



## **Ofcom Review of Postal Regulation Consultation**

### **Mail Users' Association – Formal Response**

MUA thanks Ofcom for the opportunity to contribute further to its Review of Postal Regulation, having previously responded to Ofcom's 'Call for Inputs' on the same subject.

#### **1 Introduction**

- 1.1 Mail Users' Association (MUA) seeks to champion the interests of the UK's large users of mail services. MUA members represent UK companies who are senders of large volumes of mail originating from financial services, magazine publishers, mail producers, and mailing equipment and system providers. Collectively, MUA members estimate they account for in excess of 10% of the annual volume of mail posted in the UK.
- 1.2 MUA seeks an open and efficiently competitive market for mail services, which offers a wide choice of services with specifications, service quality and pricing that encourage the use of mail as a communications medium between businesses and their customers.
- 1.3 Given the high market power of Royal Mail and its monopoly in delivery of mail, MUA members believe effective regulation to mitigate that market power is a vital requirement for a healthy mail market, while ensuring the continuing sustainable provision of the Universal Postal Service.
- 1.4 In that respect, we note Ofcom's statutory regulatory duties:
  - to further the interests of consumers ....., where appropriate by promoting competition (Communications Act 2003); and
  - 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 before the end of a reasonable period, and for its provision to continue to be efficient at all subsequent times (Postal Services Act 2011)

#### **2 Ofcom's Proposed Regulatory Approach**

- 2.1 MUA Members' continue to maintain that the existing regulatory regime does not provide sufficient incentive for Royal Mail to improve efficiency, or sufficient constraint on its behaviour, its ability to exercise its market power or to set unreasonable terms and conditions, and does not enable effective competition.



- 2.2 MUA would once again stress that although its members principally make more use of Royal Mail's Access contract services and non-USO services, their use of these services plays an integral part in contributing to the revenue Royal Mail requires to sustain the provision of the Universal Service. Members therefore see a strong synergy between these revenue streams, the continuance of the universal service, and Ofcom's statutory duty under the Postal Services Act 2011, to secure the provision of a universal postal service, while having regard to its financial sustainability and efficiency.
- 2.3 MUA members consider the importance of maintaining letters mailstreams alongside the developing parcels infrastructure is of paramount importance to the success of Royal Mail as a whole. Members would make the point that paradoxically even though the parcels sector of the market is the growing part of Royal Mail's business, it is in a very competitive market and is also the least profitable. Whilst at the same time, the shrinking part of Royal Mail's business is also the most profitable, given that it has a monopoly on the final delivery of mail.
- 2.4 MUA Members therefore believe the dilemma for Royal Mail is that its developing parcels business continues to rely heavily on its letters delivery network, because only by combining the costs of both elements can it realistically support its developing parcels aspirations. This makes Royal Mail's apparent pursuance of an aggressive revenue maximisation strategy in the letters market, short sighted in the extreme, and potentially damaging to the future sustainable provision of the Universal Service. As MUA has emphasised on previous occasions, excessive pricing in the bulk mail letters market, will only serve to drive down volumes in the long term, and further threaten provision of the USO.
- 2.5 This leads MUA members to believe that regulatory intervention in this matter not only makes sound sense, but also fulfills Ofcom's remit as laid out in the Postal Services Act 2011. The short-termism of using excessive price increases in the letters market as a 'cash cow' to provide revenue to develop Royal Mail's parcel offering and appease shareholders, will ultimately only serve to destabilise the UK postal market in the long term.
- 2.6 MUA members would also state as competition in the small/lightweight packets market increases (of which Royal Mail presently holds approximately 95% UK market share), and larger competing parcels businesses begin to accrue the necessary drop densities to deliver lighter weight items, Royal Mail's economic model could become increasingly vulnerable, once again potentially threatening Universal Service provision.

### 3 **Ofcom's Approach to Sustainability of the Universal Service**

- 3.1 MUA members are in general support of Ofcom's proposals to strengthen its



monitoring regime by requiring Royal Mail to provide a five year financial forecast, and to publish its longer term efficiency expectations. Members believe requiring Royal Mail to explain in successive years, how it had measured up against its forecast, and where it has deviated from that plan, will allow greater transparency for stakeholders in the market. It will also give a public reference point on which to track efficiency improvements, whilst also providing a measure on which to make future regulatory assessments.

- 3.2 However, members consider that greater accountability is required in this process, so stakeholders have a clear understanding of what regulatory actions may be taken and/or triggered in varying circumstances, in which Royal Mail is failing to achieve its efficiency improvement plan, and there is a perceived threat to sustainability of the universal service.

#### 4 **Efficiency Expectations**

- 4.1 MUA Members do not believe the approach Ofcom has taken thus far of relying on shareholder pressure to drive forward efficiency improvements, is a sound regulatory approach. Members believe shareholder pressure does not provide the right incentives for Royal Mail to improve efficiency. Nor do members subscribe to the view that shareholder incentives and insufficiently challenging efficiency targets would be likely to serve to put pressure on Royal Mail to challenge itself, and mean profit predictions would be less attractive to potential and existing investors.
- 4.2 Indeed, MUA members would maintain that shareholder pressure would only come to bear, in a scenario where profitability was impacted by a lack of cost control. However, given that Ofcom's proposed approach to regulation would enable Royal Mail to continue to introduce price increases over and above inflation, to offset any shortfalls in efficiency improvement, MUA members believe it is a valid argument to say shareholders will be likely continue to see the expected level of returns on investment, and depending on how Royal Mail approaches its pricing in the future, may well even potentially see increasing returns.
- 4.3 From the discussions MUA has thus far had with Ofcom, members also fail to be reassured by the Regulator's position that it is not within its remit to determine appropriate levels of cost reduction and/or efficiency improvement targets, given this stance offers customers no protection in terms of downward pressure on pricing. Members would argue that within Ofcom's proposals to strengthen its monitoring regime, by requiring Royal Mail to provide annually a five year financial forecast, these should reasonably include projections for volume erosion and some form of forecast as to the financial impact of this. Royal Mail should then be 'incentivised' to achieve those cost reduction targets, in line with the forecast increase in costs to offset this.



- 4.4 Indeed, MUA members would urge Ofcom to consider taking a regulatory stance whereby price increases should be targeted to remain at inflation or below, with aggressive cost control measures along with targets being put in place to ensure Royal Mail adapts its operating model accordingly, as mail volumes reduce. In circumstances where this is not possible, Royal Mail should be prevented from increasing profitability through price increases. In this way, a failure to deliver on targets for cost control would then result in a drop in profits and shareholder value, at which point the shareholder pressure to which Ofcom often alludes should become reality.
- 4.5 In this respect, MUA members do not believe Ofcom's monitoring of Royal Mail's efficiencies programme goes far enough, or is sufficiently robust. This is based on the fact that shareholder incentive as an approach to drive forward efficiency improvements has not been an effective driver to date. Members would argue shareholders are incentivised by dividends, not efficiencies. Royal Mail management's decision to pay out £400m in special dividends and share buy-backs to satisfy their shareholders' position, which are arguably being funded by above inflation price increases imposed on customers of Royal Mail's non-USO products and services, has done nothing to improve efficiency. Indeed, this has actually taken place against a backdrop of a reduction in the working week for Royal Mail operational staff (from 39 to 35 hours), thereby reducing productivity even further. Over the same period, industry pundits have reported 'Royal Mail's pre-tax profits jumped to £726 million in the 12 months to the end of March, up from £180 million the previous year. Adjusted operating profit, meanwhile, rose to £702 from £325 million'<sup>1</sup>.
- 4.6 Yet MUA Members note Ofcom states in its document 'We also considered the possibility of imposing efficiency targets for Royal Mail. However, attempts to increase incentives by setting targets could be difficult to establish, implement, monitor and enforce, and may have little additional effect for an organisation that is already under pressure to cut costs<sup>2</sup>. In light of the statements above, MUA members struggle to understand how Royal Mail is demonstrating itself to be an organisation under any real pressure to cut costs?
- 4.7 Aside from the fact that the difficulty in establishing, implementing, monitoring and enforcing targets, is arguably not a satisfactory reason for not setting them in the first place, MUA members would wish to understand that given Royal Mail is continuously failing to meet its efficiency targets year-on-year, at what stage does Ofcom consider such targets would be beneficial?
- 4.8 As MUA stated in its submission to Ofcom's 'Call for Inputs': 'MUA believes the key findings of Ofcom's most recent Annual Monitoring Review 2019-20, clearly show Royal Mail is not improving its efficiency as it needs to and/or could do, as there was no efficiency improvement in 2019/20 and efficiency actually worsened in 2018/19. Nor is Royal Mail improving its quality of service

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<sup>1</sup> <https://retailtechinnovationhub.com/home/2021/12/28/the-retail-technology-year-in-review-may-2021>

<sup>2</sup> Ofcom Review of Postal Regulation Document Page 41 Para 4.42



sufficiently, while using high price increases to provide support for its profits. As a result, Royal Mail's profitability trend raises great concern for the sustainability of Universal Service provision, in the long term'.

- 4.9 MUA would also have cause to question the corporate mind-set of a PLC within a monopoly market, facing the trade-off between short term gains required to strengthen share price, and the burden of long term costs associated with the implementation of a transformation plan necessary to bring about sizeable cost efficiencies. Members would argue in a competitive market the pressures to hold down prices and drive forward efficiencies are essentially balanced, but this is not the case for a monopoly market player, with unlimited access to price increases, and minimal direct competitive pressure. Members believe this clearly supports the case for Ofcom to put in place some type of price control to protect customers from unreasonable price increases, which will ultimately be detrimental to sustaining of the universal service.
- 4.10 MUA members acknowledge the argument that it is not in Royal Mail's interests to set prices at a point that will accelerate volume decline. However, it could be argued that such short-termism (as mentioned above), may be underestimating the impact excessive pricing will have on the market, given that these price increases take time to filter through to the marketplace.
- 4.11 As previously stated in MUA's response to Ofcom's 'Call for Inputs': Ofcom states 'In 2012, we explained our view that market conditions and shareholder discipline would be more likely to be effective in securing an efficient and financially sustainable universal postal service rather than imposing more regulation, such as wholesale or retail price controls and/or efficiency targets which could potentially increase the risk of regulatory failure<sup>3</sup>. Ofcom maintained that view in the last Regulatory Review in 2017. Ofcom then goes on to say 'However, we also recognised that Royal Mail might have the incentive and ability to increase prices or decrease service levels, to the detriment of consumers, instead of taking on the efficiency challenge. This might be done in a way that resulted in a detriment to the universal service in the longer term by, for example, accelerating the market decline of letters<sup>4</sup>.
- 4.12 MUA Members believe this is where the mail industry now finds itself: - In an environment of year-on-year large price increases (in some cases of more than 10%), against a backdrop of Royal Mail failing to meet efficiency performance targets, with consequent minimal improvements in quality of services levels.
- 4.13 MUA Members believe this is where the mail industry now finds itself: - In an environment of year-on-year large price increases (in some cases of more than 10%), against a backdrop of Royal Mail failing to meet efficiency performance targets, with consequent minimal improvements in quality of services levels.

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<sup>3</sup> Review of Regulation – Call for Inputs - Page 10 Para 3.10

<sup>4</sup> Review of Regulation – Call for Inputs - Page 10 Para 3.11



- 4.14 MUA Members would also make the point that this is based on evidence from the results of Ofcom's year-on-year monitoring and analysis<sup>5</sup>, which consistently appear to indicate that there is a need for more regulatory control to constrain Royal Mail pricing policies, and equally the need for increased efficiency within the postal service, more generally. Members believe this is further exacerbated by a concern that as Royal Mail is clearly behind the curve on the rapidly growing area of its parcels business, the letters business appears to be taking the brunt of the efforts being made to support developments in the parcels sector.
- 4.15 In short, MUA members believe Ofcom's regulatory regime thus far, has not gone far enough to: sufficiently incentivise Royal Mail to drive forward efficiencies (including greater transparency); push the national carrier to enable development of competition through downstream access services; or offer protection to users through greater controls to ensure Royal Mail does not utilise revenue gained from the declining letters market, to support its ambitions in the parcels sector.
- 4.16 MUA Members therefore believe that Ofcom should seriously reconsider the need to introduce efficiency targets and price controls, and carry out feasibility studies to assess their likely impact.

## 5 **Quality of Service Standards**

- 5.1 MUA continues to be seriously concerned by Royal Mail quality of service levels. Members appreciate the Covid-10 pandemic has produced many challenges for Royal Mail (as it has for all businesses, particularly those heavily reliant on a large workforce), but given the emergency period ended on 31 August 2021, quality of service levels remain alarmingly low. Members note Ofcom states in its Annual Monitoring Update for Postal Services – Financial Year 2020-21 that 'As Royal Mail continues to face challenges to return its quality of service to pre-pandemic levels, we (Ofcom) continue to closely monitor its performance on this'<sup>6</sup>. However, six months on from the cessation of the emergency period serious delays persist.
- 5.2 MUA members also ask Ofcom to investigate fully the reasons for why (over and above the unavoidable but mitigatable impacts brought about by the pandemic) quality of service was so poor over the period of the pandemic, suspecting as they do that Royal Mail actively prioritised parcel deliveries in a competitive market, over letters where Royal Mail has a monopoly in final delivery.
- 5.3 MUA members believe customers' experience during the Emergency Period clearly showed that Ofcom does not currently have the necessary regulatory

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<sup>5</sup> Annual Monitoring Update on Postal Services Financial Year 2019-2020

<sup>6</sup> Ofcom Monitoring Update for Postal Services Page 3 Bottom Paragraph



ability to do anything more than simply allow Royal Mail to have a unilateral, unconstrained and unchallenged ability to be exempt from providing the Universal Service if it decides there is an Emergency situation. At the moment, Ofcom does not even have the ability formally to review the position after a set period of time.

- 5.4 MUA is not suggesting that Ofcom should have the regulatory powers such that Royal Mail needed Ofcom's formal authorisation to declare an Emergency Period, or to require Royal Mail to act in any particular way during an Emergency Period, but Ofcom should have clear regulatory ability to monitor what Royal Mail is doing.

## **6 USO Letters Regulation**

- 6.1 MUA supports Ofcom's proposal to retain the existing scope of the USO services, including its decision to retain metered mail in the USO. Members believe this will assist hard-pressed SME businesses that are the main users of the meter channel.

## **7 Access for Bulk Mail**

- 7.1 MUA members use many Royal Mail services, both retail and wholesale (downstream access) but their predominant use is of RM Wholesale Access services. Ofcom has reported (in its latest Annual Monitoring Report) that 65% of all addressed mail posted in the UK uses Access.
- 7.2 As alluded to in the previous section (Quality of Service Standards), MUA members have been greatly impacted as postal users by the very poor quality of service provided by Royal Mail on its Access Services. Members are very frustrated that since April 2020, Royal Mail has declared a Disruptive Event meaning Royal Mail has unilaterally waived its quality of service obligations for Access mail, and also exempted itself from paying any compensation to its customers for the poor service provided.
- 7.3 Despite Ofcom declaring that the Emergency Period (which suspended Royal Mail's Quality of Service obligations for USO mail) ended on 31<sup>st</sup> August 2021, RM has refused to end the Disruptive Event for Access mail. This means Royal Mail has suspended its Access quality of service obligations for nearly two years, and throughout that long period has failed to provide the 95% service standard specified in the Access contract.
- 7.4 To make the situation worse, at the end of November Royal Mail notified customers of changes to the Access contract, which will be effective from mid-June 2022, without any discussion with the industry. These changes alter the Disruptive Event clause and the terms for payment of quality of service



compensation, to be even more in Royal Mail's favour.

- 7.5 MUA members believe Royal Mail has not acted properly in making these contract changes, and that the new terms are not fair or reasonable to customers. We believe Ofcom should consider what Royal Mail has done and if any action is needed.

## 8 **Parcels Market Regulation**

- 8.1 As MUA members are not parcel operators or significant posters of parcels, they have not responded to Ofcom's proposals relating to the parcels market.