

USO benchmarking review findings

A report prepared for Royal Mail

27 November 2023

Summary of key insights



Most other countries have already changed their USO

Most comparator countries made material changes including delivery speed, delivery frequency, quality of service, or delivery point. Other USPs (UK, Germany, France) had previously sought to retain volumes of letters, but decline is now reaching the point to act.



Financial sustainability is a key driver of change

Falling letter volumes are an important driver of USO change. Revenue growth from parcels has been insufficient to offset impact of declining letter volumes.



Frequency/speed reform used to reduce costs

Main options used:

- Reducing from 6-to-5 days;
- Allowing for optimised delivery model of non-priority items
- Slower speeds for non-priority mail



Mixed Quality of Service approaches

Some countries reduced QoS* targets (e.g. Italy). Others increased QoS targets as speed decreased (in response to consumer reliability preferences). Royal Mail is at the top of the 2c range for Quality of Service targets, and has more stringent local targets (rather than national as in other countries).



Royal Mail's prices

Royal Mail's 1c stamp is below the European mean and slightly above the median notwithstanding recent price increases.

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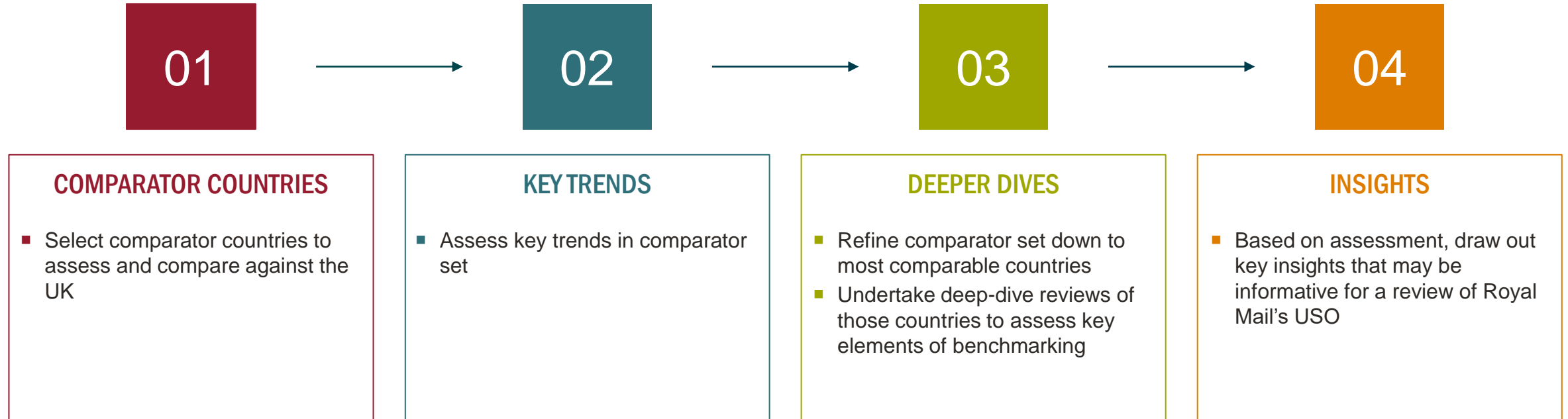
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Changes to the USO in comparator countries can inform a USO review in the UK

We were commissioned by Royal Mail to benchmark international experience of USO reforms focusing on five key elements:



Our benchmarking approach has four steps



The first step was to determine a set of comparator countries

In selecting comparators for a comparative scan, we considered factors such as:

- the characteristics of the postal sector in the country and how this compares to the UK; and
- the postal legislation or regulation that is in place for that country, the restrictions it places on the universal provider, and any changes that were required to enable the USO reforms.

Our review, therefore, focuses primarily on European comparator countries, with some examples from elsewhere (i.e. Australia, Canada and New Zealand).

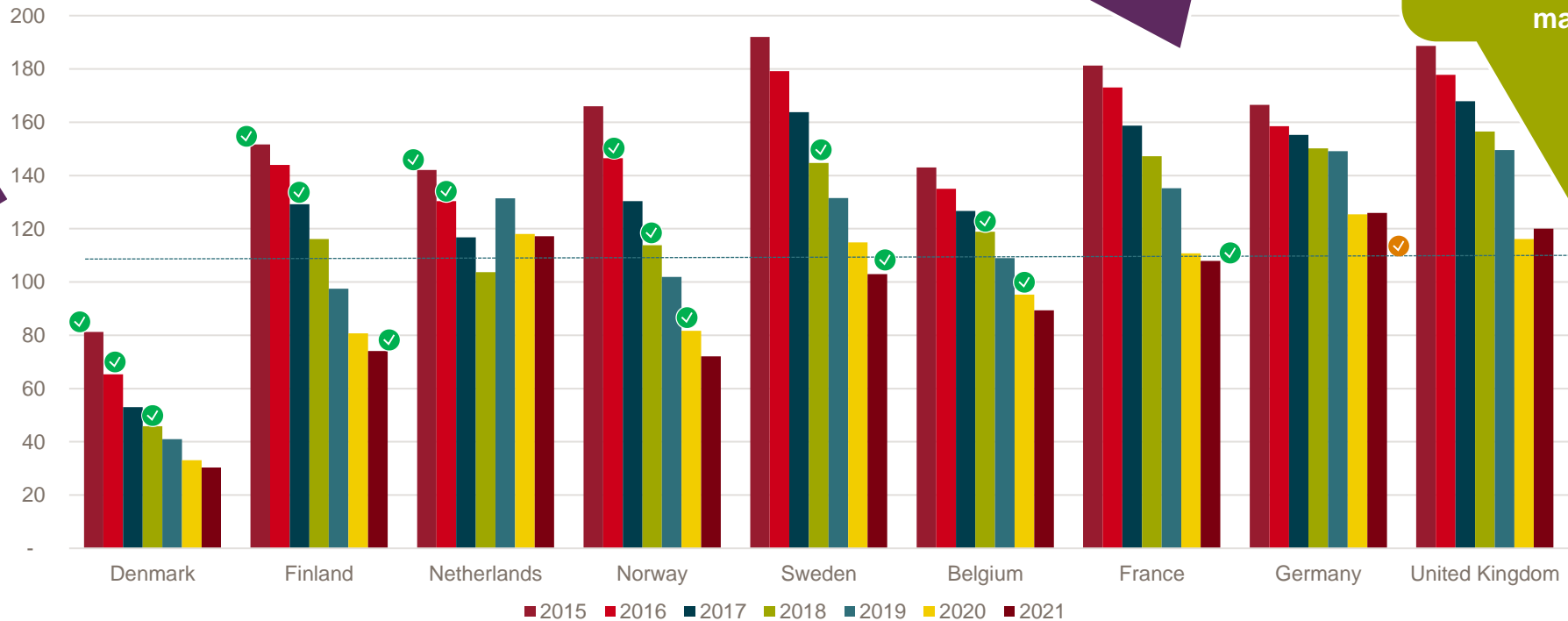
This resulted in a long-list of 30 comparator countries.

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Reducing mail volumes impacts on the economics of delivery and hence has been an important driver of USO change

Addressed letter items per capita delivered by Universal Service Providers



Early mover countries tended to be those with lower initial volumes.

Countries with similar starting points, such as France and Germany, have changed or are considering change.

By 2022/23, Royal Mail delivered approximately 105 addressed letter items per capita. This is below the level per capita at which several other countries made change.

Source: Company accounts, PostNL European Postal Markets overview

Note: ✓ ⚠ = year in which USO change was made or considered. Tick to the left or right of the bars shows that change was made before or after the years shown.

Dashed line is the UK's 2022/23 items per capita. In Netherland, PostNL acquired a competitor in 2019 which resulted in increased in volumes.

Financial sustainability is the key driver of change in other countries, but other factors also matter

Country	Financial sustainability	Consumer needs	Change in government policy	Improve competition	Environment impact	Reduce need for subsidy
Belgium	✓	✓				
Canada	✓					
Denmark	✓		✓			
Finland	✓	✓		✓		
France	✓				✓	
Germany	✓				✓	
Italy	✓					
Netherlands	✓	✓				
New Zealand	✓	✓				✓
Norway	✓	✓			✓	✓
Sweden	✓				✓	✓

These factors were included in public documents. It is difficult to discern from published papers the extent that other factors also played a role, or whether some factors were weighed more heavily in the decision-making process.

Source: Frontier Economics review of company and regulator documents

Four countries cited environmental improvements as an additional benefit of changing the USO, although these countries have different characteristics from the UK

France

- La Poste discontinued its timbre rouge (its D+1 stamp), replacing it with “e-lettre rouge”.
- La Poste argued that USO changes will allow for a **25% reduction in CO2 emissions (by 2030)**. This is by optimising the filling of trucks and no longer using planes to transport letters in France.

Germany

- Germany has proposed reducing speed, which they claim would have the benefit of reduced emissions.
- It is most concerned about the impact of “last mile” delivery.
- Also proposing greater transparency and reporting of CO2 emissions as part of its package.

Norway

- In 2018, two classes of mail were merged to one D+2 service, allowing a A/B delivery model.
- This allowed for flights to be replaced by road/rail.
- An ex-post review found Posten drives around 20 million fewer kilometres per year as a result.

Sweden

- In 2018, speed changed from D+1 to D+2.
- This was to reduce Postnord’s costs and environmental impact by reducing air transport.
- An ex-post review by the regulator also found PostNord had rearranged its transport in a more productive way, both locally and regionally.

The main environmental benefits in other countries were:

- more efficient last mile delivery due to reduced frequency/speed, including better truck optimisation (both locally and regionally) ; and
 - reduced emissions from long-haul transport due to reduced speed, including fewer flights.

However, the geographic characteristics of these countries are different to the UK. Moreover, Royal Mail may have already achieved many of these savings through existing efficiency initiatives.

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Eighteen out of 30 comparator countries have made, or are making material changes to their USO: including speed, frequency, quality of service, and/or or delivery point

- The below 18 countries have all made changes to their USO specification in the last 10 years.
- Of those countries that have not changed, the majority are Central Eastern European countries.
- Several of those have stated that the net cost of the USO is totally financed from State funds.*

Country***	Delivery frequency	Delivery speed	QoS	Delivery point****
Austria			X	
Belgium	X	X	X	
Canada				X
Czech Republic	X			
Denmark	X	X		
Finland	X	X	X	
France		X		
Germany**	X		X	
Greece			X	
Italy	X		X	
Latvia			X	
Netherlands	X			X
New Zealand	X	X		
Norway	X	X	X	
Romania			X	
Slovakia			X	
Slovenia			X	
Sweden	X	X		

Source: ERGP, Report on the Future needs of the USO, 2023

Note: * For example, Bulgaria, Estonia, Croatia, Hungary, Lithuania (source: ERGP report); ** Germany is currently consulting on changes *** Countries in the sample that are not listed here had no material change in USO scope; **** Delivery point changes relate to increased use of public mailboxes in certain areas.

After identifying the trend towards change in these countries USO's, we refined the comparator set down further to allow for deep dives into these countries

We select countries for deep-dives based on:

1. similarity of economic and social characteristics (e.g. GDP);
2. similar postal sectors (e.g. postal items per capita)
3. Availability of data

Based on this, we do deep-dives into the following 10 countries



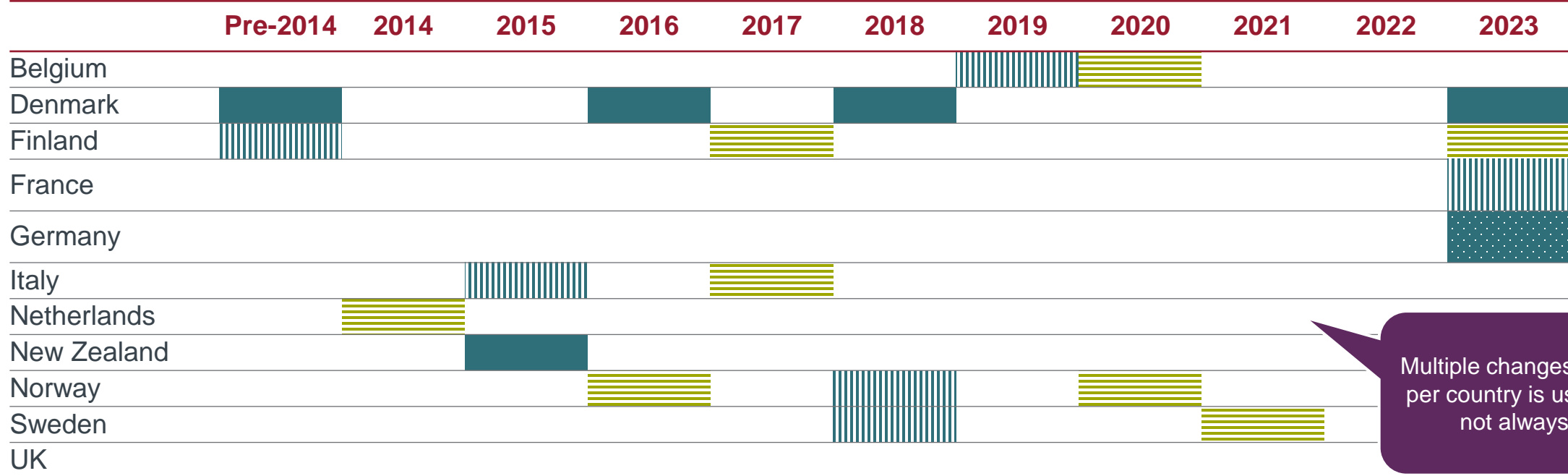
1. Belgium
2. Denmark*
3. Finland
4. France
5. Germany
6. Italy
7. New Zealand
8. Netherlands
9. Norway
10. Sweden*

Over a decade of USO reform has taken place; while no change has occurred in the UK

Speed and frequency are key levers of change. In some instances, changes to speed have allowed for *effective* change to frequency. However, in other cases, there have been *explicit* changes to the USO frequency requirements for letter delivery.

Some countries have been slower to change – such as France, Germany and the UK – as USPs sought to slow letter declines by retaining USO service requirements. However, further volume reductions precipitate the need for change. France changed its USO in 2023, and Germany is currently consulting on potential change.

Speed and frequency USO change

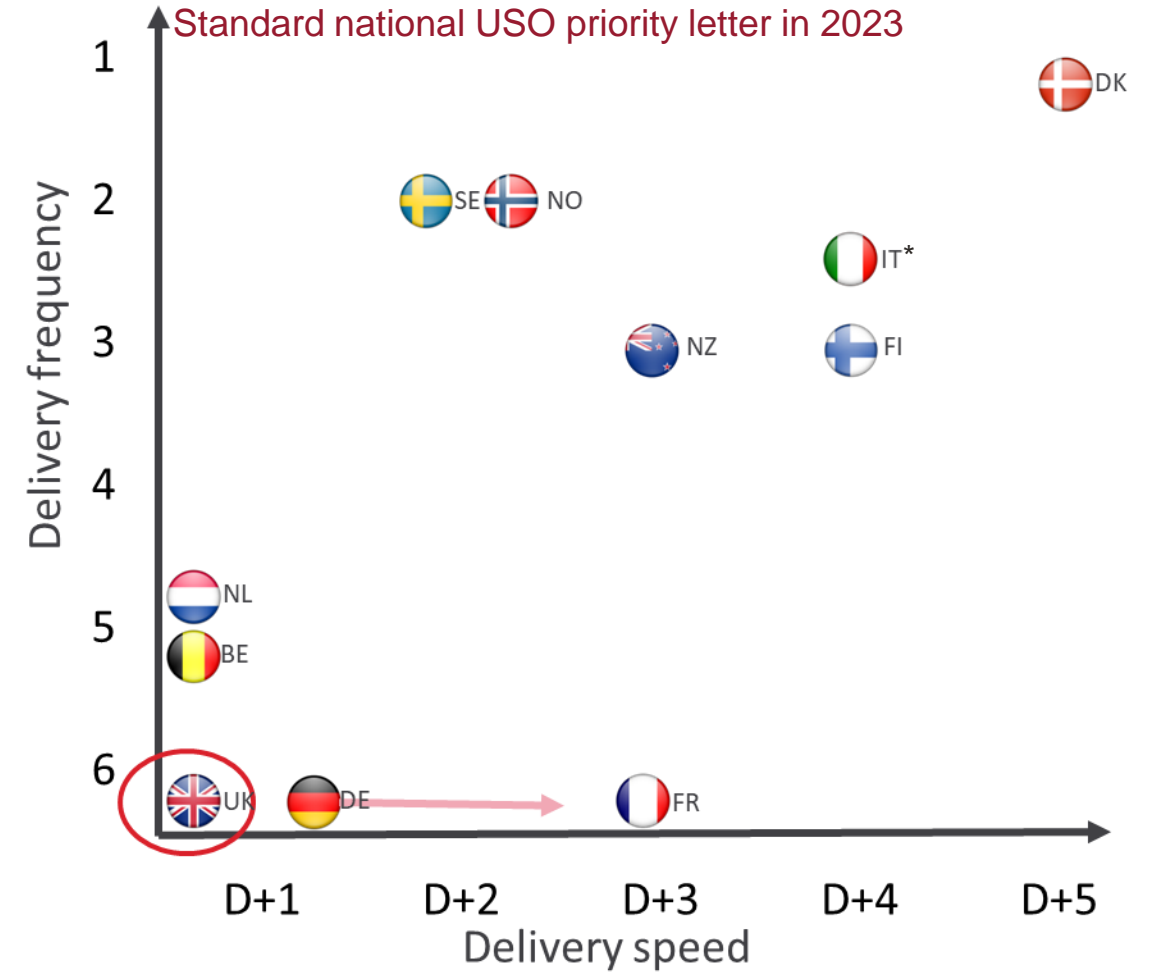
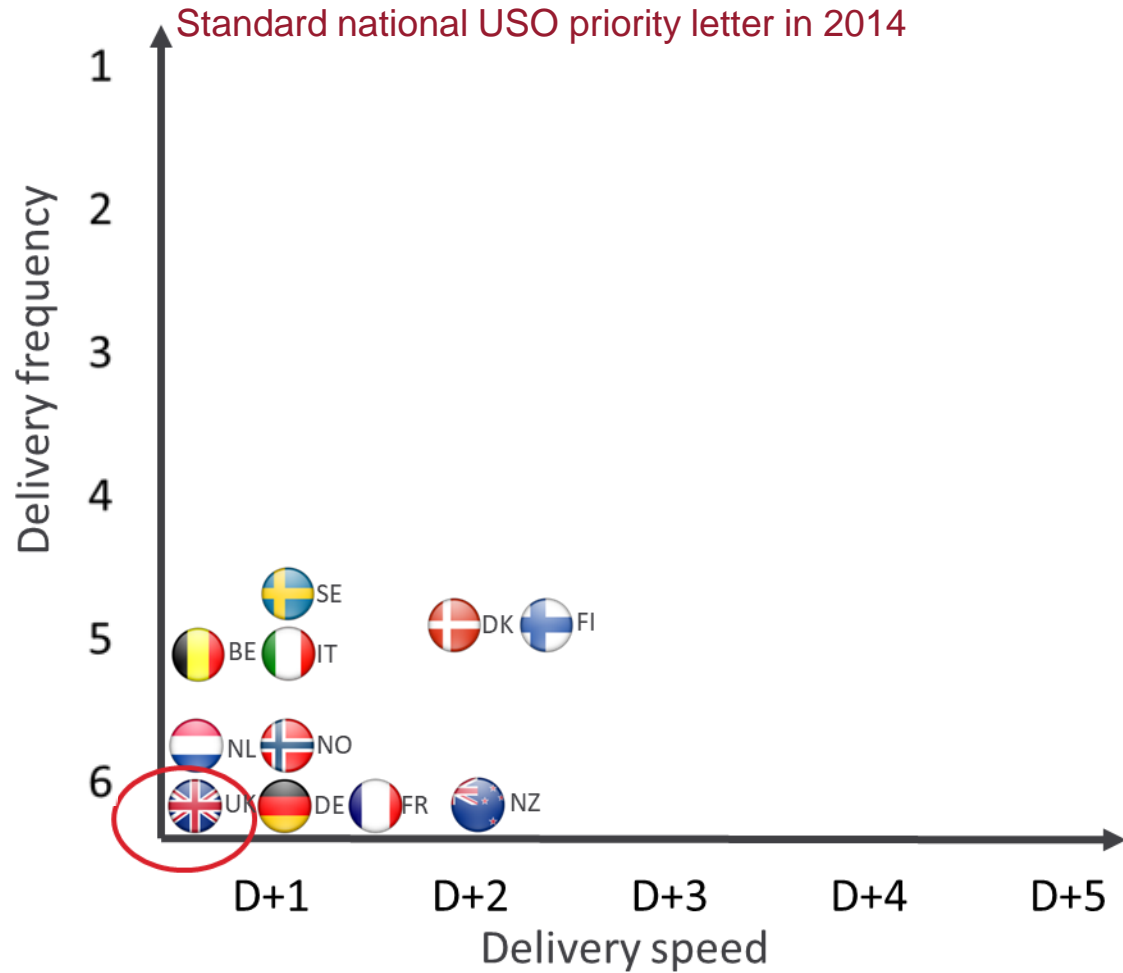


Multiple changes in USO scope per country is usual, but this is not always the case

Key: Vertical lines indicate a change in speed; horizontal lines are a change to frequency (either through change in legislation or move to optimised delivery model allowed by regulator); a solid cell indicates a change in both speed and frequency; and a dotted cell indicates a change is currently under consideration.

Note: In some countries where delivery frequency was explicitly reduced – such as Finland and Norway – collection frequency was also reduced.

Speed and frequency are two key levers of reform



Note that arrow indicates proposed change in speed

* The story for Italy is complicated. The Italian reforms retained a much higher priced priority letter, which has different delivery speeds in different parts of the country (1-3 days). We have included here the D+4 product that has the same delivery speed nation-wide.

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USO reforms to frequency and/or speed have allowed USPs to adopt two different models to reduce transport and delivery costs

These models are not mutually exclusive

5 day letter delivery

- Move from 6 to 5 days for collection and delivery
- Options include removing Saturday delivery, or another weekday with lower volumes (e.g. Monday or Tuesday)
- Examples include:
 - Denmark and Norway removing Saturday;
 - Finland removing Tuesday; and
 - Netherlands removing Monday

- Relatively uncomplicated to implement as does not require major operational change
- Savings can be achieved reasonably quickly but may also be modest
- Three of the four examples have subsequently decreased frequency further (Denmark, Finland and Norway) as letter volumes continued to decline

Optimised delivery model

- Rather than deliver non-priority letters every day, USPs have optimised deliveries to alternate days, or less frequently, to achieve efficiencies
- Most comparator countries have moved or are moving to this model. For example, Belgium, Denmark, Finland, France, Germany (possibly), Italy, New Zealand, Norway, Sweden
- An optimised delivery model can be implemented by reducing the speed requirements for non-priority mail (e.g. to D+3, which is already Royal Mail's speed for 2C)

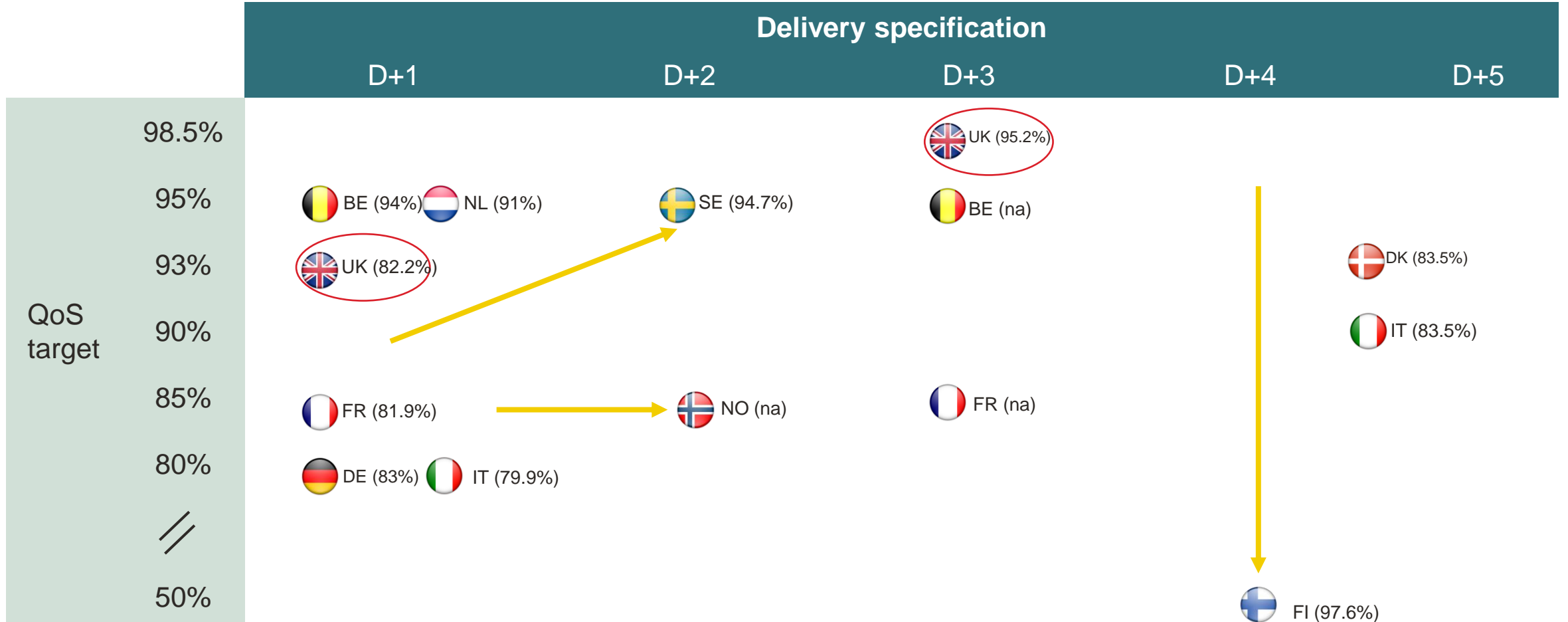
- Most countries also retain (or introduce) a “premium” priority letter product
- Cost savings are dependent on relative volumes of priority product and parcels, as lower volumes imply greater delivery savings from reducing letter day deliveries*
- Optimised delivery model is sometimes trialled before implementing on a national basis (e.g. Finland, France, Sweden)

* Note that some Nordic countries have a higher proportion of parcels collected from pick-up points, which means it is more economic to reduce letter delivery days further given reduced economies of scope.

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Royal Mail is at the top of range for Quality of Service targets



QoS performance is typically measured on a national basis. However, in the UK, Royal Mail is required to reach minimum QoS targets by post code, which will be more challenging to achieve.

Key: Figures in brackets are QoS Performance for latest year available (data not available for all).

Change in QoS target shown by:

Note: Finland also has a 97% QoS target for its USO product to arrive within D+5

A mixed approach to changes in Quality of Service targets has been taken in other jurisdictions

Targets updated to ensure alignment with new delivery speed specification



- **Norway (2018)** – When the D+1 and D+4 services were merged into a D+2 service the same target (85% of mail) was applied to the new published delivery speed.
- **Belgium (2019)** – The new D+3 service was assigned the same QoS target (85% of mail) as the existing D+1 service.

A higher QoS target is assigned when delivery speed is reduced



- **Sweden (2018)** – When the D+1 service was replaced by a D+2 service the QoS target was increased from 85% of mail to 95% of mail (i.e. D+1 for 85% of mail to D+2 for 95% of mail).
- **Germany (TBD)** - The changes to the postal legislation that are currently being considered include, adjustments to current delivery speed specifications – longer delivery speed, and potentially higher QoS targets.

Both delivery speed and QoS targets are reduced



- **Finland (2017)** – When delivery speed was reduced from D+2 to D+4, the QoS target was significantly reduced from D+2 for 95% of mail to D+4 for 50% of mail.

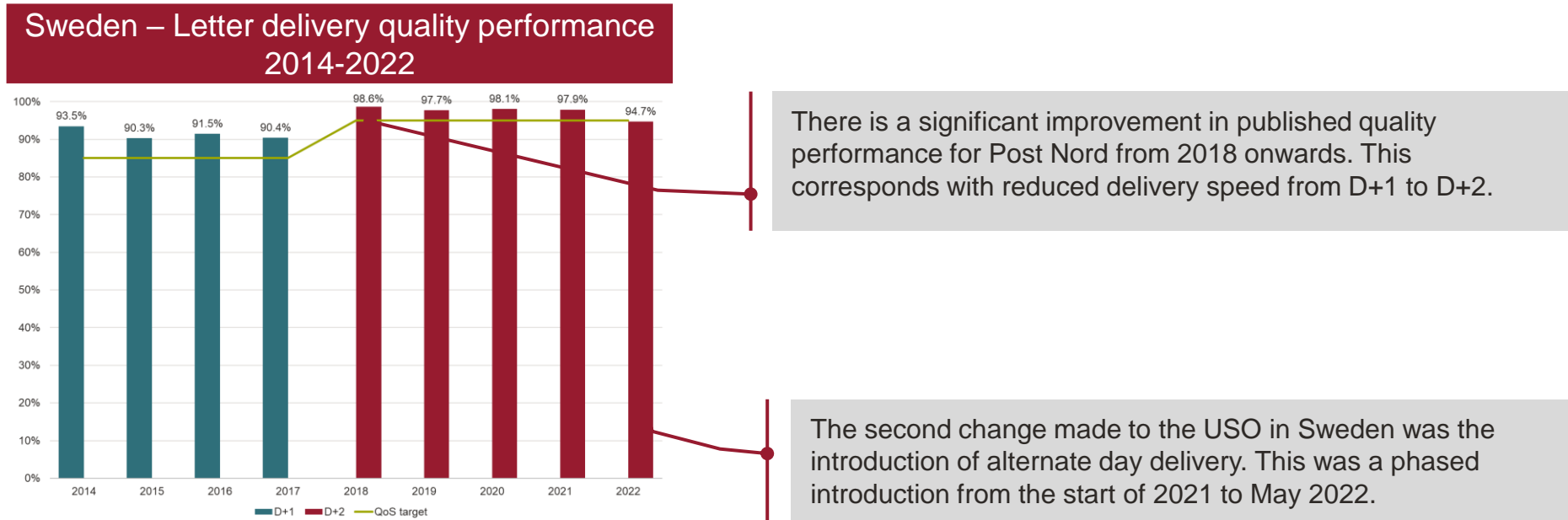
QoS targets are updated to reflect changes to delivery frequency



- **Italy (2015)** - As part of the updated exemptions from providing a five-day service under the 2015 Stability Law, QoS targets that were previously 80% for the priority (D+1) service were adjusted to 80% of priority mail arriving:
 - D+1 where the delivery and access points are both served five-days per week;
 - D+2 where either the delivery or access point are served on alternate days; and
 - D+3 where the delivery and access points are both served on alternate days.

The changes made to delivery speed and QoS targets often make it difficult to get a true picture of what has happened to actual QoS performance after USO changes

The quality performance data that is measured and published by other operators is calibrated to the QoS targets that operators are measured against. Therefore, when changes are made to these QoS targets, the published quality performance data reflects these changes. This makes it difficult to get an accurate view of trends in QoS performance and how these relate to changes to the USO in each country, as illustrated by data from Sweden below. It is generally only possible to comment on QoS trends around changes to USO delivery frequency.



QoS trends are mixed across countries where USO changes are not related to delivery speed or QoS targets

Through our analysis of QoS data for countries where USO changes were not related to delivery speed or QoS targets, there is some evidence to support a hypothesis that QoS improves following a change in speed, but not frequency, however the data is very limited.

Netherlands

- QoS has declined over time, with the 95% target not being met since 2018, but a QoS >90% being consistently achieved.
 - There was no obvious impact of reduction in delivery **frequency** from six to five days in 2014, or reduction in required network of service points in 2016.
 - PostNL attributed its 2019 QoS under-performance to the merger with Sandd, and the quality issues related to the Sandd network.
 - It then blamed subsequent issues on the impact of the pandemic. However, 2022 performance was even lower with QoS of 91% (compared to 94.3% in 2020 and 94% in 2021).

Italy

- The move to a reduced delivery **frequency** of 2.5 days per week for 25% of the population (more rural areas) was completed in Feb 2017.
 - **QoS for the D+1 product appeared to improve initially (82.2% in 2017 to 85.9% in 2018), but then declined subsequently.**
 - 2022 is the first year where 80% D+1 target not met, with a QoS of 79.9% (80% was still achieved for D+2 and D+3).
- QoS performance of the D+4 product (introduced in 2015) has declined over time
 - QoS target of 90% not met since 2018.

Belgium

- QoS for the D+1 product improved following the change of **speed** to D+3 product in 2019.
 - **QoS was 91.2% in 2018 and increased to 95.8% in 2019** (declining slightly to 94% in 2020).
 - Note: No data on QoS for the D+3 product is available.
- No published QoS data available for 2021 or 2022, so unable to assess impact of the 2020 move to an alternate-day delivery model.

Note: Data availability also plays a role here. For some countries (e.g. Norway), we have not been able to source QoS data, and for others (e.g. France) the data time series is not long enough to comment on the impact of changes.

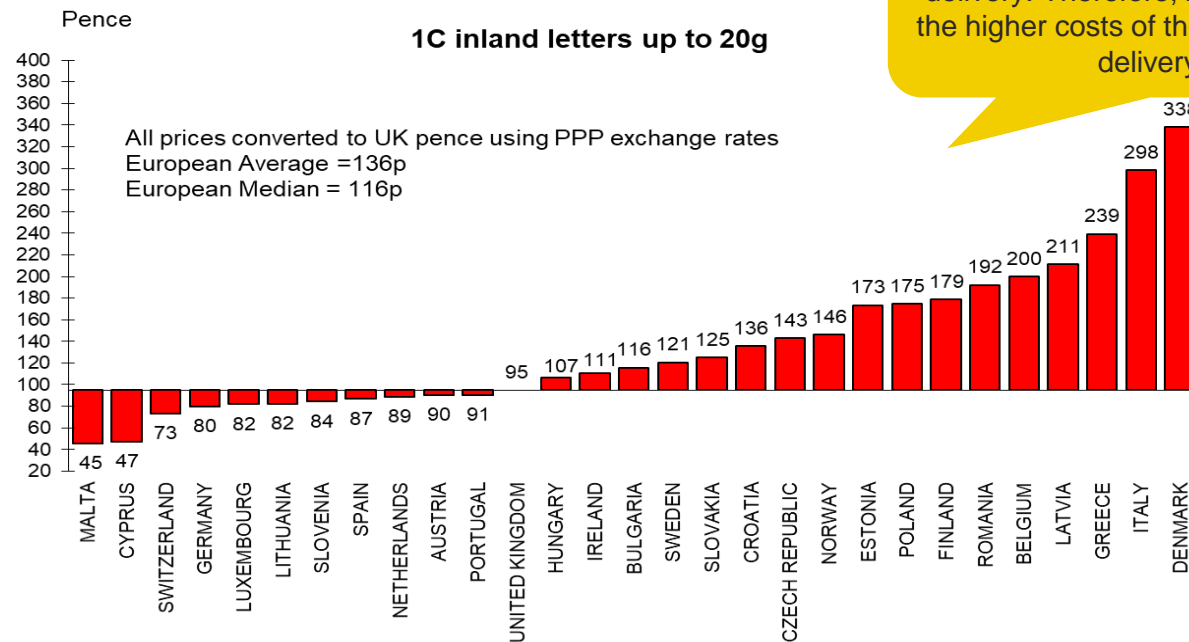
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Royal Mail's 1c stamp price is below the European mean notwithstanding recent price increases

- Price comparisons need to be undertaken cautiously, as not all products are identical and pricing approaches differ by country (e.g. weight and size bands).
- Royal Mail has increased its price for first-class stamps in recent years in response to increasing per unit costs. The price is now £1.25. This is below the European mean of January 2023 (£1.36); however, it is above the median of £1.16.

Benchmarking of European stamp prices, January 2023



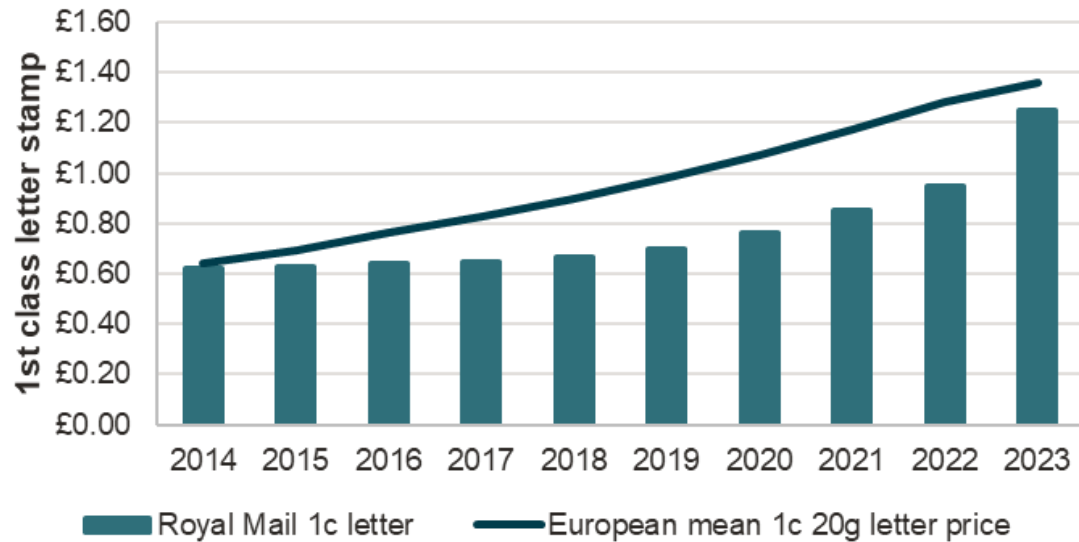
Several of the countries with higher 1c prices also have non-priority services with optimised delivery. Therefore, higher 1c prices reflect the higher costs of these services with lower delivery density.

Source: Royal Mail, Stamp Letter Price Trends & European Comparisons, January 2023.

Note: Comparison as at January 2023 prices. The provision of a 1C service sometimes requires an interpretation of what constitutes an equivalent service as they are not identical across countries. Some countries, such as Spain, offer an "Urgent" service for delivery within 24-hours which is not comparable to 1C service. The comparison is for a standard stamped letter (rather than a packet or a "flat" or "large letter").

Royal Mail's 1c stamp price has increased over the last decade although at a slower rate than the European average

Royal Mail 1c stamp price over time



- The increase in the European 1c stamp price reflects the higher costs of these services as delivery densities have reduced over time.
- As optimised delivery has been implemented in some jurisdictions, this has increased the cost of priority mail, and hence the price and price differential with non-priority mail.
- For example, in Italy the price of the priority letters was increased from €0.80 to €2.80 in 2015, to reflect increased costs.

Source: Royal Mail, Stamp Letter Price Trends & European Comparisons



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