

Professional Publishers Association (PPA) response to Ofcom's Review of Postal Regulation

Written Evidence submitted by the Professional Publishers Association (PPA)

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Sent by email to postalreview@ofcom.org.uk

Full Name: [REDACTED]

Contact Phone Number: [REDACTED]

Representing: Organisation

Organisation Name: Professional Publishers Association (PPA)

Email Address: [REDACTED]

Confidentiality

We are happy for our response to be published, but with the following highlighted sections kept confidential: Table 2 in its entirety; the highlighted sections of the Executive Summary; and the highlighted section of our answer to Question 5.1.

About Us

The Professional Publishers Association (PPA) is the membership network for UK consumer magazine media and business information publishers, representing around 160 of the UK's most renowned publishing houses. With more than 40 million adults in the UK reading magazine media every month, the sector is worth £3.74 billion to the UK economy, employing more than 55,000 people.

The PPA's membership incorporates the UK's largest publishing houses and titles, including Future Plc, Bauer Media Group, Condé Nast UK, The Economist, Hearst UK, Immediate Media, The Week, New Scientist, the BMJ, and William Reed Business Media as well as many smaller independent publishers. A full list of members can be found here: <https://www.ppa.co.uk/members>

Executive Summary

PPA welcomes the opportunity to submit evidence to Ofcom's Review of Postal Regulation, having submitted evidence to the previous consultation on postal regulation in 2021.

Print subscription copies (often combined with a digital subscription) are a key element of publishers' revenue, particularly given the difficulties associated with monetising content through digital channels with online advertising. PPA's Sector Report shows that, for consumer and mixed consumer/business-to-business publishers, subscriptions brought in [REDACTED] (this figure does not include the significant pure business-to-business subscription market). This represents around [REDACTED] of total revenues. The pandemic spurred a sharp rise in subscriptions meaning the current figure may well be higher.

However, European wholesale gas prices remain at record levels and PPA members are, as a result, experiencing dramatic increases in paper costs due to increased energy costs for suppliers. Papermaking is intrinsically energy-intensive and cost increases of the current magnitude are not sustainable. PPA members are also being impacted by the increased costs experienced by printers (also an industry with high energy costs). These problems have been accentuated by logistical issues, with a lack of HGV drivers further stretching the supply chain.

Royal Mail's efficiency, sustainability, and service obligations are critical to the future of the specialist publishing industry: this is particularly pertinent given the sharp growth in subscriptions during the

pandemic. This Review is a timely opportunity to support businesses by holding Royal Mail accountable, guaranteeing that the UK postal system can support growth in the UK economy.

We have responded to specific questions below and would be happy to provide further evidence on request. PPA is also a member of the Mail Users Association, and we have seen and wholeheartedly support their submission to this consultation.

Consultation Questions

Consultation Question 2.1: Do you agree with Ofcom's proposed regulatory approach for regulating postal services over the next 5-year period (2022-2027)? If not, please explain the changes you think should be made, with supporting evidence.

When assessing Royal Mail's regulatory approach, it is important to note Ofcom's statutory duty under the Postal Services Act 2011 to secure the provision of a universal postal service with regard to 'the need for the provision of a universal postal service to be financially sustainable' (Clause 29, Subsection 3, Paragraph a). Also, for Royal Mail's provision of the USO to 'be efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times' (Clause 29, Subsection 3, Paragraph b). Further, Ofcom's statutory duty under the Communications Act 2003 is to further the interests of consumers, where appropriate by promoting competition.

PPA members are significant contributors to the revenue that Royal Mail requires to sustain the universal service provisions. Despite utilising Royal Mail's USO services less than other contract/non-USO services, specialist publishers are important customers that rely on Royal Mail's letter service.

Mail is fundamental to publishers' ability to reach readers across the UK, and competition is critical to the future of the market. However, Royal Mail has a monopoly in final mile mail delivery, with competition restricted to downstream access. Ofcom's regulation is failing to fulfil its duties relating to competition in Communications Act 2003 (Clause 3, Subsection 1, Paragraph a), to further the interests of consumers, where appropriate by promoting competition. This also means there is little incentive for Royal Mail to improve efficiency, in contrast to Ofcom's statutory duty in the Postal Services Act 2011, and no constraint on its market power.

Royal Mail's parcels business, whilst growing, is the least profitable element of the business and is in an extremely competitive market. In contrast, the letters business is shrinking but remains the most profitable due to Royal Mail's final mile monopoly. It would appear that Royal Mail can only support its ambitions for its letters business by combining the costs of both operations, meaning the company's efforts to maximise revenue in the letters market is myopic and potentially damaging to the universal service. Therefore, regulatory interventions in this area will fulfil Ofcom's obligations under the Postal Services Act 2011.

This lack of adequate regulation has led to the current situation where PPA members experience year-on-year price increases significantly above inflation, whilst Royal Mail fails to meet its efficiency targets. Efficiency improvement targets are necessary to ensure that publishers are able to continue to reach readers across the UK.

Consultation Question 3.1: Do you agree with our proposed approach to sustainability of the universal service? Please substantiate your response with reasons and evidence.

Whilst the proposals for Ofcom to require a five-year financial forecast from Royal Mail will help allow better scrutiny of the universal service, a firm distinction should be drawn between scrutiny/transparency, and true accountability.

Ofcom states that it 'does not propose to hardwire specific regulatory actions to a given measure', and PPA accepts that EBIT margins that fall out of the 5% to 10% range do not necessarily mean that

sustainability is threatened, or excessive profits are being earned. However, it would reassure stakeholders if given measures automatically triggered a formal regulatory decision-making process on potential action, conducted transparently, ensuring that Ofcom is considering appropriate regulatory actions wherever there is a perceived risk to sustainability.

In preparation for the strengthened monitoring regime, Ofcom will hold a regulatory reporting consultation. Ofcom must ensure it can collect the most relevant information and can demonstrate this to stakeholders going forward.

Consultation Question 4.1: Do you agree with our proposal to maintain the historic approach but with the additional requirement on Royal Mail to set and report against a five-year expectation? Please substantiate your response with reasons and evidence.

Consultation Question 4.2: Do you agree with our proposals in relation to the monitoring and publication of the efficiency expectations prepared by Royal Mail? Please substantiate your response with reasons and evidence.

Again, there should be a distinction drawn between scrutiny/transparency, and true accountability when assessing Ofcom’s proposal to require Royal Mail to publish the efficiency change it expects to have achieved across a five-year period, and the proposal to require Royal Mail to explain how it has performed against the plan. In the absence of external efficiency targets and price controls, it is unclear precisely how the publishing of changes anticipated by Royal Mail alone will ensure the changes necessary to secure sustainability. There is also a danger that Royal Mail will set unambitious efficiency targets to ensure it satisfies expectations.

Ofcom’s Annual Monitoring Review 2019-20 was clear that efficiency did not improve in 2019-20, whilst performance worsened in 2018-19. In 2019-20 Royal Mail did not achieve its productivity target of 2%, achieving instead only 1%. Real costs rose 1.4%, with no underlying efficiency improvements, excluding transformation costs. The consultation document acknowledges that progress has been ‘slow’ and that additional costs from COVID-19 are ‘potentially exacerbating the efficiency challenge’.

It is particularly concerning that poor performance in 2019-20 followed the acknowledgment from Royal Mail in its Full Year Financial Report 2018-19 that ‘a new transformation plan is now required, with a renewed focus on improved service, efficiency and productivity supported by a focus on productivity initiatives, a range of new, digitally enabled work tools and targeted investments.’ Given that Royal Mail already acknowledged the need for efficiency as central to its strategy, yet continues to fail to meet its targets, it is unclear how greater transparency alone will result in the necessary improvements.

Further, Royal Mail’s Annual Report and Financial Statements 2020-21 lists efficiency as a principal risk or uncertainty, with a ‘high’ ‘relative severity’ rating. Royal Mail states: ‘The continuation of tighter COVID-19 restrictions, including changing standard ways of working to allow social distancing, has added costs and has impacted our processing and delivery operations. *These arrangements may continue for some time* [emphasis added]. In turn, they may have an adverse impact on cost control and productivity’. The ongoing and long-term impacts of the pandemic make regulatory intervention all the more necessary.

Additionally, Royal Mail’s reduction in the working week for frontline workers whilst also giving a pay rise represents a very real challenge for sustainability. Ofcom’s Annual Monitoring Review 2019-20 noted: ‘Frontline pay increased due to the October 2019 pay rise of 5% and the impact of the shorter working week and this was not fully offset by hours reductions.’ This may be compounded by wage inflation, with around half of Royal Mail’s operating costs being staff costs. According to *Investors Chronicle* analysis, the 2022 National Insurance increase is set to cost Royal Mail £50m per annum with every 1% of wage inflation hitting profits by a further £40m. It should be clear that urgent action

is required to address the concerning efficiency trends and mitigate the impact of higher relative staffing costs.

Ofcom has decided against efficiency targets and price controls, in part because it asserts that ‘shareholder pressure and market forces already create significant incentives for Royal Mail to become more efficient in the provision of the universal service’. In fact, Royal Mail may be compensating for its inefficiency by implementing above inflation price increases, with the revenues used to pay substantial shareholder dividends. In November 2021, Royal Mail paid shareholders £200m through a special dividend, £200m through a share buyback, and an additional £67m interim dividend.

As long as shareholders receive these dividends, there is little prospect of meaningful pressure to spur greater efficiency. These substantial dividends may be set to continue, further suppressing pressure for greater efficiency: analysis in *Investors Chronicle* states: ‘The [Royal Mail] board has stated that it wants to run close to a nil debt/nil cash balance sheet and as there is good free cash flow even after investment in UK upgrades, there is likely to be a similarly-sized, similarly-structured capital return in FY2023 and FY2024, possibly beyond.’ Royal Mail’s Interim and Final dividends consistently increased YOY from 2014 to 2019 (see Table 1 below).

Therefore, what shareholder pressure there is may be on the CEO and board of Royal Mail to pay substantial dividends in the short term, which in fact conflicts with long term efficiency plans: it is quicker and simpler for Royal Mail (or indeed any plc) to increase prices in the short term rather than implement long term cultural and organisational transformation. In short, shareholder pressure is only relevant to efficiency where profitability is linked to cost controls, and this is currently not the case. Further, in a competitive market, there is a relationship between the pressure to improve efficiency and the pressure to limit prices. However, it may be that Royal Mail’s market power insulates the company from market pressures in this regard.

Table 1: Royal Mail dividend payments (Source, Royal Mail).

Type	Announced	Ex-div date	Record date	Payment date	Pence per share
Final	22 May 2019	25 July 2019	26 July 2019	4 September 2019	17.0
Interim	15 November 2018	6 December 2018	7 December 2018	16 January 2019	8.0
Final	17 May 2018	26 July 2018	27 July 2018	31 August 2018	16.3
Interim	16 November 2017	7 December 2017	8 December 2017	10 January 2018	7.7
Final	18 May 2017	29 June 2017	30 June 2017	28 July 2017	15.6
Interim	17 November 2016	8 December 2016	9 December 2016	11 January 2017	7.4
Final	19 May 2016	30 June 2016	1 July 2016	29 July 2016	15.1
Interim	19 November 2015	3 December 2015	4 December 2015	13 January 2016	7.0
Final	21 May 2015	2 July 2015	3 July 2015	31 July 2015	14.3
Interim	19 November 2014	27 November 2014	28 November 2014	14 January 2015	6.7
Final	22 May 2014	2 July 2014	4 July 2014	31 July 2014	13.3

Ofcom states that efficiency targets could be ‘difficult to establish, implement, monitor, and enforce’. It would be useful if Ofcom could elaborate on the difficulties it envisages – that regulation of such a market will be ‘difficult’ is self-evident, but the challenges faced by the regulator in setting targets is not an adequate reason to not pursue such remedies. Ofcom states: ‘We therefore do not consider that such targets would be beneficial at this stage’. However, the difficulties faced by the regulators in setting targets will remain in the future as at ‘this stage’, and intervention may become even more ‘difficult’ to establish, monitor, and enforce if the situation deteriorates further.

There is a danger that Ofcom could be seen to be averse to setting targets in the future even if it becomes clear that Royal Mail is not setting ambitious efficiency expectations and/or is failing to meet

such expectations. This attitude may not incentivise Royal Mail to make satisfactory progress against its efficiency expectations, even if it sets and reports against five-year expectations.

Ofcom also states that efficiency targets 'may have little additional effect for an organisation that is already under pressure to cut costs'. As already stated, Royal Mail is allowed to compensate for failing to meet efficiency targets by implementing above-inflation price increases and can pay substantial dividends, reducing market pressure for greater efficiency.

It could also be argued that it is not in Royal Mail's interests to raise prices to an unreasonable level as it will accelerate a decline in the letters market. However, for some business mail, it takes several years for price increases to feed through to the marketplace. Therefore, the impact of above-inflation price increases may well not be immediately apparent. Royal Mail may be underestimating the impact of such increases.

Given the above, Ofcom should seriously consider the need for efficiency targets and price controls, and the design of such measures; at the very least, conducting the work to explore the design of such a framework would provide Ofcom with valuable information regarding the feasibility of, and likely impact of such measures. Price increases could be targeted to remain, or be below inflation, with cost control measures in place as Royal Mail correspondingly adapts its operating model.

For clarity, PPA supports the requirement for Royal Mail to set and report against five-year expectations as an absolute minimum requirement. However, Ofcom should review progress made against targets year by year with Royal Mail, and benchmark the progress against international comparisons. The forecast should also include projections for volume erosion and a forecast of the financial impact of this. Royal Mail should be incentivised to achieve cost reduction targets in line with the forecast increase in costs to offset this.

In addition, although we appreciate that Ofcom cannot give a firm commitment of what further action it will take if efficiency expectations are not met, it should at least give an indication of what action it would consider. Otherwise, there is little prospect of the new requirement spurring meaningful change.

Question 5.1: Do you agree with our proposed approach of maintaining the current regulatory safeguards of the safeguard cap, high quality of services standards, and requirements on access to universal services? Please substantiate your response with reasons and evidence.

It is hard to square Ofcom's consultation view that the existing regime for Quality of Service targets is working well with Ofcom's January 2022 update on Royal Mail delivery days. In the Update, Ofcom stated: 'As the regulator for Royal Mail, we're concerned about these delays and have made it clear to Royal Mail that it must take steps to improve its performance as the effects of the pandemic subside.' Ofcom acknowledged recent news reports of delays in deliveries from Royal Mail, with some people receiving their post much later than expected. It is important to note that the emergency regulatory period finished on the 31st August 2021, but significant delays have persisted for six months. We would urge Ofcom to take appropriate action.

Late delivery of a magazine will seriously undermine the value of the content to consumers. This also reduced the value of advertising space for marketers, meaning consistent late deliveries could see publishers lose advertising revenue. One publisher, which has a print circulation of [X] delivered by Royal Mail, received over [X] as a direct result of Royal Mail delays. (It should be noted that the number of people who choose to proactively complain is likely a minority of those who experience delays.)

Whilst PPA appreciates that COVID-19 will have had an impact on staff absences, there is also a danger that Royal Mail's monopoly in final mile letters delivery will have allowed it to prioritise parcel

deliveries over letters (where it faces stiff competition). Ofcom is currently preparing to review Royal Mail's performance for the current 2021/22 financial year: we would urge Ofcom to distinguish between the unavoidable impacts of COVID-19, and choices that Royal Mail has made when prioritising services, when deciding on appropriate regulatory action.

Universal Service Obligations: Saturday Letter Deliveries

PPA's argument that the six-day delivery schedule should be retained was acknowledged by Ofcom in the consultation document. We appreciate that the requirement for delivery of letters to homes and businesses six days a week falls under the minimum requirements of the universal services set by the Government and Parliament cannot be changed by Ofcom, and is not within the scope of the current review.

However, given Ofcom's 2020 proposal that letter deliveries could be reduced to five days a week, and the widespread debate that Ofcom's review sparked, Ofcom should continue to consider the importance of this in relation to the Review's objective to further the needs of its customers. It was also widely reported in July 2021 that Royal Mail was beginning a six-month review of its whole product offering, including Saturday letter deliveries. We understand that Ofcom will be in communication with Government and Royal Mail about any potential changes to the USO: Royal Mail's review will have recently concluded, or be about to conclude, so the regulator must continue to consider the impact of such a change as part of any discussions with Government and Royal Mail on the issue.

Further, we believe that more work is required by Ofcom as its 2020 User Needs Review did not provide a full picture of the impact on business customers. Whilst 971 SME customers were interviewed in a formal programme, it is understood that a very small number (understood to be around a dozen; no figure was provided in the User Needs Review) large-volume users including publishers were interviewed by Ofcom staff and that this took place a short time before the Review was written.

We appreciate that Ofcom's statutory duty is to review the needs of users of the universal service, but the revenue from large-volume users of non-USO services is critical in the sustainability of the universal service. Further, all services offered by Royal Mail are reliant, to varying extents, on the universal service network. Any changes will have significant impacts on PPA members. This is particularly pertinent given the statement in Royal Mail's H1 2021-2022 that: 'We believe there is an important role for letters as part of the UK's social fabric. But as demand for letters reduces, Ofcom's recent User Needs Review suggests that our customers are open to change. As customer needs change, so must we.' Ofcom's User Needs Review is being used as evidence that customers are open to change, yet significant customers including publishers are not properly accounted for in the Review.

Ofcom should also review its advocacy of the removal of Saturday deliveries: there appears to have been very little consideration of which day of the current six could be lost without such damaging repercussions.

Therefore, although Ofcom considers that a decision on Saturday deliveries is now a matter for Government and Parliament, Ofcom should seek to better understand the needs of large-volume mail users and review and the rationale for removing Saturday and not a weekday, allowing Government to make a properly informed decision when it chooses to review the regulator's evidence.

To aid this future work, we will now set out the impact of the removal of Saturday letter deliveries (or indeed the removal of any day) from the USO.

The impact of reducing letter deliveries to five days a week on the specialist publishing industry

For many publishers, changing the USO for letter deliveries to five days a week would have a detrimental impact, particularly as the pandemic has hastened a structural decline in publishers' advertising and circulation revenues, meanwhile accelerating the uptake in paid subscriptions.

Many specialist publishers use Royal Mail's Publishing Mail product offering and have built subscriptions businesses around being able to deliver their publications on a Saturday. This service in turn provides consumers with easy, timely, and good value access to high-quality and trustworthy content. Royal Mail stands to benefit from publisher gains in this area, and equally stands to lose business if the effectiveness of their Subscription & Publishing Mail service is impacted by changes to the USO.

The impact of reducing Royal Mail's letter delivery from six to five days through the removal of Saturday deliveries would have a significant impact on several publishers' business models. Certain titles are mailed to land on a Friday or Saturday, and a sizeable portion of copies mailed to land on Fridays end up being delivered on Saturdays due to Royal Mail processing delays. With Saturday letter deliveries removed, time-sensitive information could be subject to further delays and result in readers receiving their copies on a Monday, reducing the value of a subscription's USP to consumers (publishers have reported that the temporary suspension of Saturday deliveries in 2020 prompted a wave of complaints from consumers). This would lead to subscribers moving to digital subscriptions or cancelling entirely.

Furthermore, if publishers could no longer guarantee that an advertiser's advert would be viewed over the weekend period - which is precisely what advertisers are paying for in these publications - then many would stop advertising in the publication altogether. The fall in subscriber numbers, and subsequent reductions in renewal and acquisition levels, would reduce the circulation of the print edition, further devaluing the publication from an advertising perspective.

Publishers are also concerned that the removal of the Saturday delivery could impact the quality of the service across the rest of the week due to additional volumes, as well as evidence that Royal Mail is prioritising parcels over letters. In 2020, this resulted in a marked rise in customer complaints and refunds.

Table 2: A recent survey of PPA members provided us with a series of case studies demonstrating the impact of not only ending Saturday deliveries but the removal of any days from the USO on a variety of publishers. This is by no means an exhaustive list of publishers that would be impacted: [X]

From a printing perspective, changing the USO would also have a considerable detrimental impact. Different markets have distinct production patterns, and printers aim for a balanced portfolio spread of production scheduling to achieve an optimum fill of the presses, binding, and mailing lines. This in turn optimises print scheduling and print runs, allowing better pricing and improved economies of scale for printers. In addition, this is better for the environment as optimal printing press usage reduces wastage of raw materials and electricity.

An enforced postal change, dropping one day from Royal Mail's service, could affect the production scheduling for a publication. If schedules are altered to allow a title to print earlier in the week, with less capacity available, any change could lead to late printing, thus impacting schedules and the economies of the process. The result would be increased costs for publishers at a time when the industry can ill afford to incur additional expenses, particularly due to sharp increases in print and paper costs. Inefficiencies would also be created, with bottlenecks at certain times and on certain days, leaving gaps at other times. Problems for the printer and publisher could result, particularly if a title is running late due to a breaking news story. Printers assert that the impact on the upstream elements of the production process, including editorial, production, printing, mailing, and delivery cannot be ignored, as the change to the USO would inevitably have a damaging domino effect across the entire chain.

Clearly, it would be extremely difficult, if not impossible, for long-established titles to operate effectively without a Saturday delivery. Publishers have stated that this could even lead to the closure of UK print editions. Furthermore, those who could in theory bring forward production schedules would find it both challenging and uneconomical. By bringing the editorial deadline forward by one day, key stories would be missed, diminishing the value of a print copy. Even if editorial integrity could be maintained, the lack of cost-effective printing slots earlier in the week presents an even greater challenge. A reduction in available capacity would cause printing costs to rise. Also, the resulting bottlenecks and scheduling gaps would hurt print companies' profitability; inefficient print solutions would damage both publishers and the wider supply chain.

Such a major break with the established USO would have serious adverse impacts on magazine publishers' businesses, and the wider supply chain. In turn, this would severely impair publishers' ability to build back from the pandemic by investing in high-quality journalism. Indeed, the six-week suspension of the USO in 2020 demonstrated the adverse impacts that a permanent change would have on publishers. Publishers fear that if a permanent change were agreed, this would be the beginning of more substantive and aggressive changes, opening the floodgates to further detrimental impacts.

If letter deliveries were to be reduced to five days a week, there are simply no viable alternatives for publishers from a business, commercial, brand, or customer services perspective. For many, it would be an immensely damaging blow.

Serious consideration should also be given to whether reducing the USO for letter deliveries to five days a week would be beneficial to Royal Mail in the long term. As already stated, shareholder pressure on Royal Mail may be leading to short-term planning which does not capture the impacts of such a change. The parcels market, whilst a growth part of the mail industry, is extremely competitive and has far smaller margins than letters (a market in which competition is absent). Royal Mail's parcels offering is entirely dependent on a letters business: without the letters business, Royal Mail will not be able to deliver the small packages and parcels efficiently: it is only by combining the costs of letter and parcels delivery that Royal Mail can make their parcels business competitive. Therefore, removing the six-day USO for letter delivery would potentially inhibit Royal Mail's long-term sustainability.

The Government must take this into account when determining whether any changes are required. Maintaining the USO for letter deliveries six days a week would ensure both Royal Mail and publishers can build a sustainable future following the huge challenges induced by the pandemic, serving the public by investing in high-quality content. Furthermore, if Royal Mail proposes to reduce its services, the movement to a five-day delivery should be reflected in future price increases in the letters market, and savings should be passed onto customers, not solely shareholders.