

Your response

This is the response of Moonpig Group plc ("Moonpig") to Ofcom's call for input in relation to its document "[The future of the universal postal service](#)".

Moonpig is the UK's largest online platform for physical greeting cards and gifting and a FTSE 250 constituent with 730 employees. Any of the changes proposed by Ofcom and Royal Mail ("RM") to RM's Universal Service Obligation ("USO") would have a serious detrimental impact on Moonpig's business, its customers and wider society across the UK.

We are concerned that Ofcom's document appears to have inappropriately prejudged the outcome of the consultation, that the questions asked are overly narrow and that Ofcom is failing in its duty to protect the interests of consumers, particularly in respect of choice, price, Quality of Service and value for money. In addition, we do not understand how Ofcom reconciles its duty to secure the provision of a universal postal service with the options it is currently considering which seem to us to have the inevitable consequence of continuing the decline of the postal service.

The text on Ofcom's website states: *"This document sets out evidence that suggests the universal service needs to change to better align with the needs of consumers and to ensure it can continue to be affordable and sustainable in the future... so that there can be an informed public debate on how the specification should be modernised for the future."* This assumes that the specification of the USO requires modification, prior to any consultation. Such pre-judgment is inappropriate. Particularly so when the case for change is not made out by the consultation document which contains substantial gaps in its assessment of the current situation.

These gaps include the following two fundamental points: (i) Ofcom's analysis of demand ignores the fact that RM's performance has consistently been below the levels it is supposed to be achieving; and (ii) Ofcom's analysis of costs and revenues is incomplete.

Consumer demand

The consultation document notes falling numbers of letters over time. However, it does not factor in the fact that the falling demand is at least partially a consequence of RM's performance failures and consistently above inflation price increases. Moonpig data offers compelling evidence that this is the case.

Reliability

A key element missing from Ofcom's analysis is the effect of RM's poor performance on demand. In particular, Moonpig has observed that demand is elastic with respect to consumer confidence in RM's performance. The following examples support this point:

-  This clearly shows the impact of reliable delivery on demand.

- We have observed that customers who have not experienced delivery issues have been increasing their order frequency over the past two years. This is further clear evidence of the impact of the perception of reliable next day delivery – and evidence that volumes can potentially grow alongside a high-quality service level from RM.
- Moonpig's customer satisfaction figures for the purchase journey itself are high and stable at around [REDACTED]. However, measured four days after the order, after which delivery should have taken place, it is much lower (at around [REDACTED] which shows that the negative impact of delivery problems.

RM's own Quality of Service Reports show that since 2020/21 it has not met its delivery targets for 1st or 2nd class mail in any quarter and that this poor performance is national (in most reported quarters RM failed the targets in every postcode). For example, in Q3 2022/23 only 54.2% of 1st class mail was delivered on time. Although RM was consistently missing its targets prior to the pandemic, it was much closer to achieving them, and indeed was achieving them in many postcodes.

Ofcom has duties and powers to ensure that RM meets its targets. Although Ofcom has taken some enforcement action, that has not been effective.

Moonpig collects performance data across more than [REDACTED] 1st class letters each year, which shows continued significant underperformance. March 2024's data shows that 25% of 1st class mail has not been delivered on time. The best performing figures are the East Midlands at 15% and the South East at 16% not on time. The worst performing areas are the North East at 69%, Yorkshire and Humber at 32% and Scotland at 29% not on time.

Moreover, Moonpig's perspective shows that any changes in consumers' use of mail is not necessarily due to digitisation. Indeed, Moonpig's business model is fundamentally based on digitisation: customers place online orders for cards (and gifts/flowers) to be delivered. Moonpig's 20 year growth is in line with digitisation. Moonpig's experience is that customers place considerable importance on next day delivery. For example:

█ [REDACTED]

█ [REDACTED]

All of these real world 'natural experiments' show the importance of reliable next day delivery to Moonpig's consumers, and the negative impact on volumes of reduced delivery options.

Price increases

Stamp price growth has exceeded inflation and wage growth across recent years, with 1st class stamp prices rising by an astonishing 92% from 65p in 2017 to £1.25 in 2023.

Ofcom's report does not attempt to consider price elasticity of demand in any meaningful way. The simplistic approach taken of assuming that higher prices will generate higher revenues simply exploits vulnerable consumers and ignores the economic reality that price decreases demand and may do so in a way that fundamentally undermines the financial sustainability of the delivery of the service.



Financial sustainability of USO provision

It is extremely unfortunate that Ofcom, as RM's economic regulator, has not been able to devise an accounting and cost allocation method to separate the costs and profits of the USO products from the non-USO products. This failure by Ofcom generates a distinct level of uncertainty in any of the conclusions that might be drawn from the current data that Ofcom has.

This generates a distinct risk of cross subsidisation between USO and non-USO products. It seems more likely that RM is using the USO products to subsidise its provision of non-USO products than the other way around given that these are subject to competition. It is very surprising that this is not something that Ofcom has prioritised investigating under its regulatory or Competition Act 1998 powers.

Nevertheless, the data shows that between 2012-13 and 2021-22 (excluding 2019-21 which was impacted by the pandemic) RM's financial performance was relatively stable and only varied between 3.3% and 5.6% EBIT margin. **Accordingly, there does not appear to be a direct causal link between letter volume decline and RM's profitability. This is particularly important as the narrative from RM is that 10 years of consistent letter volumes have impacted profitability, but profitability was not impacted for the majority of these years, and in fact only dropped in the year in which industrial action commenced.**

Furthermore, other regulated industries are arguably facing lower levels of return. For example:

- In November 2022, Ofgem published its final determination of the RIIO-ED2 price control for electricity distribution networks. Ofgem used an initial vanilla WACC of 3.90% for frequent issuers of debt and 3.93% for infrequent issuers of debt (CPIH-real). This WACC will be updated through the control period to reflect the combined effect of debt and equity indexation mechanisms.
- In February 2023, the UR made final licence modifications for GD23 using an initial WACC of 4.76% to 5.17% (CPIH-real).
- In March 2023, the CAA published its final decision for Heathrow, which used a pre-tax RPI-real WACC of 4.04%, equivalent to an RPI-vanilla allowed return of 3.18%.

While these other sectors rely on different financial metrics based on investments in a range of circumstances, they suggest that Ofcom's target levels of profitability for RM may be on the high side (particularly given these other regulated sectors have seen levels of return declining – subject to efficiency gains – over the last 10 years or so).

It is not clear that Ofcom's targets for RM's profitability is in accordance with its statutory duty to protect the interests of consumers.

Moreover, given the evidence of RM's performance against its targets, it is not clear that there is not scope for RM to be considerably more efficient than at present.

Ofcom's consumer survey data

It is far from clear that Ofcom's consumer survey data is robust.

Rather obviously, the data was collected against the backdrop of RM's extremely poor performance. This can be expected to have significantly skewed many of the results generated. For example, some respondents may have prioritised certainty over delivery because that is the minimum requirement in the face of being used to RM not reliably providing a next day service.

Moreover, the surveys have not been general data gathering rather than being focussed precisely on the issues at question. This makes them unreliable research for actual decision-making purposes.

Such surveys are extremely unreliable as individual consumers find it very difficult to imagine what they would do in alternative hypothetical circumstances.

Conclusion

Ofcom asserts that the letters market is in "structural decline". Specifically, Ofcom asserts that digital communications are replacing demand for physical letters. However, the evidence that it relies on for this is at the very least overstated. Indeed, Ofcom's consultation reads very much as though it has been the victim of significant 'regulatory capture' by RM.

In this response, we have set out Moonpig's perspective and provided data from natural experiments that undermines many of the assertions Ofcom has made about the provision of postal services by RM.

We have previously written to Ofcom with our views on the wider impact of Ofcom's seeming direction of travel towards reducing the USO. These include the, as yet unaccounted for by Ofcom, negative impact of such a course of action on:

- Social connections between people provided by physical mail;
- Maintaining inclusion and bridging the digital divide;
- Dependence on the postal service for key communications such as medical and other appointments;
- Other impacts on small businesses that rely on mail services for an affordable, consistent next day service, available to all consumers; and
- The cultural and historical significance of managing the decline of the world's oldest postal service, which is a 500-year-old British institution with an integral role in our national heritage.

We note that pre-pandemic, although RM's performance was not great it was much closer to meeting its targets despite declining mail volumes at the time. **Accordingly, there is no basis for an assumption of a direct or linear relationship between letter volume, service and profitability.**

We would urge Ofcom to seriously reconsider its approach to the regulation of postal services and the USO. In particular, rather than being in the role of managing the decline of services in an unending spiral of decline (as has previously happened, for example with bus and rail services – that government and local authorities are now trying hard to reverse), Ofcom should consider ways to promote operational reforms with RM to facilitate RM to be able to perform in line with its obligations before changes are even considered.

Question	Your response
<p>Question 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?</p>	<p>Confidential? – N</p> <p>We believe that the current USO should be maintained, and that Ofcom should use its powers to enforce the adherence to this in accordance with its powers and duties.</p>
<p>Question 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?</p>	<p>Confidential? – N</p> <p>No. Ofcom's customer research has been carried out against the background of declining performance levels by RM as opposed to the stable provision of the USO levels. In addition, it has sought to gather general information in this context rather than specific information about customer demand. Moonpig's evidence of actual customer demand shows high demand for reliable, affordable next day services through the week.</p>
<p>Question 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?</p>	<p>Confidential? – N/A</p>
<p>Question 4: Are there specific events/changes that could trigger a significant change in demand for large mail users, including public services?</p>	<p>Confidential? – N</p> <p>If RM were to achieve its targets consistently and reliably over a significant period of time this could have massively beneficial effects to the demand for mail services.</p>
<p>Question 5: Do you agree with our proposed approach to estimating the financial burden of the USO?</p>	<p>Confidential? – N</p> <p>No. This approach is incomplete. Please see our general response above.</p>

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<p>Question 6: Do you agree with our considerations regarding the unfairness of the financial burden of the USO?</p>	<p>Confidential? – N</p> <p>No. This approach is incomplete. Please see our general response above.</p>
<p>Question 7: Do you agree with our considerations regarding the impact of the financial burden of the USO?</p>	<p>Confidential? –N</p> <p>No. This approach is incomplete. Please see our general response above.</p>
<p>Question 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.</p>	<p>Confidential? –N</p> <p>No. This approach is incomplete. Please see our general response above.</p> <p>In particular, we do not consider that there is a case made for changing the USO particularly given that the current USO has not been delivered.</p>
<p>Question 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?</p>	<p>Confidential? – N</p> <p>We consider that Ofcom should look seriously at requiring effective operational reforms at RM aimed at achieving the current USO before considering alternatives (should such achievement actually impose an undue financial burden on RM).</p>
<p>Question 10: Do you have any other views about how the USO should evolve to meet users’ needs?</p>	<p>Confidential? – N</p> <p>We do not consider the case is made out for changing the current USO. Accordingly, considering evolution is premature.</p>

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