

Royal Mail

Response to Ofcom's call for input on the future of the universal postal service, 24 January 2024

Royal Mail Submission - Annexes

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Public Version



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Separate documents

Annex 8 - Royal Mail Consumer and SME Research (December 2023)

Annex 9 – Frontier Economics -USO benchmarking review findings (November 2023)

Annex 1 - Innovations

A1.1 We have a track record of introducing innovations to meet customer needs (examples below), ensuring letters stay relevant and keeps as many letters in the network as possible.

A1.2 **Product development** to meet the evolving needs of key segments and the wider market:

- Economy Product launched to give bulk mailers a choice of delivery speed vs choice;
- Subscription Mail gives Publishers advanced notice of price changes to enable them to manage their Subscription rates to readers;
- Partially Addressed Mail provides a GDPR complaint product for brands to acquire new customers by post;
- Mailmark barcoding was a significant investment which provides Royal Mail and customers item level visibility through our network. More recently we barcoded stamps;
- an evolving incentive portfolio which secures additional discretionary spend from brands however mature their relationship with mail; and
- online postage gives consumers options to pay for postage from their computer.

A1.3 Investing in being a **Media Owner** to make the case for letters:

- through MarketReach, Royal Mail invests in a centre of excellence for letters, mirroring best practice in other media channels, providing mail users with insights, evidence, tools, inspiration and training to be able to maximise their returns from investing in mail; and
- we initiated JICMAIL, the independent industry standard audience measurement data for advertising letters, which serves the marketing services community as Barb does for TV.

A1.4 Making Mail as **easy to use** as possible for all customers:

- simplifying the product portfolio to ensure that letters are easier to understand;
- providing free industry training solutions for brands and agencies, providing the necessary craft and technical skills to plan mail effectively;
- data and campaign planning solutions to brands who don't have the in-house skills or knowledge on how to build effective direct mail or door drop campaigns; and
- best practice guidance and tools for brands on how to produce successful campaigns, such as eye tracking tools to assess campaign creatives and guidance on how to reduce the environmental impact of mail campaigns.

A1.5 **Collaboration** with third party organisations:

- sponsorship of **The Strategic Mailing Partnership**, a collaboration with over 800 Mail Producers. It has five core working parties focusing on: 1) how the industry can better promote and sell the channel; 2) sustainability; 3) skills and education; 4) innovation and 5) incentives.
- **marketing automation** – as marketing automation software grows, often driven by the use of digital channels, we have worked with the software suppliers to include mail planning capabilities into these tools. Today, all major suppliers have letter campaign planning capabilities within their marketing clouds, enabling brands to plan and create letter campaigns in similar ways to their digital campaigns.

Annex 2 - Review of Ofcom net cost methodology

Introduction

A2.1 In this annex, we provide our feedback on Ofcom's approach to calculate the net cost. We explain:

- we believe Ofcom's methodology is reasonable and, as Ofcom has found, there is a significant net cost of being the USO provider;
- we make some observations for further consideration in Ofcom's net cost calculation; and
- we suggest that Ofcom bases its estimate of the net cost of providing the USO in the UK on the one day letter delivery modelling outcomes.

Ofcom's methodology is reasonable

Ofcom has stated that the net cost calculation is not an assessment under Section 44 of the PSA2011

A2.2 We note that Ofcom's approach is in accordance with the approach set out in Section 44 of PSA2011 (acknowledging that Ofcom states that its net cost is not a formal assessment under that framework). Under the PSA 2011, such an exercise would be more comprehensive including an audit report on that assessment and would be expected to take more time to complete. Were such an assessment to be required, we consider that the current approach forms a solid basis for such an assessment as it contains the key elements that such an assessment would require.

A2.3 Given the urgent need for USO reform, we are comfortable that Ofcom's faster approach provides a view of net cost burden that can usefully inform a national debate now on the future of the USO. A detailed full assessment is not required for this purpose.

Approach to estimating net cost burden

A2.4 Ofcom's methodology to estimating the net cost is reasonable. It calculates the difference between the Reported Business 'as is' (the 'factual') and a hypothetical Report Business (the 'counterfactual') where there is no USO, i.e. what would Royal Mail do if it had complete commercial freedom. The key elements of Ofcom's approach are:

- model the counterfactual using 2021/22 data;
- add the incremental net profit from changing the USO delivery operation;
- add the incremental net profit from additional pricing freedoms (but does not include surcharging for remote/rural areas); and
- remove the VAT exemption benefits.

A2.5 Ofcom models a range of different counterfactual scenarios covering one day to three day letter delivery. It adjusts the outcome for Ofcom's view of efficiency.¹ It also assumes Access would remain regulated² but critically that the Access letter delivery frequency requirement would

¹ Ofcom's application of an efficiency adjustment to the actual costs is inconsistent with its recognition that the net cost of a hypothetically efficient operator would be higher than it estimates. See Paragraph A2.7.

² For each counterfactual scenario, Ofcom have modelled two scenarios where i) Royal Mail retains the VAT exemption for the relevant Access products, and ii) Royal Mail loses the VAT exemption for the relevant Access products and applies a 20% price increase.

align to the letter delivery days for alternate counterfactual scenarios. Ofcom's estimate of the net cost is in the range of £325m to £675m in 2021/22. This is based on Ofcom's two day and one day letter delivery counterfactual scenarios.

The USO is a significant net cost on Royal Mail

A2.6 Ofcom's assessment is that *"providing the USO imposes a significant net cost on Royal Mail"*.³ We agree. Although we make some observations on Ofcom's calculation, it is clear that Royal Mail is facing a significant net cost burden and has been doing so for some years. Directionally, we are comfortable with Ofcom's assessment of a net cost burden in the order of hundreds of millions of pounds per annum.

Alternative approaches

A2.7 As Ofcom has set out in its CFI, there are alternative approaches. In the 'full counterfactual' approach, the 'to be' Reported Business network and resources could be redesigned bottom-up. The 'scorched earth' approach would require the creation of a new network of parcel hubs, mail centres and delivery units that does not match Royal Mail's topography. Also, the full counterfactual may have a different labour resourcing model. To undertake such an exercise would take significant time and resources. Given the urgency of the need for USO reform and Ofcom's approach is to work out whether changes to the USO scope are appropriate, we agree that in this instance, it is right not to calculate the full counterfactual. We also agree with Ofcom that conceptually this approach could reflect more accurately the true costs of an efficient USP⁴ which suggests that Ofcom's current net USO costs may be an underestimate.

A2.8 Ofcom set out a further approach which was to evaluate the *"USO revenue and cost"*, which calculates the net cost by only considering Royal Mail's USO services. Ofcom explains the shortcoming of this approach as it *"does not account for why the network within the Reported Business is organised and run the way it is. One key reason is to deliver the USO. In order to account for this, a larger proportion of common costs should be allocated to the USO products than are allocated under this approach."*⁵ We agree. We have consistently argued that the statutory obligation as sole DUSP with a requirement to deliver a next day letter service across the UK six days a week drives the architecture and costs of our network. So, we also concur with Ofcom's conclusion that *"The approach using FAC therefore considerably underestimates the net cost of the USO by not accounting for all of the relevant costs. We accordingly do not consider this approach to be appropriate for the exercise we are undertaking."*⁶

A2.9 Ofcom also stated that there is a related approach which is the Stand-Alone Cost (SAC) of the USO. Ofcom found that *"Our estimate of the SAC means that, if only the USO was provided without providing any other products, then the net cost of the provision would be £1.9 billion."*⁷ Ofcom states that the SAC considerably overestimates the net cost, and that *"it would, at best, represent an upper bound on any net cost results"*.⁸

A2.10 SAC is a valid data point that does provide a view of the net cost that is likely to be the 'upper bound' of the net cost. Underlying the net cost calculation is an attribution of variable costs to USO and non-USO segments, with a sizeable common cost that straddles the two. These common costs should be allocated to the USO in the first instance. Ultimately, Royal Mail's network is driven by the USO requirements of six day letter delivery across the UK, i.e. the network and common costs would largely be the same as now. If Royal Mail only provided non-USO services, it could have a different network structure with different costs.

³ CFI, Paragraph 8.42.

⁴ Ibid, Paragraph A7.22.

⁵ Ibid, Paragraph A7.29.

⁶ Ibid, Paragraph A7.30.

⁷ Ibid, Paragraph A7.33.

⁸ Ibid, Paragraph A7.37.

Observations on Ofcom's approach

A2.11 There are several areas where we suggest Ofcom reviews the calculation of the 'counterfactual' net cost:

- **Ofcom has made simplifying assumptions on price elasticity.** As set out in Annex 7 to Ofcom's CFI, Ofcom explains that it uses an average elasticity as the midpoint between elasticities that Royal Mail has provided and unit elasticity (i.e. 1).⁹ We have provided Ofcom with our views on price elasticity and switching functions on a confidential basis and would welcome the opportunity to discuss this detail further.
- **Parcel drop rates** – this is a key modelling assumption. Ofcom's assumption must be reviewed for reasonableness against what is operationally achievable.
- **Ofcom assumes a 15% cost saving in the upstream pipeline based on previous analysis. We do not believe that this will be achievable.** Our proposed solution only has material savings in our delivery function. Given that Ofcom's ranges are in hundreds of millions, it is likely the assumption of 15% cost saving in upstream costs will overstate the potential savings.
- **Ofcom's analysis excludes the impact of surcharges for remote and/or rural areas.** It is common practice, in the UK and internationally, for parcel operators to apply geographic surcharges. It is highly likely that a commercial counterfactual operation could profitably levy surcharges to some more costly to serve locations.

Rate of return analysis

A2.12 Ofcom has also considered how the commercial rates of return of other postal operators (both European USPs and global parcel operators) compare against the net cost range it has calculated.

A2.13 Ofcom estimates the difference in EBIT margin between the 'commercial operators' and 'USPs' as 3-4% EBIT margin. Assuming this as a proxy EBIT margin uplift for not having the USO and applying it to Royal Mail's revenues and returns, Royal Mail's EBIT would increase by c£200 to -£300m. This is towards the low end of Ofcom's calculation of net cost £325 to £675m, but Ofcom acknowledges that "*Royal Mail's USO may be more demanding and costly than some of these comparators*"¹⁰ as the UK USO has not been reformed. Ofcom also notes that the margins for commercial operators could be subject to higher level of competition that would depress their earnings.

The rate of return analysis provides an interesting comparison on relative returns. However, this analysis should not be used to understate the true cost of providing the USO

A2.14 A comparative analysis of EBIT margins across European USPs and global parcel operators is interesting, but it is not directly relevant for the assessment of the net cost of the USO in the UK. There are a number of reasons why European posts and global parcel operators' margins will be different e.g. differences in the actual USO obligations on USPs, different geographies such as spread of the population (which impacts delivery costs), different levels of competition across markets and different labour models etc. Ofcom should not use this analysis to conclude that only the mid-point of the one day delivery scenario should be used, rather than the upper end of the net cost which is £850m.

A2.15 We acknowledge that results will become more speculative the greater the USO change, but the whole framework to estimate the counterfactual is hypothetical and informed by educated

⁹ So, if Royal Mail had provided an elasticity of 0.6, Ofcom would use a midpoint between this and 1, and so use 0.8 in its modelling.

¹⁰ CFI, Paragraph A7.44.

estimates. We are not aware why there would be a material increase in the level of 'speculation' between the two day and one day delivery options such that the upper end of the one day range becomes questionable. Accordingly, we disagree that Ofcom should arbitrarily limit the upper range of the net cost to £675m. We instead propose that Ofcom uses the upper end of the one day letter delivery range (£850m). For the same reasons, we propose that Ofcom should use the lower end of the one day range (£475m).

Annex 3 – Our approach to identifying a customer-led financially sustainable solution

Our approach to developing options started with listening to our customers

- A3.1 From the outset we were determined to set out a compelling, fully formed and evidence-based vision for the future of the USO. This necessitated taking a holistic approach which started with gathering customer insight across our customer base.
- A3.2 As set out in Chapter 4, we undertook a comprehensive set of surveys covering large customers, SMEs and consumers. The research was carried out by independent customer research companies. The Illuminas research (consumer and SMEs) built on our previous customer research in 2020 as well as Ofcom’s User Needs Review (2020). It helped us to identify relevant patterns and themes. We also undertook research with B2B international which explored reactions to potential USO changes amongst large UK businesses.
- A3.3 We complemented our customer research with a series of detailed internal workshops with customer-facing experts within Royal Mail to provide further customer insight. This included views on how volumes could react in relation to changes in product specification and price.

We set key criteria that our proposal had to meet

- A3.4 In developing our proposal, we have focused on ensuring the reform is:
- **good for our customers and growth** – for USO reform to be good for our customers, it must take account of the characteristics our customers have said are important which are: universality, reliability, choice and affordability;
 - **financially sustainable and addresses the significant net cost of the USO to Royal Mail.** To be sustainable, USO reform has to materially reduce the significant net cost burden; capable of being implemented in a short time frame; flexible to allow for future change and continue to support our ‘feet on the street’ network that contributes to our low emissions; and
 - **good for our people** – we carefully considered the impact on our people as we want to continue to offer leading employee Ts&Cs and manage change sensitively.

A ‘long list’ of levers for USO reform was identified drawing on our previous modelling and international benchmarking

- A3.5 We began by considering all the potential levers for USO reform. We worked with Frontier Economics to assess a range of options.
- A3.6 Our understanding was added to by a comprehensive international benchmarking exercise. Frontier Economics analysed the drivers, scope and impacts of USO changes in a range of comparable jurisdictions. An assessment was made of the market and USP characteristics in those countries. The research accessed a wide range of published documents describing the change to the USO in other jurisdictions. The analysis also considered the challenges to making changes and how other postal services, regulators and governments had addressed them. Further detail is provided in Annex 9.
- A3.7 This process led to the identification of six key parameters of the current USO requirements:

- delivery speed;
- delivery frequency;
- QoS;
- enhancements to the USO parcel offering;
- geographic pricing; and
- pickup and delivery points.

We funnelled the ‘long list’ of levers to four key levers and we undertook detailed operational modelling for two levers

A3.8 The table below summarises how we refined the long list to a shorter list.

Lever	QoS	Parcels USO	Letter delivery frequency	Letter delivery speed	Geographic pricing	Letter Pickup & delivery points
Decision	Progress	Progress	Progress	Progress	Ruled out	Ruled out
Rationale	International benchmarking supported changes. Key customer feedback	Growing parcel volumes and competition. Customers are demanding more from their parcel service	Potential significant cost savings	Assumption that significant cost savings could be achieved	Unattractive to our customers and expected to be more challenging to implement	Unpopular with customers and likely to need significant capital investment

A3.9 At this stage, we ruled out two of the levers as they did not seem to fully meet our criteria for USO reform:

- **geographic pricing** - our customer research found that 82% of customers and 87% of SMEs indicated that ‘same price for same speed of delivery anywhere in the UK’ is very or fairly important; and
- the introduction of **new pick up and delivery points** for letters (e.g. centralised letter boxes) was ruled out because of the unattractiveness to customers and the low level of cost savings compared with the high level of capital investment.

A3.10 Of the four key levers to progress, letter delivery frequency and speed showed the highest opportunity for financial impact whilst meeting customer needs. We undertook detailed modelling in relation to these two levers.

A3.11 Of the remaining two key levers, for QoS we considered rebalancing reliability and speed, recognising that the UK has amongst the highest QoS targets amongst the countries considered. For parcels, we considered how the USO offering could be enhanced to better meet user needs.

Our operational modelling underpinned our proposal

A3.12 We modelled different combinations of letter delivery frequency and speed through the lens of our customers, financial sustainability and our people to ascertain the most appropriate solution to USO reform.

A3.13 This work allowed us to refine and evolve the options so that we could have confidence that our proposal is truly customer led, that it is operationally feasible and good for our people, and that we can implement commercial and people strategies that will work. The detailed review meant we could consider further the role and importance of First Class as well as the important need to continue working in partnership with the NHS to deliver a service that works for them.

A3.14 The outputs of this work are set out in:

- Chapter 5 our proposal for a reformed USO;
- Chapter 6 our proposal for a rebalanced QoS regime with new reliability targets for First Class and Second Class; and
- Chapter 7 USO enhancements to meet customers' needs.

Annex 4 - Impact of proposed approach on different customer groups

Impact of the proposed approach on consumers

- A4.1 Under our proposal we will meet consumer needs by retaining the First Class and Second Class service, coupled with a rebalanced regime that increases the importance of reliability through new regulatory targets, and revises speed of delivery to realistic targets that we believe customers will accept. In combination, we believe this new approach will be good for customers and increase confidence on mail delivery. Further details are in Chapter 6.
- A4.2 We expect the majority of consumers to be satisfied with our proposals for delivery days. When receiving letters 92% of consumers told us they would be satisfied with a service where First Class letters are delivered up to two days after posting on six days per week and Second Class letters delivered up to four days after posting on two days per week. Our proposal goes beyond this with First Class delivered one day after posting and Second Class within three days after posting.
- A4.3 We note at paragraph 9.95 of the CFI that Ofcom asks us to consider the impact of any future changes on stamps consumers have already bought and to what extent they can continue to be used following any change to USO specifications. We are carefully considering the implications of our proposed changes to the services we offer to customers, including our USO stamp letter services, and will ensure that any proposals in this regard are fair and reasonable, given customers sufficient notice, and that changes are carefully and clearly communicated so that users, particularly vulnerable users, understand the changes and the effect on how they use the service.

Impact of proposed approach on Retail Sorted and Unsorted Mailers

- A4.4 Customers (including both bulk mailers and SMEs) currently using retail bulk, unsorted and USO services will see no change to the delivery specification under our proposal. Our customer research indicated that the vast majority of customers prefer that we maintain the current two-tier service structure we have today. We propose to continue offering First and Second Class delivery services with no change to the delivery promise (delivery within one day and three days of posting respectively).
- A4.5 Our customer research has told us that customers value reliability more than speed. We propose to improve reliability via continued high quality of service targets with enhanced visibility and management of the tail of items that are not delivered to specification. This will mean that users of our Second Class service can expect 95% of items to be delivered by D+3 and 99% delivered no later than two days after the target date.

Impact of proposed approach on customers who rely on next day services

- A4.6 We know that some customers have the need to send letters via a next day service, for example, weekly publications, some financial mail and court summons. We expect this demand to continue to be important. We are proposing to maintain a First Class service option that will be delivered six days per week Monday to Saturday.
- A4.7 We also know that there are some publishers with weekly titles who currently rely on a Saturday service. For them, the weekend is a prime 'magazine consumption period' and the last chance for delivery to take place before the start of the new week. Our proposal to retain a six day First Class service maintains Saturday letter deliveries. We already have a specific publishing service that we will retain.

Impact of proposed approach on Access customers

- A4.8 Our proposal would require the speed of Access Standard mail to be changed from D+2 to D+3 (although in practice, 50% will continue to be delivered on D+2). This will mean that customers using our wholesale services will experience a change in their service level specification for standard Access. However, we expect the impact on customers to be limited given customers increasingly use the Economy Access service, which will remain under in its current specification. The Access industry recognises its interdependence with the USO provider and as such realises that adjustments to a service which make the USO operator more viable in the mid-term are beneficial to their ongoing survival and success.
- A4.9 In particular, since the launch of our Access Economy service in January 2021, we have seen significant migration to the Access Economy service from Access Standard – customers have made an informed choice based on their own individual trade-offs between price and speed of delivery. As of February 2024, c. 50% of Access letters (c. 70% of Advertising Mail and c. 40% of Business Mail) are sent using the Access Economy service.
- A4.10 We expect this migration to continue and predict that well over half of Access mail will be sent using Access Economy services during 2024.
- A4.11 We anticipate that some customers will plan to mitigate any impact on their delivery schedule by planning their mailing campaigns around delivery days. For example, publishers may bring forward their production schedules to ensure delivery is completed by Friday instead of Saturday. Other customers with large mailing files will take opportunities to batch their customer address files by scheduled delivery date and adjust their production schedule according to when mail is due for delivery e.g. on Monday only hand over mail that is due to be delivered on Tuesday.
- A4.12 Our research shows that large businesses place a lot of importance on knowing when mail will arrive as it helps them to plan internally to ensure their deadlines are met. Customers have told us about their need for certainty e.g. to plan mailing campaign posting dates and to help with call centre staffing. We recognise that different postal areas getting mail on different days may not suit all bulk mail users i.e. those remaining on standard Access services. To help meet the customer need to understand when their mail will arrive, we offer predictive data (i.e. Mailmark Direct Data) that can be used to give customers knowledge of which day their mail is due to be delivered.

Annex 5 – Why our proposal best meets the needs of customers, financial sustainability and our people

Overview

A5.1 We carefully considered and modelled a range of USO reform options. We believe our proposed reform option best meets the needs of customers, best addresses the significant financial sustainability challenges, and is best for our people.

A5.2 Importantly, we assessed and discounted two common USO reform solutions:

- Reducing the number of letter delivery days from six to five with no letter delivery on Saturdays (**five day delivery**); and
- Reducing the number of letter delivery days from six to three (e.g. letters only delivered on Monday, Wednesdays and Fridays) (**three day delivery**).

A5.3 The rest of this annex sets out the reasons why.

Five day delivery

A5.4 Reducing the number of letter delivery days from six to five does not meet customer needs as there is not a next day letter delivery on a Saturday. Our customer research found that certain industries (particularly, the publishing industry) rely heavily on Saturday deliveries to meet their customers' needs such as for magazines for weekend reading. No Saturday letter delivery would also impact NHS time-sensitive letters. Ofcom's research also supports that this does not meet customer needs *"A reduction of delivery days below 5 would make the delivery speed of Royal Mail's current First Class product unachievable. However, the evidence suggests that consumers value access to faster services (similar to the existing First Class D+1 service)."*¹¹

A5.5 Five day delivery does not deliver sufficient savings to offset the net cost of the USO. Ofcom has estimated the net cost saving of this option (in 2021/22) as £100m - £200m.¹² Ofcom has estimated the net cost burden of the USO to Royal Mail as £325m - £675m. On Ofcom's calculations this option would only address around a third of the net cost.

A5.6 This option would be too slow to implement, as Ofcom has explained, this option would require legislative change. Changes to legislation depend on the Government's timetable for change which could take several years (and would be currently complicated even further by an upcoming General Election). Even when the legislative change takes place, Ofcom would need to consult on changes to the regulations. We simply don't have the time – the net cost burden and the financial sustainability concerns of both the USO and Royal Mail mean the risk of this timeline are too great (putting aside the fact the benefits are too small). As explained in Chapter 2, USO reform is long overdue and essential for the financial sustainability of the Universal Service. These changes need to happen as soon as possible.

A5.7 Whilst the impact of the proposal may mean a higher number of delivery roles are retained in the short term, this is likely to be short-lived as the financial sustainability of the USO and the net cost burden to Royal Mail is not addressed in this option.

¹¹ CFI, Paragraph 9.11.

¹² Our view is that, due to ongoing letter volume decline, the net cost saving will be materially lower than this by the time that the savings materialise.

Three day delivery

- A5.8 Reducing the number of letter delivery days from six to three does not meet customer needs as it would not be possible to operate a next day letter delivery service. Our customer research found that the choice of a next day letter delivery service is a key part of what customers want in a USO, and this option would remove that choice and remove First Class. By doing so it would severely also impact important mail like NHS time-sensitive letters. Ofcom's research also found that consumers valued a next day option: *"We note, however, that there is evidence of some consumer need for a D+1 service to be available on the occasions where users need to convey urgent items."*¹³
- A5.9 This option would also be too slow to implement as it would require legislative change. In addition to the points made above about the slow speed of legislative change, a three day delivery model would be significantly more divisive across customers and stakeholders, including our unions, and make the process of legislative change even more challenging than five day delivery.

Ofcom's option of an express (First Class) letter delivered every day six days a week and non-First Class letters delivered every other day Monday to Saturday

- A5.10 There are several similarities between this option and our proposal.
- A5.11 Both options include non-First Class letters delivered every other day¹⁴, require a change in the Access Standard specification from D+2 to D+3, and can be delivered through regulatory change.¹⁵
- A5.12 However, Ofcom's option includes non-First Class mail delivered every other day Monday to Saturday and is therefore over-specified, with Ofcom itself finding that *"a reduction in delivery frequency of letters from 6 days a week to 5 days a week would have a very small impact on users and would continue to meet the needs of virtually all users, including across a wide range of residential demographic subgroups."*¹⁶ Our proposal is that non-First class mail is delivered five days a week (Monday to Friday) every other day.
- A5.13 As a consequence of being over-specified, Ofcom's options fall short on the potential net cost savings to address the significant net cost burden. There is an incremental net cost savings of up to c. £50m p.a.¹⁷ from not delivering non-First Class mail on Saturdays. These savings are material, in the context of a sizeable net cost.
- A5.14 Importantly, as letters continue to decline, removing non-First Class letter deliveries, at a later date, on a Saturday only would require a significant change across the network. It would require further structural revisions in every delivery office, which for a c. £50m p.a. cost saving would not be worth doing. Therefore, it makes more financial and operational sense to move directly to a five day alternate day model.
- A5.15 Ofcom's option likely has fewer benefits for our employees. In retaining non-First Class letter deliveries on Saturdays, the need for Saturday working will remain.

¹³ CFI, Paragraph 9.52.

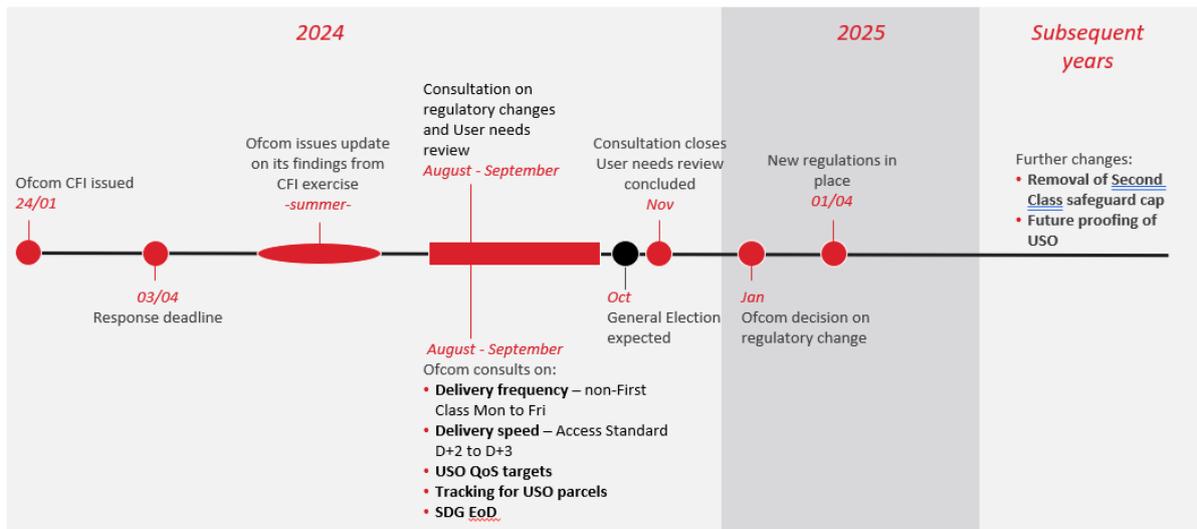
¹⁴ Ofcom's Option 1 is to hold letters back where possible, taking advantage of specified delivery speed, to increase the number of items being delivered per address, allowing fewer deliveries per week to each address. This drives up the call rate at each address. In the upper end case, this means non-First Class letters are delivered three-days a week using an alternate day model (Mon-Sat).

¹⁵ Ofcom stated that three day letter delivery requires legislative change. That is correct if a next day letter delivery service is not maintained. However the First Class (Express) service is delivered six days a week, hence option 1 and 2B meet the requirements set out in the PSA2011.

¹⁶ CFI, Paragraph 5.34.

¹⁷ Royal Mail estimate based on financial year 2025/26.

Annex 6 - Indicative timeline for regulatory change



A6.1 Our understanding is that Ofcom can consult during the pre-election period but cannot issue a statement / consultation during that period due to the need to consult with Government.

Annex 7 - Summary of Royal Mail’s responses to questions raised by Ofcom in its CFI

We set out below a short summary to answer Ofcom’s CFI questions. Further detail and evidence are in our main response, as per the chapter reference column.

Ofcom’s Question	Royal Mail’s summary response	Chapter reference(s)
<p>Question 1:</p> <p>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>	<ul style="list-style-type: none"> • We agree with Ofcom’s identification of the three main aims of the USO: promoting social cohesion, promoting economic growth, and facilitating key interactions between citizens and state (CFI 4.12). • We also agree with Ofcom’s identification of three fundamental principles underpinning the USO: universality, affordability and uniform pricing (one-price-goes-anywhere). • However, we would add two further principles - reliability (a dependable service where mail is delivered on time) and financial sustainability (Royal Mail must be able to earn a financially sustainable rate of return in order to invest in modernising and transforming to provide products and services that customers want and need, and to provide a reliable service). • We agree that these aims and supporting principles should be respected as far as is reasonably possible when assessing potential changes to the USO, and we believe our proposal for reform does so. • However, we disagree with Ofcom’s position that the USO is a “<i>safety net to provide a good quality basic postal service to those whose needs might not be met by the wider competitive market</i>” (CFI 9.38). The widespread use of the USO generates significant UK-wide socio-economic benefit, and it is hugely important for social cohesion and economic growth. A modern, reliable, efficient and sustainable USO that is attuned to evolving customer needs will deliver greater economic and social value than one that is stuck in the past. 	<p>Chapter 1 on reform criteria in particular paragraphs 1.5, and 1.7</p> <p>Chapter 5 (our proposal for reform).</p>

Ofcom's Question	Royal Mail's summary response	Chapter reference(s)
<p>Question 2:</p> <p>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>	<ul style="list-style-type: none"> • We broadly agree with Ofcom's assessment of the direction of change in postal needs of consumers. • We agree that there is still a strong desire to use post despite the structural decline in letter volumes. Geographic universality and the "one price goes anywhere" remain important. • Reliability is paramount for all our customers and affordability for all is considered important. • Our customers want choice and the option of a priority (First Class) service when they need it. User needs would be met with less frequent non-priority letter delivery. Whilst large businesses do want frequent deliveries, they also want to know that their mail will be delivered on time. • Yes. There are other factors that Ofcom should consider - Ofcom should reconsider its position on (1) tracking on parcels in the USO; (2) SDG EOD; and (3) QoS. On QoS, we propose rebalancing reliability and speed, to give customers further confidence in the service they would receive by introducing new, additional reliability targets in First Class and Second Class USO products alongside revised, realistic speed targets. 	<p>Chapter 4 on how our reforms put customers first</p> <p>Chapter 6 on QoS</p> <p>Chapter 7 on enhancements to the USO</p>
<p>Question 3:</p> <p>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>	<ul style="list-style-type: none"> • Yes, we broadly agree with Ofcom's assessment of the bulk mail market. • As part of USO reform, Ofcom needs to consider the changes to meet USO reform from a bulk mail perspective. The regulation of bulk mail (Retail and Access) services should align to the relevant USO services, e.g. Access Standard (currently D+2 specification should move to D+3) to align to Second Class USO (D+3). 	<p>Chapter 2, in particular paragraphs 2.1 to 2.6</p> <p>Chapter 5 paragraph 5.3 and 5.4</p> <p>Annex 4 on the impact of our proposal on customers</p>

Ofcom's Question	Royal Mail's summary response	Chapter reference(s)
<p>Question 4</p> <p>Are there specific events/changes that could trigger a significant change in demand for large mail users, including public services?</p>	<ul style="list-style-type: none"> • The key driver influencing demand for mail will continue to be the ongoing trend towards the use of digital alternatives to mail. • We will continue to work with our customers to understand their needs and introduce innovations to allow the market to evolve and look to ensure letters stays relevant. • We carefully consider our prices: <ul style="list-style-type: none"> ○ we seek to keep prices to a level that delivers good value for money for our customers whilst allowing us to make a reasonable return. This is hard in the face of increasing cost pressures, declining letter volumes and lack of USO reform. It is inevitable that with declining letter volumes and a fixed cost network, the reality is letter prices need to rise each year. This risks triggering a significant change in demand; and ○ whilst prices will continue to rise across our products alongside any reform, reform of the USO will mean that prices do not rise as sharply as they would absent reform. • We expect letters will continue to remain a vital channel for the NHS for years to come and we remain committed to working in partnership with the NHS to deliver a service that works for them. 	<p>Chapter 2, in particular paragraphs 2.1 to 2.6</p> <p>Chapter 5, paragraphs 5.5 and 5.6</p> <p>Annex 1 on innovation.</p>

Ofcom's Question	Royal Mail's summary response	Chapter reference(s)
<p>Question 5</p> <p>Do you agree with our proposed approach to estimating the financial burden of the USO?</p>	<ul style="list-style-type: none"> • Ofcom's proposed approach is reasonable. This provides transparency on likely order of magnitude of the net cost of the USO. We however have some observations for further consideration in Ofcom's net cost calculation. • The significant net cost burden of providing the USO to the UK as it stands today must be addressed and Royal Mail must be able to earn a financially sustainable rate of return in order to invest in modernising and transforming to provide products and services that customers want, and to provide a reliable service. • We are concerned about Ofcom's indicative timelines. USO reform is urgent – we ask that Ofcom commits to a process that will have the new regulations being in place for 1 April 2025 	<p>Annex 2 on our detailed feedback on Ofcom's net cost calculation</p>
<p>Question 6</p> <p>Do you agree with our considerations regarding the unfairness of the financial burden of the USO?</p>	<ul style="list-style-type: none"> • We agree with Ofcom that <i>"as a starting point, imposing that financial burden on Royal Mail is likely to be unfair"</i> • We agree with Ofcom that this net cost burden is not transitory and is significant. 	<p>Chapter 3, in particular paragraphs 3.3 to 3.6</p>
<p>Question 7</p> <p>Do you agree with our considerations regarding the impact of the financial burden of the USO?</p>	<ul style="list-style-type: none"> • We agree with Ofcom that the impact of the net cost burden of the USO will negatively affect consumers through higher prices, less innovation, and impacts on QoS. • We also agree with Ofcom that the significant net cost burden will contribute to the financial challenges we face. But we disagree with Ofcom's view of Royal Mail's efficiency which does not give due credit for the significant steps we have taken. • The now recognised significant net cost of the USO to Royal Mail (£325m-£675m p.a.) has been borne since at least 2021/22. Whilst the process of regulatory reform is ongoing, and during any period of implementing change, we call for Government to consider making a temporary contribution to address the net cost of providing the USO. 	<p>Chapter 3, in particular paragraphs 3.7 – 3.21</p>

Ofcom's Question	Royal Mail's summary response	Chapter reference(s)
<p>Question 8</p> <p>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>	<ul style="list-style-type: none"> • We have listened to our customers to inform our proposal for USO reform. The detail of our core proposal is set out in Chapter 5. • We agree with Ofcom that the main options to reform the USO centre on delivery speed and frequency. • We have set out in Annex 5 why our proposal best meets the needs of customers, financial sustainability and our people. • Our proposal will continue to meet the needs of the vast majority of our customers. Annex 4 sets out the impact of our proposal on consumers, SMEs and bulk mail users. • We remain committed to working in partnership with all customers especially those who have time critical requirements. 	<p>Chapter 4 on our proposed reforms put customers first</p> <p>Chapter 5 for our proposal, particularly paragraphs 5.5 and 5.6</p> <p>Annex 2 on our feedback on Ofcom's net cost methodology</p> <p>Annex 4 on impact of our proposal on our customers</p> <p>Annex 5 on why our proposal best meets customer needs, financial sustainability and our people.</p>

Ofcom's Question	Royal Mail's summary response	Chapter reference(s)
<p>Question 9</p> <p>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>	<ul style="list-style-type: none"> • Our proposal is the most appropriate to meet the challenges that Royal Mail faces, as well as meeting the needs of customers. It maintains the one price goes anywhere service to all parts of the UK; the choice of First Class USO letters delivered to the same timescales; First Class letters delivered six days a week; and parcel services delivered six (or increasingly seven) days a week. • Our proposal addresses the financial sustainability concerns and net cost burden by introducing a more efficient delivery model. We will deliver all non-First Class letters to every address every other weekday; and we will align the speed of Access Standard letters with Second Class. • We propose rebalancing reliability and speed, to give customers further confidence in the service they will receive by introducing new, additional reliability targets in First Class and Second Class alongside revised, realistic speed targets (recognising that high speed targets drive high fixed cost in a declining market, and that no country of a comparable size has First Class or Second Class speed targets as high as the UK). • We propose enhancements to the USO for tracking on parcels and by SDG EOD. • We ask that the Second Class Safeguard cap is removed as there is no affordability issue in post for the vast majority of users. We welcome input from Ofcom on our approach to address the concerns of the small proportion of consumers who genuinely find postal services to be unaffordable. 	<p>Chapter 5 for our proposal</p> <p>Chapter 6 for QoS reliability</p> <p>Chapter 7 for our USO enhancements</p> <p>Chapter 8 for Second Class Safeguard cap</p>

Ofcom's Question	Royal Mail's summary response	Chapter reference(s)
<p>Question 10</p> <p>Do you have any other views about how the USO should evolve to meet users' needs?</p>	<ul style="list-style-type: none"> • We agree that the USO needs to continue to evolve to meet users needs. • The current legislative and regulatory framework for change is not “fit for purpose”. To get to this stage, of Ofcom even starting the CFI process, has taken far too long. • USO reform is now urgent – we ask that Ofcom commits to a process that will have the new regulations in place for 1 April 2025. Whilst the process of regulatory reform is ongoing, and during any period of implementing change, we call for Government to consider making a temporary contribution to address the net cost of providing the USO. • There is also a clear need to “future proof” the USO to ensure the USO can continue to evolve. We propose: <ul style="list-style-type: none"> ○ Ofcom carrying out a regular (at least every two years) net cost assessment to provide an effective early warning system and potential solutions to address USO financial sustainability issues; ○ Ofcom to be given the power unilaterally to make changes to the minimum number of delivery days, if required, rather than having to obtain Government and Parliamentary approval; and ○ A revised contribution fund mechanism to support any net cost in providing the USO, to replace the existing mechanism which Ofcom has itself has recognised as not being fit for purpose. • To strengthen the regulatory framework, we ask Ofcom to review the costing methodology in the regulatory accounts. This provides an opportunity to ensure the regulatory accounts reflect the true cost of providing the USO. 	<p>Chapter 2 on urgent need for reform</p> <p>Chapter 3 on significant cost of being USO provider</p> <p>Chapter 10 on future proofing the USO</p> <p>Chapter 11 for legal and regulatory framework for change</p>