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# **UK consumer parcels: Assessment of tracking in the Universal Service**

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## Executive Summary

Our analysis of the C2X market segment has highlighted a number of key considerations that support the case for Royal Mail being allowed to introduce tracking to its USO parcels.

- Growth in the B2X market segment has led to the C2X market segment not only becoming viable, but an attractive proposition for Royal Mail's competitors. In the context of a high fixed cost base, C2X volumes are likely to be a key source of (financial) contribution for Royal Mail's competitors going forward.
- There are now a number of large PUDO networks available across the UK, and two of the largest, Collect+ and the Post Office, are no longer exclusive to a single operator. Therefore, barriers to entry to the C2X parcels segment have been lowered, giving established operators the flexibility to increase the density of their networks relatively easily in response to customer demand. This flexibility makes the C2X segment more sustainable and agile.
- The development of these PUDO networks means that consumers now have a wider number of access points available to them, further reinforcing the competitive dynamics.
- Evidence that product features, including speed of delivery and tracking, are of value to consumers is provided by the fact that operators have systematically improved their product offerings, and features that were initially viewed as premium have become the norm (e.g. tracking is offered as a standard feature by Royal Mail's competitors in this segment).
- Operators face clear incentives to grow C2X parcels volumes, and their established PUDO and logistics networks enable them to deliver C2X services at low marginal costs. This means that competition in this sector can be considered sustainable, even in the event that Royal Mail enhances its USO parcels product offering through the inclusion of tracking.
- Furthermore, we consider that the introduction of tracking on USO parcels would be valuable to consumers, especially those located in remote and difficult-to-serve areas of the UK.

To conclude, on the basis of the analysis undertaken, we do not consider that Royal Mail including tracking features on its USO parcels products would, in principle, harm the strong competition we observe in the C2X parcels segment. Furthermore, it would be beneficial to consumers.

In this report we describe the economics of the C2X parcels segment, and draw on this and our analysis to support our observations regarding the potential impact on competition, and on customers, of tracking features being allowed in the Universal Service Obligation (USO) parcels products of Royal Mail.

### The economics of the C2X parcels segment

Competition in the C2X parcels market segment is strong. Specifically, a number of operators, including Hermes, Yodel and DPD, all have substantial logistics and Pick Up Drop Off (PUDO) networks that enable them to offer competitively priced, high-specification, nation-wide, single-piece, addressed parcel delivery services. Consequently, Royal Mail's share of this segment reduced from [x]% to [y]% between 2013/14 and 2019/20.

These PUDO and logistics networks developed rapidly, initially in response to market liberalisation, and then in response to the sharp increase in e-commerce (including marketplace sellers), which was further accelerated by the COVID-19 pandemic (between 2016/17 and 2020/21, domestic parcel volumes increased by 102%). Competition for C2X parcels delivery has thrived as a result of these investments, and the incentives to maintain and further

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develop these networks will remain strong due to growth in the wider parcels industry beyond C2X volumes, including B2X bulk deliveries.

Due to the growth in e-commerce, delivery contracts with large retailers have become a key part of postal operators' B2X business models—and with deliveries come returns. In order for operators to be able to offer their retail business customers a full service, operators need to demonstrate that they have a nationwide network of PUDO points that facilitate returns for their retailers' customers. These networks have positive spill-over effects on the competitiveness of C2X deliveries, as the infrastructure required to serve C2X customers is already in place, making C2X deliveries a more viable commercial proposition. Thus, growth in B2X and C2X is mutually reinforcing, and indeed the expectation is that the C2X segment would continue to grow in line with the B2X segment.<sup>1</sup>

Further, the postal industry has evolved its offering in response to changing customer needs and expectations. Innovation has led to enhanced customer offerings and increased efficiency. Tracking, photos on delivery, alternative delivery addresses and tools to facilitate live communication during delivery all offer value to customers and in some cases reduce costs (e.g. by minimising the number of failed deliveries).

One such trend in customer expectations is the growth in demand for Click & Collect (C&C). Increasingly, parcel recipients expect to be offered an alternative delivery location from which they can collect at a time to suit them. As working from home declines following the lifting of pandemic restrictions, demand for C&C is set to increase further. Indeed, C&C fulfilled by third-party locations such as parcel shops and lockers is expected to grow at a CAGR of [8-] % over 2020–24 as networks are expanded throughout the UK.<sup>2</sup>

C&C and returns are two key drivers that have accelerated the emergence of—and will continue to sustain the incentives to grow—the established, broad and dense PUDO networks we see in the UK today, both motivated by the need to better serve the B2X segment. In addition, two of the largest PUDO point networks in the UK, the Post Office Ltd (POL) network and Collect+, are no longer exclusive to Royal Mail and Yodel respectively. This means that it is now easier than it has been historically for any operator to expand its presence quickly, through a contract with POL and/or Collect+. Similarly, the growth in the use of resellers, such as Parcel2Go, make bringing new C2X products to market easier than ever before.

Once established, these networks are extremely well placed to serve the C2X market segment and sustain its further growth. Like any network, volumes are a key driver of financial success. For that reason, it is unsurprising that some of the largest B2X operators have also established competitive C2X product offerings that utilise the product innovation and efficiency gains initially developed through the need to serve the B2X market segment.

Further, the economics of C2X now resembles B2X more closely. Specifically, PUDO point networks allow for consolidation of C2X volumes (customers bring their parcels to a single local consolidation point). When the postal market was first liberalised, the ability to consolidate volumes was a key determinant of which parts of the market offered a viable commercial proposition.

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<sup>1</sup> Apex Insight (2020), 'UK Parcels, Market Insight Report 2020', December, p. 97.

<sup>2</sup> Ibid, p. 94.

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Any large operator that is required to maintain a logistics and PUDO point network in order to serve the B2X market segment has a strong incentive to offer C2X products, and to grow volumes in that market segment. These operators are able to serve this market at low marginal cost (as the network is already there). This cost will decrease further if B2X volumes continue to rise, as the density of B2X deliveries increases and the proportion of C2X-specific deliveries required reduces. Given this observation we would expect to see prices in this market segment declining. Our analysis indeed shows that average unit revenue across the C2X parcels segment has decreased almost continuously since 2012, at a compound annual growth rate (CAGR) of -2%.

Given the economics of this market segment, competition is likely to remain strong, and may intensify as operators seek to grow volumes that can make a positive contribution to their network costs. As the largest company currently operating in this space, we note that Royal Mail C2X parcels volumes are likely to come under further pressure.

### **The impact of tracking on USO parcels**

Operators face clear incentives to increase volumes through their network. For this reason, competition in the C2X segment is strong and we expect it to remain so—or potentially to intensify—especially if the parcels industry continues on its growth trajectory. As such, we consider that competition would not be reduced were Royal Mail to add tracking to its USO parcels products.

We observe also that the Hermes price for standard delivery (2+ days) tends to track just below Royal Mail's online USO parcels price for 0–1kg small parcels. This suggests that the market already perceives this product to be a key comparable product, despite it being untracked (we note, however, that proof of purchase and online delivery confirmation are both available for this product).

Customers value tracking. Ofcom's research shows that the 'ability to track the delivery' was rated as 'important' or 'very important' by 81% of people sending parcels, and by 89% of people who choose the delivery option for parcels that they will receive. For this category of respondents, 'ability to track the delivery' was the most important service feature. In addition, 79% of respondents in the SME category rated the 'ability to track the delivery' as 'important' or 'very important'.

Consumers' needs are not static—they are rapidly evolving, partly driven by advancements in the product offerings available, which have raised the bar in relation to consumer expectations. In particular, in just four years the proportion of respondents considering tracking as being an 'important' or 'very important' product feature increased by 11 percentage points among senders and by 15 percentage points each among receivers and SMEs. Not allowing Royal Mail to add tracking to its USO products carries the risk of defining the USO based on a set of products that is rapidly becoming outdated.

Further, while competition is strong nationwide and particularly in dense urban areas, the choice of tracking products offered to sending and receiving customers in this market is not universal. Residents in remote locations are less well served than those in the rest of the UK. In the absence of a USO, Royal Mail's competitors can choose where to serve, and are free to levy surcharges, increase delivery times and impose constraints upon the level of service available to those sending and receiving parcels in remote parts of the UK—indeed, this is what we observe Royal Mail's competitors doing. PUDO

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point density is also lower in these areas, meaning that the average distance between home and a PUDO point is greater than elsewhere in the UK.

For these reasons, customers in remote locations may have limited choice in relation to tracked products. For customers seeking tracking features, the only Royal Mail USO options are Signed For and Special Delivery, only one of which is a fully tracked service, Special Delivery. Special Delivery also includes additional premium features that come at a price, making Special Delivery an unsuitable option for someone seeking a basic tracking service. If tracking was included on USO parcels products, remote customers would benefit from the level of service available to others elsewhere in the UK.

### **Conclusion**

On the basis of the analysis we have undertaken to better understand the economics of the C2X parcels segment, we do not consider that Royal Mail including tracking features on its USO parcels products would, in principle, harm the strong competition we observe in the C2X parcels segment.

Operators face clear incentives to grow C2X parcels volumes, and their established networks enable them to offer C2X services at low marginal costs. Therefore, competition in this sector can be considered to be sustainable, even in the event that Royal Mail enhances its USO product offering through including tracking.

Furthermore, we consider that the introduction of tracking on USO parcels would be valuable and beneficial to consumers, and especially to those located in remote and difficult-to-serve areas of the UK.

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