – despite the 20% fall in volumes.
- RM made no productivity improvement in 2018/19 and the improvement was only 0.6% in the year before, despite RM's own target of 2%-3%.
- RM's EBIT has consistently fallen from 5.6% (2014/15) and showed a sharp drop from 4.4% (2017/18) to only 1.6% in 2018/19.
- Ofcom believes that if RM's provision of the Universal Service is to be sustainable, its EBIT should be above 5% (or have a trend exceeding 5%); if the forecast EBIT stays below 5% or has a trend taking it below 5%, that would indicate that Universal Service provision faced financial sustainability issues.

We believe it is therefore clear that RM is not improving its efficiency as it needs to and could do, while it instead uses high price increases to support its profits, and RM's profitability trend raises real concern for the sustainability of Universal Service.

It also seems clear to us that Ofcom's belief in there being sufficient pressures on RM to improve efficiency (e.g. from shareholders), without need for regulatory action, is misplaced as such pressures evidently do not apply to the necessary extent.

Ofcom seems to believe that the best approach is to allow time for RM's 5-Year strategy to be followed and achieved, yet RM's most recent financial announcement [05/02/20] has said:

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*“Unless we are able to make significant progress in delivering our transformation plan, our ability to meet the year 3 targets of our Journey 2024 plan will be compromised”.*

RM further says *“delays to the delivery of our transformation plan, when combined with continuing economic uncertainty, increases the likelihood that UKPIL will be loss making in 2020-21.”*

There has been a further 8% fall in mail volumes since 2018/19 and RM expects a similar decline this year and next, but price increases have meant mail revenue is down only slightly (0.4%).

For 2019/20 so far, RM says it has achieved productivity improvement of 1.3%; that is still below RM’s internal target of 2%-3% (and Ofcom’s own assessment of RM’s productivity improvement has tended in the past to be lower than the company’s).

The MCF therefore strongly believes that if Ofcom is to act in line with its statutory duties, its 2020/21 Workplan needs to include considerable work on assessing the need for and application of new regulatory conditions setting efficiency improvement targets for RM and constraining the level of price increases for bulk mail services.

### **User Needs Research**

The MCF is aware that Ofcom is currently undertaking qualitative and quantitative research into the needs of postal service users and appreciates that this research should consider consumer and SME users’ needs.

However, we believe that this work cannot be limited to consumers and SMEs, but must also assess the needs of users of high volume, contract services.

Although those services are not included in the Universal Services Order (USO), the revenues which RM receives from them is the main contribution to funding RM’s provision of the USO. Also, RM applies the USO service specification, such as 6-day delivery of mail, to non-USO Retail and Access services.

There are, therefore, clear links between the USO specified to ensure there is provision of services for consumers and SMEs, and the non-USO services used by large customers.

The MCF believes this means Ofcom should have a good understanding of the needs of large-scale postal users when considering user needs and any potential changes to the USO specification or coverage.

We appreciate that Ofcom did undertake some research in 2019 into large customers’ use of mail and their perceptions of the mail market, but we strongly believe that Ofcom’s current work on postal users’ needs must include structured research into the needs of large users of postal services.

### **Ofcom Workplan 2020/21**

This includes two work areas related to the postal market: Review of user needs and Review of the future regulatory framework.

The MCF supports this work, but is concerned that Ofcom uses the heading of “Sustaining the universal postal service” when describing these two work areas.

We believe this means Ofcom is not adequately recognising that its statutory duty in relation to universal service provision requires such provision to be efficient, and for its provision to continue to be efficient.

Hence we strongly believe that the Workplan should also include the two other areas mentioned so far in this response:

- assessing the need for and means to apply new regulatory measures that will set efficiency improvement targets for RM, and constraints on the level of price increases for bulk services; and
- structured research into the needs of large users of mail.

The draft Workplan also refers to Ofcom’s continuing work on monitoring RM’s performance. As part of this, during 2019 Ofcom developed its understand and modelling of RM’s cost drivers. The MCF sees this as important work, which should be used in considering how to require RM to improve productivity.

However, we believe Ofcom’s modelling should be expanded to consider the costs and efficiencies of RM’s network if it were not predicated on existing locations but instead optimised the number of delivery depots/offices. It is clear to us that RM is already making some quite radical changes to its network and site utilisation as it seeks to move ever more to being a parcels-focussed business; as well as new parcel sortation locations, some rationalisation of delivery depots/offices must be likely. It is important that Ofcom’s cost modelling is not constrained by using a model fixed on a legacy network.

We believe this is a key aspect of Ofcom considering not just how efficient RM is in its current postal operation, but also how that operation could and should change to be more efficient.

The MCF has noticed that there are two very similar workstreams in the Citizens Advice draft work plan and the Ofcom proposed Workplan: *Making future postal services work for all consumers* and *Review of User Needs* respectively.

Given the stakeholders involved in both these workstreams, and the obvious similarities, the MCF would like reassurance that there will not be a doubling up of work carried out by both Ofcom and Citizens Advice, and that both organisations will coordinate to avoid duplication, not least because stakeholders are funding this work.



Within the *Review of the future regulatory framework for post* workstream, Ofcom states there will be a review into whether extra consumer protections are required.

The MCF would like to see more detail in the final Workplan on what it meant by “extra consumer protections”. It is very hard to provide views on this work area when so little detail is provided.

Lastly, the MCF would argue that Ofcom’s draft Workplan does not include any work in the postal market to address its statutory duty to further the interests of consumers, where appropriate by promoting competition.

When Ofcom became the postal regulator in 2011, its first regulatory review included a reduction in the scope of the condition on RM to provide access to its network. Since then, there has been no expansion in the range of competition to RM and, it could be argued, actually a reduction in competition in the mail market with the disappearance of final delivery competition and fewer upstream competitors to RM.

The MCF has said previously that Ofcom should properly consider whether to widen the requirement for RM to agree access to its network. In the past, Ofcom’s position seems to have been to wait for those seeking new services with which to compete against RM to show the commercial case for and customer benefits of a specified change to the access mandate.

The MCF believes that will not happen, as it is not good business practice to commit the considerable resources needed to make such a case, when there is no indication that Ofcom would undertake the work to consider the regulatory change needed.

As Ofcom prepares for its next regulatory review (concluding in 2022), the MCF believes that, ten years on from the reduction in the access mandate, Ofcom should consider where the mandate could be extended and engage proactively with the postal industry in that.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Ian Paterson", written over a light grey rectangular background.

Ian Paterson  
MCF Secretary