OFCOM'S PROPOSED PLAN OF WORK 2020/21 18 February 2020

- MAIL USERS' ASSOCIATION RESPONSE TO CONSULTATION

1. Introduction

1.1. This response is not confidential; it may be published (in full or part) and attributed to Mail Users' Association (MUA).

1.2. MUA seeks to champion the interests of the UK's large users of mail services.

1.3. MUA members represent UK companies who are senders of large volumes of mail originating from financial services, magazine publishers, mail producers, and mailing equipment and system providers. Collectively, MUA members account for in excess of 10% of the annual volume of mail posted in the UK.

1.4. We seek an open and efficiently competitive market for mail services, which offers a wide choice of services with specifications, service quality and pricing that encourage the use of mail as a communications medium between businesses and their customers.

1.5. Given the high market power of Royal Mail and its near monopoly in delivery of mail, MUA members believe effective regulation to mitigate that market power is a vital requirement for a healthy mail market, while ensuring the continuing, sustainable provision of the Universal Postal Service.

1.6. In that respect, we note Ofcom's statutory regulatory duties:

- *to further the interests of consumers …., where appropriate by promoting competition* (Communications Act 2003); and
- *to secure the provision of a universal postal service … for the provision of a universal postal service to be financially sustainable … for the provision of a universal postal service to be efficient …. and for its provision to continue to be efficient* (Postal Services Act 2011)

1.7. MUA welcomes the opportunity to comment on Ofcom's proposed plan of work for 2020/21. We have considered this in the context of Ofcom's 2019 Annual Monitoring Report, and Ofcom's continuing work to understand the needs of mail users, and consider the future regulatory framework for post.

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2. Annual Monitoring Report (AMR)

2.1. MUA notes that Ofcom's key statements in its AMR included:

- *"There was a downward trend across efficiency metrics. Real costs increased slightly and efficiency overall was negative. Royal Mail did not achieve its target productivity range of 2-3% or offset the increases in pay with gross hour reduction. We continue to believe that efficiency gains are crucial in ensuring the sustainability of the universal service."*
- *"Profitability of the part of Royal Mail that provides the universal service declined. Royal Mail's Reported Business EBIT margin was 1.6% for 2018-19, though the financial position and financial health metrics of the Royal Mail Group do not indicate any short-term financial health issues…. The longer term sustainability depends on a range of factors, including the extent to which the revenue growth and Royal Mail's transformation programme, set out in its five-year strategy, can be delivered."*
- *"We note that the strategy is subject to some risks… In its half-year results announcement, Royal Mail noted that transformation is running behind… Therefore, we believe that uncertainty remains about the longer-term sustainability of the universal service."*

2.2. MUA would also note the following points highlighted in the AMR:

- Mail volumes declined by 8% in the year to March 2019 and have now declined by 20% since 2014/15 (over the same period, Royal Mail's prices for the key bulk business mail services used by MUA members have increased in real terms by some 7% for both Retail and Access services).
- Royal Mail's costs increased marginally in real terms in 2018/19 and have fallen by less than 5% since 2014/15 – despite the 20% fall in volumes.
- Royal Mail made no productivity improvement in 2018/19 and improvement was only 0.6% in 2017/18, despite Royal Mail having expressed a target of 2%-3%.
- In its reviews of the regulatory framework in 2012 and 2017, Ofcom concluded that that if the EBIT measure of Royal Mail's profit margin was above 5% (or showed an increasing trend that exceeded 5%) it would indicate that its Universal Service Provision was financially sustainable. If that were not the case (for example if the forecast EBIT margin stayed consistently below 5% or had a decreasing trend taking it below 5%), it would indicate that the Universal Postal Service faced financial sustainability issues in the long term.
- In fact, Royal Mail's EBIT has declined consistently from 5.6% in 2014/15 with a sharp drop from 4.4% in 2017/18 to only 1.6% in 2018/19.

2.3. MUA believes these key findings of the AMR clearly show Royal Mail is not improving its efficiency as it needs to and could do, nor is it improving its quality of service, while using high price increases to provide support for its profits, and as a result Royal Mail's profitability trend raises great concern for the sustainability of Universal Service Provision.

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2.4. However, Ofcom seems to believe no regulatory intervention is necessary and that the best approach is instead to allow time for Royal Mail's 5-Year strategy to be followed and achieved.

2.5. MUA considers this approach by Ofcom is very concerning, given that Royal Mail's most recent financial announcement has cast much doubt on its ability to meet the year 3 targets in its Journey 2024 plan, with increased likelihood that the part of Royal Mail which provides the Universal Service will be loss-making in 2020/21.

2.6. There has also been a further 8% fall in mail volumes since 2018/19, with Royal Mail expecting a similar decline this year and next, yet price increases have largely offset the volume decline, such that mail revenue is down only marginally.

2.7. On productivity, Royal Mail says it has achieved improvement of 1.3% so far in 2019/20; that is still below Royal Mail's internal target of 2%-3%

2.8. MUA therefore strongly believes that in order for Ofcom to show it is acting in line with its statutory duties, its Workplan for 2020/21 must include considerable work to assess the need for, and means to, apply new regulatory measures that will set efficiency improvement targets for RM, and constraints on the level of price increases for bulk mail services.

3. User Needs Research

3.1. Ofcom is currently undertaking qualitative and quantitative research into the needs of mail users.

3.2. However, MUA believes that research is limited to considering the needs of the consumer and SME users of the mail services specified in the Universal Services Order (USO).

3.3. MUA sees clear links between the use of services outside the USO and those in the USO:

- It is the high-volume, high-revenue use of non-USO services by large mailers, such as MUA members, which funds Royal Mail's provision of the USO. In 2018/19, more than 40% of Royal Mail's addressed letter revenues came from Access mail services, the use of which is almost exclusively by larger mail users;
- Royal Mail choses to apply the service specification set by the USO (e.g. 6-day delivery of mail) to the non-USO services (including Access services) used by large mailers.

3.4 MUA therefore strongly believes that a good understanding of the needs of large users of mail is crucial to Ofcom's review of postal user needs, even if Ofcom's focus is on potential changes to the USO requirements or coverage.

3.5 In 2019, responding to several requests, Ofcom did undertake some research into large mailers' use of mail and their perceptions of developments in the mail market.

3.6 MUA welcomed that research and the knowledge it gave Ofcom. However, comments from MUA members suggest that Ofcom gave too much emphasis to its conclusions that the long-term decline in mail volumes was due to switching of communications to other media. MUA members believe that while there undoubtedly is such a trend, and changes in consumer preferences is a factor, switching away from mail has largely been driven by the repeated, large, real-cost increases in Royal Mail's prices. The switch to other media is therefore more an outcome of mail price increases, rather than just a cause of mail volume decline.

3.7 MUA therefore strongly believes Ofcom's current work on postal users' needs must include structured research into the needs of large users of mail.

4. Ofcom Workplan 2020/21

4.1 The draft published for consultation by Ofcom includes two work areas related to the postal market: Review of user needs and Review of the future regulatory framework.

4.2 MUA supports this work, but strongly believes it should include the two areas mentioned in this letter:

- considerable work to assess the need for and means to apply new regulatory measures that will set efficiency improvement targets for RM, and constraints on the level of price increases for bulk mail services; and
- structured research into the needs of large users of mail.

4.3 Also, MUA notes that the two areas included by Ofcom in its workplan in relation to mail (Review of user needs and Review of the future regulatory framework) are under the heading of "Sustaining the universal postal service".

4.4 MUA believes that categorising this work in this way (and having no other planned areas of work in the mail market), means Ofcom is failing adequately to recognise that its statutory duty in relation to universal service provision also requires such provision to be efficient, and for its provision to continue to be efficient.

4.5 Ofcom also mentions "a review of Royal Mail's efficiency", but Ofcom already has an ongoing review of this (as reported in the AMR). It is regulatory action to ensure there are improvements to Royal Mail's efficiency that is required (hence supporting universal service sustainability other than through yet more, real-terns price increases on non-USO services) - not merely continuing an existing review

4.6 Finally, MUA would once again stress Ofcom's draft workplan includes no work to address the Regulator's statutory duty to further the interests of consumers, where appropriate by promoting competition, in respect of the mail market

MUA further notes that Ofcom now has new regulatory responsibilities in the area of social media and we hope this will not reduce the resource which Ofcom is able to devote to the very important work needed in the postal market, or reduce the priority given to that work.

MUA would welcome further discussion with Ofcom on the comments made in this response to the workplan consultation.

Yours sincerely,

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