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Lucy Cass
Ofcom
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Dear Lucy

Re Whistl response to Ofcom Consultation
Review of the second class safeguard caps 2019

Background

Whistl thanks Ofcom for the opportunity to make relevant representations to its consultation on the proposed price caps for Second Class standard letters, large letters and parcels up to 2Kg. These caps are in place to ensure a basic universal service is available to all and that Royal Mail can earn a reasonable commercial rate of return on the safeguarded products. Caps were selected by Ofcom in 2012 as one of a series of measures to enable greater commercial freedom for Royal Mail when it took over the regulation of the sector from Postcomm.

The caps apply to USO services where Royal Mail is the Universal Service provider. As Ofcom acknowledge Royal Mail has a near monopoly in letter delivery, delivering USO mail services, Retail Bulk mail and Access mail. Ofcom also acknowledge that Royal Mail also has a significant share in the small and medium parcels sector which combined with an extensive access network gives it a significant degree of pricing power. Royal Mail deliver both letters and small parcels through its unique delivery network. Royal Mails ability to provide the USO is driven by volume and revenue from both USO services and non USO services, such as Access and Parcels.

Ofcom has legal duties to secure an efficient and financially secure universal postal service. Ofcom believes that the USO is currently financially secure and is likely to remain so in the immediate future although it does acknowledge a number of potential challenges. Ofcom surprisingly does not mention in the consultation its legal duties under the Communication Act 2003 "to further the interests of consumers in relevant markets, where appropriate by promoting competition."

As principally a provider of bulk mail services through Access and a broker of contract B2C parcels the size of the caps are not directly relevant to Whistl's business model or those of its customers but the proposals do have an impact on the market overall. Whistl has every reason to believe and support the analysis that Ofcom has produced on expenditure on services and affordability for vulnerable groups.

However Whistl does not believe that the proposals are necessary and think that Ofcom should adopt a different approach.

Competition in Post and Parcels

It is not lost on Ofcom that, in the more competitive parcel market, the existing headroom remains significant; whereas in the captive letters market, the headroom has been all but used up by Royal Mail. Competition has a big impact both on pricing decisions and in the driving of efficiency. In the Access market the prices charged to

customers for the services of collecting and transporting bulk mail in the competitive upstream sector for large contracts are currently in the order of 10% of what they were when Access was first launched, compare and contrast this with the fact that the prices in the captive downstream sector for these customers' volumes have nearly doubled in the same period.

Similarly it would be hoped that a more competitive market would act as a major spur to Royal Mail efficiency, help generate a financially sustainable USO and hold (or even reduce prices) for consumers of postal services. Whilst Ofcom acknowledge that Royal Mail have made some modest efficiency improvements their progress is said to be at the bottom end of what could reasonably be expected and if it were a school report would no doubt read "could try harder". Royal Mail's recent announcements of woeful progress on efficiency improvements in 18/19 to date, a significant downgrade on its own cost avoidance target and subsequent profit warnings emphasise this point. Ofcom's assertions that market conditions and shareholder discipline continue to provide efficiency incentives don't go far enough or deep enough.

Royal Mail must do more to tackle its legacy cost base if it is to continue to thrive and Ofcom must find ways to encourage this rather than continuing what seems like a never ending regulatory bail out of a private company. Royal Mail management must not be in a position to duck the difficult decisions or take the easy path (such as awarding pay deals above the limits negotiated in the Agenda for growth for example) and must finally grasp the nettle of its costs rather than allowing them to run away with themselves. If management is allowed simply to price its way out of trouble, as Stuart Simpson signalled was his intention during the recent investors conference call, improvements in efficiency will continue to be at the bottom end of what Ofcom, shareholders, customers and the market deserves and wants; a more efficient and sustainable Royal Mail that we can all be proud of.

Alternative proposal

Whistl believes that Ofcom should adopt a different approach to that proposed. Whistl believes that Ofcom should retain the current cap mechanism for letters until the next major regulatory review in 2022 and hold, or even potentially reduce, the parcel cap. This will ensure that the focus falls in the right area, improving efficiency across the network and not allow the cost of continued poor performance in this area to be paid for by consumers of postal services. It is through sustained efficiency improvements that the USO will be secured, not through regulatory handouts facilitating price increases as proposed.

Further Whistl believes that the users of postal services should benefit from further competition and Ofcom should use their CA powers to do more to encourage this with the widening of mandated Access, particularly in the lightweight and tracked parcels area where Royal Mail have significant market power. Rico Back acknowledged that Royal Mail needs to do much more to lift parcels automation above 10% and improve efficiency so it seems surprising that Royal Mail are as yet unwilling to entertain a barcoded tracked Access parcel product that would have all of the features necessary for such automation.

Yours sincerely

CAS Neilson
Director of Postal Affairs