

5<sup>th</sup> April 2024

## The Future of the Universal Postal Service – Call for Input: UKMail Response

As a significant Access carrier, we welcome the acknowledgement of the importance of non-USO volume and revenue in supporting RM's ability to maintain a network capable of delivering the USO. Although in decline, Access volumes have stood up better than Retail bulk and USO and so our importance in the conversation is even more relevant now. As USO only accounts for 17% of volume, using research into needs of individual USO users and SMEs as the basis for consultation misses the people who actually pay for the network. We therefore urge Ofcom to refresh its 2020 research and talk to a broad range of bulk mailers from a variety of sectors about their requirements, the options presented now, and alternative options not currently being considered. UKMail would be happy to facilitate conversations with our clients. To boldly state that "Most users are willing to consider a slower letter service provided delivery is reliable" may not be so clear cut, although we do believe that in general a drop from 6 days to 5 would not cause much concern.

Managing the expectations of bulk users during the consultation stage is important. Suggesting a trade-off of a reduced schedule in exchange for predictability should be heavily caveated. Some honesty here, please. Past behaviour by Royal Mail is a strong predictor of future behaviour. There is absolutely no certainty that they will deliver on their side of the bargain, and no indication that Ofcom would enforce service standards in any meaningful way (as they have failed to do previously). Therefore, any proposals from Ofcom must include greater powers for themselves, a willingness to use them and a separation of the contradictory requirements to hurt Royal Mail for non-compliance and protecting their profitability. This will require changes to the Postal Services Act.

If we accept that the dire financial position Royal Mail finds itself in is largely due to the financial burden of the USO, and that the sums involved are indeed circa £400m a year, then the resolution must come quickly. The Ofcom consultation document does not acknowledge the very real threat of the USO collapsing of its own accord, with IDS refusing to spend the sums needed to meet its' obligations or handing-back to Government USO mail altogether.

### **Sustainability**

With delivery forming such a large proportion of Royal Mail costs, the true cost burden of the USO to RM comes from the obligation to deliver to every household 6 days a week. In practice this is only required for 1<sup>st</sup> Class items (though would need to be offered for 2<sup>nd</sup> Class items if 1<sup>st</sup> Class did not exist). The price of a 1<sup>st</sup> Class stamp is not capped by Ofcom and RM are free to raise that price to make it become economical for them to deliver (as if it were a small parcel). That would price-out a

large portion of the volume and make what remains viable. (As Ofcom suggests it could be a little under Special Delivery price (A7.67)). As no 2<sup>nd</sup> Class item actually has to be delivered on a given day, RM can in effect go from 6-day to 5-day delivery for 2<sup>nd</sup> Class items without Ofcom having to do anything at all. Indeed, alternate days could already be implemented for 2<sup>nd</sup> Class whilst still hitting service targets without the need for any of this consultation, Ofcom agreement, or changes to legislation. It is really the impact upon Access customers who expect a D+2 service that Ofcom should be concerned about, and the volume decline brought about by awful service and excessive price rises that reduces Access revenue and threaten RM's ability to deliver for ALL customers

Much of the consultation is predicated on the basis of "If we accept that the dire financial position Royal Mail finds itself in is largely due to the financial burden of the USO..." but the true problems RM have are the inability to operate efficiently (an obligation for Ofcom to ensure was delivered within a reasonable time of the Postal Services Act 2011) and a failure to succeed in the parcels market including a catastrophic fall-off in parcel volume after the pandemic. Following a large growth in parcel activity during Covid, there has been a marked decline in the UK Express Parcels market volumes and revenue. Volumes fell by 9% between 2021/22 and 2022/23, and revenues by 8% (largely driven by inflation and cost of living) Royal Mail still have 33% market share but our data shows that of 13 major parcel carriers, RM's volumes in 2022/23 have declined the most (-21%) {source: DHL Triangle report 2024}. Since Royal Mail was privatised and the self-financing principles of Royal Mail were established, letter volumes have fallen broadly in line with predictions at that time. The parcel market has slowed, and although Royal Mail has invested heavily to transform itself into a parcel business, the volumes to deliver returns on this investment and market share achieved have not been as expected.

No doubt some of that is a loss of trust as well as the effect of industrial disputes. This is core to the financial troubles that RM finds itself in and was another key objective which has not been achieved that was due to be addressed through Royal Mail privatisation in the Hooper Report (2008) to deliver a modernised Royal Mail. The strikes throughout 2022 and 2023 demonstrate the management of the privatised Royal Mail has not achieved this. We believe it is essential that Ofcom ensures that any changes to the USO which it allows do result in a financially viable Royal Mail and are genuinely realistic and achievable within the context that Royal Mail finds itself. The CWU has already indicated it will object to alternate day delivery which they predict will result in significant job losses. So whilst Ofcom might choose to allow Royal Mail to move to such a delivery model, if in reality Royal Mail are then unable to implement such a solution without significant industrial unrest which it cannot afford, this might be seen as Ofcom trying to distance itself from any blame for Royal Mail's future demise rather than creating the financial sustainable postal service that is required.

### **Affordability**

The drop in Letter volumes has been largely offset by large increases in price. We agree with your analysis in the counterfactual modelling that assumes Royal Mail will continue to push up prices to the point of unit-elasticity (A7.67) and there is ample evidence of this being the case in Access. Rises for Business Letters of 13% then 17% and finally another 17% last October demonstrate that Royal Mail believe transactional mail is relatively inelastic over the short term although their econometric models now demonstrate that larger price rises have accelerated the rate of decline over the longer term. At the same time, large discounts are offered to try to hang on to direct marketing spend, which is much more price sensitive. Ofcom's modelling ought to be able to take account of the two

very different streams of traffic (and revenue) for Access as they are likely to be different from those used by USO customers yet account for over three quarters of volume delivered by RM's network

For years Access operators and bulk customers have been told that continuing above-inflation price rises were necessary to pay for investment in automation and especially walk-sequencing machines (the rationale behind Mailmark) which would bring efficiencies and improved service. Yet for years RM have failed to meet their efficiency targets and service standards have plummeted. Why have none of the supposed benefits materialised, why has Ofcom not set clear efficiency targets and sanctions rather than just more extensive monitoring, and why are customers being asked to accept further degradations in service ahead of RM's own issues being fixed? It does not appear that Ofcom have the regulatory powers needed to enforce positive change, or would choose to use them if available. Reduction in service does not equate to improved efficiency and based on previous commitments by Royal Mail we view a target for genuine efficiency savings of 9% by 2027-28 (for an equivalent service) and to be unrealistic and very likely to be missed, leaving RM in an even worse financial position, of its own making, but which Ofcom may have driven by building a framework which directed Royal Mail to this end state.

### **Reliability**

Royal Mail have very clearly shown by their actions that they are unwilling to spend the large amount of money required to return service to anywhere close to that required by Statute. That Ofcom can raise a fine for failure to meet its obligations (for the previous year) is one thing, but it is then at a scale that is so low as to be entirely ineffective in altering behaviour. What is £5m against a saving of £300-400m? It is clearly commercially sensible for Royal Mail to choose to fail. There is a contradiction here, of course : How does Ofcom satisfy the dual requirements to levy a fine substantial enough to act as a deterrent whilst ensuring the continuation of the USO through a company that cannot afford to pay a substantial fine? And how does it require that company to invest to improve services whilst taking away the money it might be able to invest? It now seems these requirements are completely contradictory and not feasibly achievable by the same body. Responsibility for maintaining a financially viable USO should be returned to Government, leaving Ofcom with the duty to control prices, monitor efficiency and enforce service standards. The inevitable financial gap between the two should be met through subsidy from general taxation.

Without effective controls and punishment from Ofcom, the same can be inferred to RM's other obligations. RM could simply implement an alternate day delivery without agreement or a change in legislation. What real powers could Ofcom invoke to prevent that from happening? Losing Saturday deliveries has become accepted almost as a fact-on-the-ground. One in five D+2 Access letters misses its' due delivery date. One in four 1<sup>st</sup> Class deliveries misses. We are already drifting towards alternate days even if RM and Ofcom do not formally acknowledge that to be the case. It must be very tempting for Ofcom to agree to Royal Mail's requests as it seems so powerless to prevent them.

### **Access Users**

Ofcom acknowledge that changes to the USO are likely to flow through to equivalent changes in Access mail and we seek assurances that Ofcom will not sanction a degradation to Access services ahead of changes to USO delivery expectations. Access Letters account for over 75% of volume delivered by RM (and over half of their revenue). Access services are governed by a commercial

contract where all the power to amend the terms lies exclusively with Royal Mail, with clauses specifying notice periods (the maximum of which is just 190 days) so RM could change the D+2 service to a D+3 for the majority of their traffic without the need for a change to legislation.

Over 50% of Access mail has moved to a slower Economy service (D5) from Standard (D2). This has been driven by two factors: the increasing price differential between Economy and Standard, and the very poor service on D2 mail with no signs of improvement. The delivery performance for Economy Day 3 is the equivalent of Standard Day 2 (indeed, in February Eco Day 3 = 90% whereas Standard D 2 = 84%) so why pay the premium? By moving to Economy there is a wider delivery window and customers have had to adjust their expectations in order to save in Access costs. It is a balance, and one which predominately DM customers have chosen to accept. However, this does not work for all. Large 'Transactional' customers have been slower to adopt Economy D+5 services for good reasons, not least of which are FSA and regulatory requirements imposed upon some of their communications. It is not at all a given that they will be able to pull their data and document production forward a day to account for longer delivery times of the proposed D+3 (or alternate day) service for Access. Ofcom will need to consider whether statutory change will be required beyond those proposed solely for the USO, and take a view on whether what they are proposing cuts across other legal obligations of mail producers. 'User needs' is not solely about what recipients of mail would like or accept.

### **The foreign experience and public subsidy**

Section 7 of the Ofcom document makes much of the experience of other countries in Europe and beyond, and the many cases of changes they have made to downgrade their USO services to reduce costs but also "Some have applied and/or increased public subsidies for USPs". Furthermore "Several countries compensate their USPs financially in the event of an unfair financial burden arising from delivering the USO. Many European countries have in recent years requested approval of state aid to provide to their USPs so that they can continue to deliver services. This includes in Denmark, France, Italy, Poland and Spain." Yet the 'in brief' part of Section 9, the three options presented to us seek to deal with the problem on the assumption that a public subsidy is a bad thing "Our analysis of the evidence suggests that adapting the USO specification to meet user needs is **preferable** to maintaining the existing specification given this does not appear sustainable without substantial subsidy from industry or the state."

Section 9.5d) does offer "subsidy to maintain the current USO (via public subsidy or from an industry fund)" and section 9.80 goes on to examine funding through an industry levy, concluding (rightly) that it would be inappropriate and unfair in the UK. However, this is to entirely ignore public subsidy as a source of income to RM which appears to achieve many of the key tests needed to be achievable and deliverable within a period that ensures there is a postal service to maintain, yet no mention of that is made in the conclusions. We believe this to be a fundamental gap in Ofcom's document and one that ought to be brought out in the consultation process. Ofcom's options seem to be limited to only those which could be enabled within the existing Postal Services Act, yet above we highlight that even these would necessitate changes to the Act to enable Ofcom to operate an effective enforcement regime. Therefore, this restriction of options seems rather arbitrary.

A change to the PSA where Ofcom has the duty to enforce quality and set prices that consumers and businesses pay whilst government has the responsibility to maintain the USO seems an achievable, practicable outcome. Ofcom can set prices to maintain volumes and reduce the burden on the state

rather than recover excessive costs which price volume out of the market. Any funding gap from RM commercial activities is state funded through taxation. At the highest Ofcom cost of £650m, which RM have described as “toppy”, this would equate to £20/household per year. Compare this to Amazon Prime at £95/year. However, the advantage of recovery through taxation is this would be means tested which also ensures the requirement for a service affordable to all.

We recognise that state funding of a private institution is not straightforward, but privatisation of Royal Mail does not appear to have delivered the benefits it was expected to achieve and so it should not be considered to be a commercial status that needs to be maintained at all costs. Let’s not cut down options at the start to only those upon which Ofcom have some influence or power which might then force sub-optimal outcomes.

**1: Do you agree that we have identified the correct aims, supporting principles and features of the USO? Do you consider that these should continue to be respected as far as possible when assessing potential changes to the USO?**

Supporting the principles of the USO is a political decision, in so far that there is a cost in doing so, rather than a customer decision. It is clear that the customer preference would be to maintain the current requirements but with a return to good service standards at a reasonable price.

In the world of Access there are four price plan options, one of which is a Zonal plan whereby the true cost of delivery is reflected in the price paid. To keep the One Price Goes Anywhere model for the USO means a cross-subsidy which ultimately comes from a sub-set of those buying the service. In effect we have one portion of users subsidising another. If a uniform price is so important for social cohesion and other non-monetary factors then that ought to be subsidised through general taxation, just as other spending disparities are settled by formulae that give a higher per-capita subsidy in one Region or devolved Legislature above another.

**2: Do you agree with our assessment of the direction of change in postal needs of residential (including vulnerable) users and SMEs? Are there other factors relevant to their future demand which we have not considered?**

It is clear that the overall volume of mail is on decline and will continue to be for some years to come. Quite where that flattens out is not known by us but there will always be a requirement for paper communications, especially with an ageing population. Royal Mail’s own projections have not been shared with us and so they come at this consultation with a distinct advantage. Ofcom have seemingly bought into the RM narrative that there is an existential threat to the USO and so we can only assume that Ofcom have been rigorous in validating those numbers. I would very much like to see Ofcom’s own projections of Letter volume (both USO and Access) for the next five years.

**3: Do you agree with our assessment of the bulk mail market? Are there other factors relevant to its future evolution which we have not considered?**

Ofcom need to do extensive research into the requirements of bulk mailers. Particularly they need to look beyond the obvious requirements of bank statements and catalogues to consider what messages/fulfilment these organisations would struggle with if the service spec changed. There are requirements for speed and also requirements for coordinating when messages land, both of which require daily delivery to everyone. The latter might not need to be next-day but it doesn't allow RM to save a lot in delivery if they still need to cover everywhere every day. Small businesses highlighted at the London event how they would struggle to compete with larger ones where the bigger businesses have the volumes to get a better price from carriers. Under alternate day delivery they would lose access to an economical next day delivery which again means they would lose out to the larger retailers with cheap next day options.

Regulatory changes, such as covered by the Financial Services Authority, will need to be considered in relation to notice periods for communications from financial institutions and Government departments (such as HMRC) or notification of interest rate changes when the Bank of England base rate moves. Similarly, there are some communications that require the recipient to act within a deadline set by the date of the letter or statement.

#### **4: Are there specific events/changes that could trigger a significant change in demand for large mail users, including public services?**

Continued and consistent above-inflation price rises will inevitably push yet more communications into paperless channels. Whilst these changes take time to achieve as digital options require investment and development and so may not show up in short term elasticity analysis, sustained price increases support the business cases for these investments and so accelerate this switching over the longer term. Without effective price-control measure for Access mail this trend will continue. A cynic might conclude that this year's price rise in July is timed in order to capture the (compulsory) autumn election mailings and so inflict even more of a financial burden on to councils.

Quality and cost control are the two really big asks from bulk mailers. We need a price control on access charges that works. A headroom constraint against a service that has no volume is not an effective control. It is inevitable that any headroom constraint applied with reference to a similar Retail bulk mail service will fail as the requirement for there to be a price differential will make users of the reference service switch into the DSA service and replicate the problem we have seen with Mailsort 2.

Business users are clear that they would expect a price reduction for a lesser service. They do not accept the argument that savings can be reported against alternative prices which might have existed in a different context and expect an actual real reduction in postage charges. Many customers will feel betrayed if Ofcom fails to protect their interests as postal users and allows Royal Mail to retain all savings from a reduction in service provision.

Strike activity by postal Unions (particularly the CWU) have in the past led to an immediate drop in direct marketing (DM) campaigns. There is a direct causal link. As talk for reducing delivery rounds to 2 or 3 days a week becomes more widely known, that is likely to cause some concern and unsettle staff. When it comes time to implement substantial changes in working patterns and staff numbers we have no faith that Royal Mail could actually implement anything that Ofcom or Government have agreed to allow. Based upon RM's failure to agree relatively small changes in terms with the CWU in

the past, we expect large numbers of job losses (whether through compulsory or voluntary redundancy schemes) might result in significant disruption over an extended period to come and eventually the need for government to rescue an insolvent Royal Mail. Were this to happen the loss of volume on the run up to such an event would result in much higher subsidies to fund whatever the USO may be at that point than would be required through an earlier intervention which retained more volume to contribute to Royal Mail costs.

**5: Do you agree with our proposed approach to estimating the financial burden of the USO?**

We agree that the counterfactual approach appears to be a sound basis upon which to proceed. We are not really in a place to comment upon the technical aspects of your methodology and trust that your team have been rigorous in testing their assumptions.

**6: Do you agree with our considerations regarding the unfairness of the financial burden of the USO.**

The burden of the USO, and regulation underpinning it, was known at the time that IDS took on responsibility. They would also have extensively modelled the downward flight-path in letter volume expected over the medium and long term, and should therefore have evolved their network and resources to accommodate this. Royal Mail have manifestly failed to deliver on their stated efficiency targets over so many years that Ofcom decided to increase their monitoring to cover a 5 year period. That the decline in volume is at least in part due to frequent and consistently higher than inflation price rises, especially in bulk/Access rates, imposed by the monopoly supplier which is their own doing. Therefore, the notion of 'fairness' (or otherwise) seems rather misplaced as a consideration when recommending changes to the USO. Indeed, it seems entirely unfair to now ask customers to accept a reduced service (and likely continued increased costs) to pay for Royal Mail's own failings.

In 2022/23 the RM Regulatory Financial Statements show the Reported Business had operating costs of £7.3bn. If we take RM's view that the £650m burden is "toppy" and so maybe a figure of £400m is more realistic this is pretty consistent with the £438m Financeability EBIT loss they reported. They would only have needed to have been 5.5% more efficient to have broken even at this level. The rest of the losses that result in them reporting a £939m loss on the Reported Business are mainly driven by a revaluation of IDS's investment in the Royal Mail businesses which resulted in it taking a £539m hit to the P&L. This is a one-off adjustment so not really a reflection of the underlying profitability of the operation. The underlying loss was 6.3% which doesn't sound extreme for a business recognised for being inefficient. If Ofcom wants to understand the level of unfair burden it needs to better estimate the costs of inefficiency.

**7: Do you agree with our considerations regarding the impact of the financial burden of the USO?**

Table A7.3 considers that Bulk retail (and therefore presumable also Access) will be at a reduced price to provide some compensation for the reduced frequency of delivery. A7.66 also assume some

small reduction in price. We believe this to be highly unlikely to the extent of naivety. The three past rises have been 13%, 17% and 17%. In the face of that, even “slightly lower prices” against where they are now would hardly be noticed. Royal Mail rely upon the inelasticity of demand for transactional mail and are likely to keep hitting those customers in future, whatever delivery schedules we may finally settle upon. If Ofcom are serious about reduced prices being part of the trade-off then they must seek greater powers of price control and be prepared to use them. Otherwise RM will continue as they have always done, and pocket the savings without any benefits passed back to customers.

Para A7.99 states “Our cost model is built to vary the resources needed for the different scenarios.... to the extent that the Counterfactual may involve changes in worked hours or the number of staff employed, we have assumed that Royal Mail is free to make these changes.” This is a huge assumption and not one backed-up by the results of last year’s industrial dispute. The CWU is very unlikely to accept the loss of 30,000 – 40,000 members without a fight, which is the scale of staff cuts needed to hit cost targets, even if Royal Mail say this could be achieved with just 1000 offered voluntary redundancy. The latest deal already rules out compulsory redundancies in the short to medium term. Perhaps RM is going to rely upon an ageing workforce naturally reducing in number, but that certainly won’t deliver their stated aim of having a speedy resolution to their financial woes or having their network aligned to regulatory changes they hope to be in place for April 2025.

**8: Do you agree with our analysis of the different options available to change the USO and the impact of those changes on residential (including vulnerable) users, SMEs and bulk mail users? If not, please explain why and set out any option(s) which we have not considered.**

There is a clear and obvious option that has not been mentioned at all: – returning Royal Mail to full or partial state ownership. Very few countries worldwide have fully privatised their postal service. Although Royal Mail privatisation was supported by the EU’s liberalisation of government services, most other member states stopped short of privatisation and created state-owned companies which have enabled continued state support.

Whilst state funding might equate to around £20/household per year, if consumers had to pay around £4 per use for a 1<sup>st</sup> Class service it is quite likely that many households would be worse off under Ofcom’s proposals than they would if an extra charge were added to their tax. So Ofcom’s approach to proposing only options that work within the current legislation does appear to create sub-optimal solutions for consumers, and especially vulnerable ones who may not have easy access to fast alternative communication such as digital services.

IDS have not been shy in proclaiming that Royal Mail is a “parcels company that happens to deliver mail”. Relieve them of that burden. The postal Unions would no doubt welcome it and the threat of a collapse in the USO would be averted. As many protections for vulnerable users of the USO could be provided for as the government is willing to pay for.

**9: Which option(s) do you consider would be most appropriate to address the challenges we have identified, while also ensuring that users’ needs are adequately met?**



If Ofcom's analysis of the financial burden of the USO is correct, and RM continue to make £400m+ losses, then dropping delivery frequency to 5 days a week will simply not be enough (they are already de facto dropping a day by dint of under 80% performance).

That leaves alternate days, which may not suit USO users in general and impact particular vulnerable groups disproportionately (either 3 or 2.5 makes little difference here). It would also not work for certain bulk mail uses such as where bank cards and PIN numbers need to be delivered promptly but not at the same time, where advertisers want mailings to land on specific days to coincide with offers through other media, where periodicals want their subscriptions to arrive ahead of them being on newsstands or Radio Times needing to arrive before that week's programmes commence. If post is no longer able to meet these needs then volumes will reduce which will then move the goalposts for a target Royal Mail profitability. There is a real possibility that Ofcom under-estimates the amount of exit from the market which then necessitates a further cut in service to improve Royal Mail profitability, and Ofcom drives an accelerating spiral of decline that drives Royal Mail out of business rather than saves it. Ofcom's modelling to date seems to make fairly arbitrary guesses of volume impacts as you have not done the necessary research to establish the scale of these effects. This is definitely needed to establish any confidence that service reduction will deliver an improved outcome for Royal Mail.

There are no guarantees that RM would meet their new obligations, just as they fail now and are hardly penalised for doing so. Nor is there any real guarantee that 2<sup>nd</sup> Class prices won't continue to rise as RM fail to achieve their efficiency goals and come back to Ofcom looking for more money.

We do not believe that any of the options identified truly squares the circle of maintaining a useable service at a reasonable price, whilst also remaining viable and profitable for Royal Mail. A further source of income, from general taxation, is the most sustainable option at this point.

### **10: Do you have any other views about how the USO should evolve to meet users' needs?**

Under 'Transition to any new arrangements' 9.94 it is acknowledged that transition will take time. This is a remarkable under-statement. To complete consultation, amend legislation, and RM actually get changes pushed past the CWU is very likely to be several years, by which point Royal Mail are going to be in even more of financial crisis than they are now. Getting to a point where RM management could actually start to implement anything of significance seems unlikely in the near term but the resultant chaos could easily kill RM before they get the chance. Ofcom's proposals need to be genuinely deliverable – allowing RM enough space to commit suicide is not a solution for a responsible regulator.

Under these circumstances you should consider recommending government financial support, delivered quickly and lasting at least up to the point that your changes have had a measurable positive effect; and if not achieved then provision for continued financial contribution in support of the USO.

A change to the PSA where Ofcom has the duty to enforce quality and set prices that consumers and businesses pay whilst government has the responsibility to maintain the USO seems an achievable and practicable outcome. Ofcom can set prices to maintain volumes and reduce the burden on the state rather than recover excessive costs which price volume out of the market. Any funding gap from RM commercial activities is state funded through taxation. At the highest Ofcom cost of £650m, which RM have described as "toppy", this would equate to £20/household per year.

Compare this to Amazon Prime at £95/year. The advantage of recovery through taxation is this would in effective be means tested which also ensures the requirement for a service affordable to all.

As always, we would be happy to discuss our views and offer further insight into feedback we have had from our clients, directly with Ofcom if you think that would be useful.

Yours sincerely,

Jon Wilkins  
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