
Written Evidence submitted from the Citizens Advice Service (Citizens Advice and Citizens Advice Scotland) to the Business, Innovation & Skills Select Committee into Competition in the UK postal sector and the universal service obligation

About the Consumer Advocacy Bodies

On 1 April 2014, Consumer Futures (previously Consumer Focus) – the statutory representative for consumers of postal services across the United Kingdom, for energy consumers throughout Great Britain, and for water consumers in Scotland – became part of the Citizens Advice Service. The responsibility for post in Northern Ireland transferred to the Consumer Council for Northern Ireland.

Citizens Advice Service in England, Wales and Scotland

The Citizens Advice Service provides free, confidential, and impartial advice to help people resolve their problems. Citizens Advice's charitable aim is to make society fairer by providing the advice people need for the problems they face; and improving the policies and practices that affect people's lives. As the UK's largest advice provider, the Citizens Advice Service is equipped to help everyone with any issue, from debt and employment, to housing and immigration. We value diversity, promote equality, and challenge discrimination.

Executive Summary

- 1.1 Continuing evolution of a postal market fulfilling both communications and logistics needs, requires regulatory vigilance and robust oversight to ensure the sustainability of the universal postal service which provides a vital service to consumers. Regulatory action should be taken by Ofcom if a comprehensive review of the evidence at the appropriate time concludes that this is necessary to protect the universal service. However evidence in the public domain on the sustainability of the universal postal service does not currently point to an immediate material threat from either end to end letters, access mail or parcel delivery services competition.
- 1.2 Ongoing declines in mail volumes, attributable to the steady growth of e-substitution and the reduced reliance on mail as a communications tool, is a

primary influencing factor on the dynamics and shape of the UK postal market and is likely to influence the future sustainability of the postal universal service obligation (USO). However growing competition in all segments of the market (albeit still relatively low in end to end letters competition) has increased the incentives for improved efficiency and reduced costs of the universal service provider, while creating clear benefits for consumers through driving postal operator innovation and improved delivery convenience and restraining price rises especially in parcels products.

- 1.3 It is critical that any regulatory intervention is coupled over the longer term with a robust and informed policy debate amongst key national and European stakeholders on user needs, and the appropriate parameters for a universal postal service in the digital age.

2. Background

- 2.1 The clearest and most predictable trend in the postal market, contextualising any debate on the sustainability of the universal service, is the steady decline in letter volumes contrasted with the significant increases in parcel volumes. In 2013 overall addressed mail volumes fell by 5% as a result of continued electronic substitution by traditional bulk mailers such as financial institutions and utility companies and this trend is expected to continue.¹ In contrast, e-commerce traffic is rising with UK retailers set to despatch 930 million parcels in 2014 with 120 million orders forecasted in December alone.²
- 2.2 Royal Mail, as the designated universal service provider, delivers an essential service in the postal market through legislatively enshrined minimum requirements for the USO on mail delivery and collection service six days a week for letters, and five days a week for parcels, at a uniform affordable tariff across the UK.³
- 2.3 Sustainability of the USO is the focal point of the postal regulator, Ofcom, is charged with a primary and overriding duty under the Postal Services Act 2011, of ensuring provision of the universal service so that it is financially sustainable (including the need for a commercial rate of return on the universal service) and efficient, whilst also being required under the Communications Act 2003 to further the interests of citizens and consumers through promoting competition.
- 2.4 Residential consumers are still reliant on the universal service and the Citizens Advice Service considers that safeguarding of the universal postal service is the most important priority for postal consumers. The universal

¹ *Ofcom Communications Market Report 2014* (August 2014); PwC report *The Outlook for mail volumes to 2023* <http://www.royalmailgroup.com/sites/default/files/The%20outlook%20for%20UK%20mail%20volumes%20to%202023.pdf>

² IMRG MetaPack UK Delivery Index Summary (September 2014) <http://www.metapack.com/press-release/uk-e-retail-ends-summer-with-high-christmas-delivery-volumes-forecast-2/>

³ Postal Services Act 2011, s.31

postal service is most likely to be financially viable over the long term in a fully competitive postal market where consumers and customers choose to use the universal service and purchase postal products which meet their needs. Customers and consumers will benefit from additional choice under a competitive environment with economy wide benefits from the lower prices that are likely to be generated.

3. Competition and the sustainability of the universal service

- 3.1 Competition across the various segments of the postal market has impacted directly on Royal Mail's key market revenues and the operator's future position in the wider postal market. The intensity of competition, particularly in parcels, continues to reduce its relative dominance in the market, both in general and with regard to services within the universal service.
- 3.2 Since full opening of the market, access competition where one operator collects and sorts mail ("upstream") and then injects it into the network of another operator (usually the incumbent) for final delivery ("downstream") has grown at a far greater rate than end to end entry which involves the operator both collecting and delivering the mail. About 49% of mail volumes in 2013 were carried by access operators and the access market is now considered mature.⁴
- 3.3 Access competition has the lowest impact on the sustainability of the USO as Royal Mail still retains 85 to 90% of the total revenue for access mail.⁵ As a result, regulatory submissions from Royal Mail have stressed the threat from competing end to end operators. The largest alternative end to end operator is Whistl (previously known as TNT Post)⁶ who since commencing end to end operations in April 2012 in London (in addition to its access operations) have expanded operations to other urban areas in Liverpool and Manchester with an aim to cover 42% of addresses by 2019.⁷ There are also smaller end to end operators such as cycle couriers and local delivery companies who focus on geographically based delivery.⁸
- 3.4 The universal service provider's concern on the threat posed by end to end operators is based on their ability to "cherry pick" the lowest-cost delivery areas which may result in Royal Mail only being able to serve the more expensive delivery areas and eliminate the geographic cross-subsidy vital for a sustainable uniform price.⁹ However the slower growth rate of end to end

⁴ *Ofcom Communications Market Report 2014*

⁵ *Ofcom Annual Monitoring update in the postal market – Financial Year 2012 – 2013* (November 2013) at para. 6.26

⁶ TNT Post UK changed to Whistl on 15 September 2014.

⁷ Extension of time period from 2017 to 2019 for meeting this target was highlighted in presentation by Nick Wells, CEO, Whistl at Marketforce, *Future of UK Postal Services Conference*, 21st October 2014

⁸ *Ofcom Communications Market Report 2014*

⁹ Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service, Regulatory Submission to Ofcom* (June 2014)

competition means that these operators deliver less than 1% of total addressed mail and Ofcom estimates that end to end competition is less than 0.4% (although acknowledging that the number of items carried by alternative operators represents a six-fold increase on 2011 mail volumes).¹⁰

- 3.5 Royal Mail still remains the largest player in the UK postal market and retains market power in the letters delivery market and in the delivery of lower weight parcels, although it is becoming less preponderant in relation to the market as a whole and delivery of higher weight parcels is generally more competitive.¹¹ Research in 2012 by our predecessor organisation, Consumer Focus, indicated that Royal Mail's share of the wider postal market declined from 69% in 2007 to 64% in 2011.¹² We expect that this market share has continued to fall in line with the intensity of competition in the parcels segment of the postal market. Developments in internet fulfilment (and broader retailing) markets such as the growth of Amazon Logistics, the online retailer's own courier delivery network, and consumer use of click and collect services are likely to have a greater impact on the sustainability of the universal service than either end to end or access competition.
- 3.6 The company's financial performance since privatisation has been satisfactory. Its latest results, for 2013/14, showed an operating profit for the regulated business, UK Parcel, International and Letters business (UKPIL) of £309 million. Parcels revenue for UKPIL increased by 7 per cent, but letters revenue declined by 2 per cent. The volume of letters delivered by Royal Mail declined by 4 percent.¹³ Despite greater commercial incentives from privatisation in October 2013 and the improved financial performance driven by parcels business, the company needs to be more flexible and nimble in responding to market developments and continue implementing effective efficiency and cost control measures. Citizens Advice Service considers that the risks in this market are not from competition but from Royal Mail's slower adaptation to market changes together with the sustained impact of e-substitution. If Royal Mail proves unable over time to adapt then new models of universal service provision will need to be considered by the regulator.

4. Consumer benefits from a competitive market that delivers choice and innovation

- 4.1 Competitors spur Royal Mail to up their game and be more responsive to consumer needs. The intensity and level of competition in both the letters and parcels segments of the postal market has accelerated since market liberalisation in 2006 and has delivered clear benefits to customers and

¹⁰ *Ofcom Communications Market Report 2014*

¹¹ Based on turnover in the wider postal market including letters, packets and parcels up to around 20 kg.

¹² *Postal Market Review, Consumer Focus* (April 2013); *Ofcom Communications Market Report 2014*

¹³ Royal Mail financial statements 2013 – 2014 <http://www.royalmailgroup.com/royal-mail-plc-full-year-results-2013-14>

consumers through increased choice, innovation, increased incentives on improved efficiency and reduction in costs, and price stability through lower levels of price increases.

- 4.2 Choice in the letters market has primarily developed for larger mailers with consumers still reliant on the universal service provider. However the parcels market offers greater options for consumers and small and micro businesses. These are accessible through a variety of shop front and online avenues. Innovation in the wider market has also accelerated with valued features such as use of barcode technology, timed delivery slots and Sunday deliveries becoming a standard part of market offerings by all postal operators. Royal Mail itself has taken innovative strides introducing Sunday opening at 100 delivery offices across the UK, trialling Sunday deliveries within the M25 and offering Click and Collect at Post Offices.¹⁴ Over time these types of features and innovations may help safeguard mail volumes.
- 4.3 Previous research conducted for Consumer Futures concluded that upstream competition for mail services (in the collection of mail) has benefitted customers and consumers by restraining price rises in this area.¹⁵ However the introduction of size based pricing and price increases in 2012 for both, end to end retail product and access services, would have impacted and led to consumer prices rises for mail products. Although stamp prices remained steady in 2013 they increased again in April 2014. More recently Royal Mail has launched promotional pricing on small parcel sizes arguably in response to offerings of competitors.¹⁶
- 4.4 Of concern however is that competition has not benefitted all groups of social consumers equally, particularly those in rural and remote areas who have limited choice and are more reliant on the USO. We have a significant body of evidence of detriment to rural and remote consumers in the parcels market including non-deliveries, delivery surcharges and lengthy journeys to collect undelivered items.¹⁷

5. Evolving consumer needs in the postal market need to be reflected in the universal service

- 5.1 Consumers still rely on and value the universal service as a communications tool and the USO acts as a critical safety net to avoid social exclusion and the

¹⁴ <http://www.royalmailgroup.com/royal-mail-launches-sunday-opening-weekend;>
<http://www.royalmailgroup.com/media/press-releases/royal-mail-make-uk%E2%80%99s-largest-%E2%80%98click-and-collect%E2%80%99-network-available-20000-sme;>

¹⁵ *Postal Market Review*, Consumer Focus (April 2013)

¹⁶ <http://www.royalmailgroup.com/royal-mail-increasing-its-small-parcel-format-and-launching-festive-price-promotion> (6 October 2014)

¹⁷ Citizens Advice Scotland 2014 *The Postcode Penalty: The Business Burden*; Consumer Futures 2013 *Signed, Sealed... Delivered?*; Citizens Advice Scotland 2012 *The Postcode Penalty*; Consumer Focus Scotland 2012 *Effective parcel delivery in the online era: What consumers in Scotland need*; Consumer Focus Scotland 2010 *Parcel Deliveries: current practice and possible solutions*.

potential lack of services due to market failure. Traditionally, rural consumers value and appear to have a greater reliance on postal services than users in other geographic locations. Recent research published by Ofcom in their user needs review, also showed that other categories of users such as older, disabled or housebound users, are more likely to use postal services and to feel cut off from society if they are unable to send or receive post.¹⁸ Access for vulnerable and rural consumers (at affordable rates) must be maintained as this is becoming increasingly important for their effective participation in the economy. Ofcom must also continue monitoring quality of service provision.

5.2 However consumer needs are changing and overall consumers have reduced their use of post for communications needs, while increased their use of post and logistics services for fulfilment of e-commerce. This signals a clear move for the relevance of the postal service from a letter based communications system to a parcel delivery fulfilment service through logistics networks. This is not to minimise the importance of mail and the USO to social consumers and small and micro businesses but points to a different focus for a regulator charged with ensuring sustainability of the service.

5.3 Ofcom's user needs research produced similar findings to Consumer Focus' 2012 report, *Sense and Sustainability* and pointed to user needs being more than met by the current specifications of the service.¹⁹ Both examinations revealed that although the current universal service largely satisfies users' core needs, respondents were willing to consider some changes to the service. Changes considered include removal of Saturday deliveries providing there was greater innovation and they were given more convenient packet services and re-delivery options, including extending the number of pick up points; longer opening hours; and more convenient locations, including pre-specified locations such as pubs or corner shops. Meeting these needs is the key to future sustainability of the service.

6. Mix of regulatory and policy solutions required to fully address the sustainability of a modern universal service

6.1 At any time Ofcom can trigger a review of the need for intervention in relation to the provision of the universal service, if "prima facie, there is a potential material threat to the provision resulting from end-to-end competition."²⁰ The guidance that Ofcom provides then goes on to set out circumstances by way of example and clearly the intention is that a review could be instigated if that material threat existed either in the present or in the foreseeable future. The

¹⁸ Consumer Focus, July 2012, *Sense and Sustainability*.

¹⁹ Ofcom Consultation document on the reasonable needs of users in relation to the market for the provision of postal services in the United Kingdom (October 2012) <http://stakeholders.ofcom.org.uk/consultations/review-of-user-needs/>

²⁰ *End-to-End competition in the postal sector – Ofcom Final Guidance* (March 2013) Para 3.26

threat does have to be material, i.e. significant and realistic, and based upon objective analysis of the evidence available.

- 6.2 We share the wider aim for a sustainable universal service and consider that if a market review identifies a material threat to the USO, Ofcom needs to exercise its powers, by considering as primary options, the tendering out of loss making elements, state aid or compensation funding arrangements (although we note that Ofcom is precluded immediately from using either public procurement procedures to tender out loss making universal service elements or from setting up a compensation fund for entrants). We recognise that Ofcom may need to impose regulatory conditions if it considers that there is a more immediate threat.
- 6.3 As the expert body with the clearest and most detailed insight into the financial performance and business plans of Royal Mail and its competitors, Ofcom is well placed in a market review to assess the impact of market developments on its primary duty on the sustainability of the universal service. Additionally, other regulatory and competition powers should be utilised as necessary, to ensure that the postal market is working effectively and in the interests of consumers. Resolution of the on-going competition investigation into some of Royal Mail's changes to access contracts and the review of the USP access conditions will be key actions in meeting any regulatory changes required in the market.
- 6.4 Although Royal Mail's recent regulatory submission to Ofcom suggested that the USO is under threat on the basis of end to end competition in the market, this submission does not provide compelling, robust evidence based reasons for immediate intervention to protect the sustainability of the USO.²¹ The evidence, based on projected scenarios and key assumptions, needs to be tested by the economic regulator who is best able to evaluate and weigh the evidence competently and in a balanced manner. Importantly, due to commercial confidentiality concerns, Royal Mail has only placed a redacted version in the public domain and Ofcom is the only body privy to and properly able to evaluate the full regulatory submission. Additionally, it has been said publically by Whistl's CEO, that their expansion plans will not come to fruition until 2019.²² It is therefore a matter for Ofcom to decide whether the current activities of Whistl present a danger to the USO in the here and now, or whether they are likely to do so in the near future. As part of that decision making process, one would also expect an experienced regulator, such as Ofcom, to be able to factor into the timeline, not only the period that such a market review would take, but also the time that any resultant regulatory steps might take to put in place, to safeguard the USO, if it felt it warranted it.

²¹ Royal Mail, *Direct Delivery: A Threat to the Universal Postal Service, Regulatory Submission to Ofcom* (June 2014)

²² Marketforce, *Future of UK Postal Services Conference*, 21st October 2014

- 6.5 The Citizens Advice Service considers that regulatory action should be taken by Ofcom if a comprehensive review of the evidence at the appropriate time concludes that action is warranted to protect and sustain the universal service. There are complex questions to be answered on the exact costs and benefits on providing the USO and any cross-subsidies from loss-making services and an assessment as to whether providing the universal postal service is a net cost to Royal Mail. However the available evidence does not point to a need for an immediate market review as there is there is no evidence of current consumer detriment and we are satisfied that Ofcom's regulatory monitoring together with the flexibility and sufficiency of regulatory remedies is sufficient to address any short to medium term threat to the universal service.
- 6.6 It is critical that sufficient regulatory time and space as well as adequate staff and financial resources are allocated to ensure that the market review, a complex technical exercise that requires significant deployment of resources, produces credible robust conclusions. Any accelerated review that is not properly resourced could lead to an inconclusive or flawed outcome that would not be in the interests of the regulator, Royal Mail, competitors or most importantly consumers. In light of this and the absence of robust evidence on an immediate material threat we consider that the review should be conducted along planned timing to minimise unnecessary disruption to other key regulatory activities by Ofcom within the wider regulated communications sector.
- 6.7 Over the longer term the regulatory approach to the universal service needs to meet what consumers really need from a universal service. Consumers need a consistent and high quality service that provides greater delivery convenience and control and product innovation to meet consumer needs in the communications environment, not necessarily tied to a 6 day delivery schedule. Initiatives at the European level especially within the European Regulators Group for Postal Services (ERPG) have begun the debate on the contours of the minimum requirements for a universal service.²³ Policy makers need to ensure that regulatory actions are coupled over the longer term with a robust review of user needs from the universal service and consideration by key national and European stakeholders on the appropriate parameters for a universal postal service in the digital age.

Further information

For further information, please contact Robert Hammond, Director of Postal Policy and Regulation on 03000 231 335 or via email at robert.hammond@citizensadvice.org.uk.

²³ http://ec.europa.eu/internal_market/ergp/docs/documentation/2014/ergp-14-26-press-release-uso-ancom_en.pdf