Securing the universal postal service

Ed Richards, Chief Executive
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Overview

- Recap: Why is the universal service under threat?
- Ofcom’s focus and priorities
- Our decisions on the regulatory model
- Our safeguards to protect consumers
- Summary and next steps
A challenging market context

• Delivered mail volumes have fallen by 25% since 2006

• Royal Mail delivered 84m letters a day in 2006, but 62m in 2010/11

• Access has grown rapidly but RM still delivers 99% of all mail

• Mobile connections tripled between end 1998 (13m) and end 2000 (40m)

• Broadband take-up doubled between 2004 (6.1m connections) and 2006 (13.0m)

Royal Mail performance (Hooper Report 2010)

Note: Data refers to three year moving average annual growth rates
Source: Economics Forecasting, Group Regulation
Royal Mail’s financial performance has suffered

• Royal Mail Letters’ revenues have declined to £6.4bn from £6.8bn in 2006

• Royal Mail reported that the Letters business profits are erratic

• A loss of £120m last year (including costs of modernisation)
The UK’s universal service is set at the high end

<table>
<thead>
<tr>
<th>Directive requirement</th>
<th>UK</th>
<th>Denmark</th>
<th>Germany</th>
<th>Spain</th>
<th>Italy</th>
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</thead>
<tbody>
<tr>
<td>5 day per week delivery and collection</td>
<td>6 day per week delivery and collection</td>
<td>6 days per week</td>
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<td>5 days per week</td>
<td>6 days per week</td>
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<tr>
<td>Minimum standards of service</td>
<td>D+1 = 93%</td>
<td>D+1 = 93%</td>
<td>D+1 = 80%</td>
<td>D+3 = 90%</td>
<td>D+1 = 87%</td>
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<tr>
<td></td>
<td>D+3 = 98.5%</td>
<td>D+3 = 93%</td>
<td>D+2 = 95%</td>
<td>D+5 = 98%</td>
<td>D+2 = 95%</td>
</tr>
<tr>
<td>Priority service price comparison (pence)</td>
<td>D+1 = 46p</td>
<td>D+1 = 66.8p</td>
<td>D+1 = 53.8p</td>
<td>D+3 = 37p</td>
<td>D+1 = 69p</td>
</tr>
</tbody>
</table>

D= day of posting  
D+X = day of arrival
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Ofcom’s clear priority is securing a financially sustainable universal service

<table>
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<tr>
<th>What we can regulate</th>
<th>What we don’t regulate</th>
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<tbody>
<tr>
<td>Universal service products – including the prices that are charged</td>
<td>The composition of the minimum requirements of the universal service – this is for Parliament</td>
</tr>
<tr>
<td>Access to Royal Mail’s network – should it be mandated</td>
<td>Post Offices</td>
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<tr>
<td>End-to-end competition should it arise</td>
<td>Parcelforce and GLS (Royal Mail’s European parcels operator)</td>
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<tr>
<td>Quality of service</td>
<td>Royal Mail’s pension deficit and payments</td>
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Our decision seeks to protect the universal service

– Every home will continue to benefit from the universal service

– Current quality of service targets will remain (over 90% of First Class must arrive the next day)

– Prices will remain affordable

– Royal Mail will be required to improve efficiency to sustain the universal service in the medium-term

– Royal Mail will be given commercial freedom to compete in the market and meet customer needs
Our decisions today

– We issue the first Universal Postal Service Order – confirming the service and quality that Royal Mail has to offer every day throughout the UK

– We are otherwise removing the majority of regulation as of now from Royal Mail including price regulation and its ability to negotiate and agree terms and conditions with customers

– We are putting in place key safeguards to ensure that prices remain affordable and that Royal Mail addresses the challenge of improving its efficiency
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Safeguard 1 – Ensuring that a basic universal service product is available to all

- A safeguard price cap for Second Class stamp prices (particularly relied on by vulnerable consumers)

- Over the next 7 years, Royal Mail can price Second Class stamps no higher than 55p (linked to CPI) – this level appears affordable and provides enough flexibility to be sustainable

- To further protect consumers and small businesses, we are extending the safeguard cap to large letters and small parcels up to 2kg in weight

- The level of the cap for larger items will be set following consultation but subject to similar considerations as that for letters
Safeguard 2 – Effective monitoring of Royal Mail’s performance

• We will monitor Royal Mail’s performance in three main areas to ensure that:

1. The universal service is provided to the same high level

2. Royal Mail cuts costs and becomes more efficient over time

3. Prices remain affordable for consumers

• Our approach is deregulatory but we retain the power to intervene if appropriate
Safeguard 3 – Competition within the mail market

Competition here and abroad has brought benefits in terms of efficiency, choice and innovation for customers

Access
• Ensure access for other operators to Royal Mail’s Inward Mail centres
• Access will be less prescriptive (as Royal Mail would set prices) but also supported by a ‘margin squeeze test’

End-to-end
• Any operator wanting to provide a significant end-to-end service will have to notify Ofcom
• We can place obligations on end-to-end providers in order to protect the universal service
• Case-by-case consideration of any end-to-end entry
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A summary of what our decision will achieve

• Our decision will help secure the universal service, so consumers and businesses continue to benefit from postal service that is:
  – provided six days a week;
  – available anywhere in the country:
  – available at the same price across the UK (for USO services);
  – affordable, with safeguards for 7 years; and
  – sustainable.

• Royal Mail will have the incentive to cut costs and become more efficient over time

• For competitors, access is maintained and Royal Mail will have to report to Ofcom to ensure it is pricing fairly
Next steps

- Royal Mail is now expected to make decisions on the price of stamps based on Ofcom’s statement

- Any new stamp prices would come into effect a month after Royal Mail’s announcement

- Ofcom will consult on the level of the cap for Second Class large letters and parcels up to 2Kg in weight

- Ofcom will begin to monitor Royal Mail’s performance under our regulatory framework
Questions?