Agenda

Welcome and introduction
Ed Richards, Chief Executive

New legislative and regulatory approach
Stuart McIntosh, Group Director, Competition

The regulatory framework
Chris Rowsell, Competition Policy Director

Questions & answers
Ed Richards
Introduction

Ed Richards,
Chief Executive
Much has changed since Ofcom took over regulation of postal services in 2011

- In 2011 Royal Mail’s financial position was not sustainable and the regulatory framework was not flexible enough for Royal Mail to react quickly to structural changes in the market

- Since then:
  - Historic pension deficit assumed by Government (March 2012)
  - New regulatory framework put into place (March 2012)
  - Royal Mail now 70% privately owned (October 2013)
Our duties with respect to the postal sector

• Our primary duty is to carry out our functions in a way that we consider will secure the provision of a universal postal service

• In doing so, we must have regard to the need for such provision:
  – to be financially sustainable (including the need for the universal service to earn a reasonable commercial rate of return); and
  – to become efficient before the end of a reasonable period, and for it to continue to be efficient

• We have a general duty to further the interests of citizens and consumers, where appropriate by promoting competition

• In the event of conflict with our general duties, our primary duty to secure the universal postal service takes precedence
The new legislative and regulatory approach

Stuart McIntosh,
Group Director, Competition
Regulatory framework
In 2012 Ofcom put in place a new regulatory framework to support the sustainability of the universal service

- Removed the vast majority of retail and wholesale price controls
- Removed the requirement for Royal Mail to maintain a guaranteed margin between its retail and access prices (known as access headroom)
- Provided greater commercial and operational freedom for Royal Mail
- The framework is in place for seven years to give regulatory certainty and stability
But with key safeguards

- A safeguard cap on Second Class letters and parcels up to 2kg
- Effective monitoring of Royal Mail’s performance
- Competition within the mail market
The universal service
The Act sets the minimum requirements for the universal service

- Six days per week delivery and collection of letters
- Five days per week delivery and collection of parcels
- Affordable and geographically uniform prices
- Registered and insured services
- Free services for the blind and some legislative petitions/addresses

These minimum requirements can only be changed by the Government, following a vote in both Houses of Parliament
In March 2013 Ofcom confirmed the scope of the universal service

• Our 2013 review showed that the postal market is currently meeting the “reasonable needs of users”, including next day delivery / First Class

• We also concluded that universal postal services are affordable for almost all residential consumers and small businesses

• We have made the following changes:
  – Approved Royal Mail’s proposal to allow it to deliver parcels to neighbours when recipients are not home
  – Strengthened regulation of the post box network, i.e. there must be a postbox within 0.5 miles of 98% of addresses
  – Clarified the circumstances in which RM does not have to deliver / collect six days a week (exceptions policy)
Quality of service is an essential part of the universal service

- Royal Mail has regulatory quality of service targets for universal service products, but not access or non-universal service such as bulk mail

- In 2012/13 Royal Mail failed to meet the majority of its quality of service targets

- We wrote to Royal Mail underlining our expectation that all necessary steps are taken to ensure targets are met in the future

- The first three quarters of 2013/14 show real improvements:
  - 93.0% of First Class delivered D+1 (target: 93.0%, prior year: 92.2%)
  - 98.8% of Second Class delivered D+3 (target: 98.5%, prior year: 98.6%)
  - 112 of 118 Postcode Areas hitting 91.5% D+1 (prior year: 87 of 118)
The regulatory framework in more detail

Chris Rowsell
Competition Policy Director
Financial sustainability and efficiency
Approach to defining financial sustainability

- Relevant entity defined by those products that use the universal service network
- Universal service network largely based around people
- Operating costs are therefore significantly higher than the value of tangible assets
- Return on sales more relevant measure than a return on capital
A reasonable commercial rate of return

- We consider this to mean an EBIT margin for the reported business in the range of 5-10%. We based this on:
  - returns of comparator companies;
  - analysis of different approaches to measuring financeability; and
  - Royal Mail’s risk profile

- This is an indicative range of what earnings we consider will represent a reasonable commercial rate of return

- It does not represent either:
  - a cap on earnings or
  - a guarantee of such returns
Reported Business profit margins have increased

Royal Mail Reported Business EBIT Margins (%)

Source: Ofcom’s Annual monitoring update on the postal market: Financial year 2012-13
* adjusted 52 weeks
Efficiency

• Ofcom must have regard to the need for the provision of the universal postal service “to be efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times”

• We have said:
  – we need to be confident that increased returns are not simply based on price increases but should also reflect improved efficiency
  – Royal Mail must take appropriate steps to respond to the challenge posed by competition, such as improving efficiency levels

• Ofcom is developing appropriate metrics to measure efficiency. It is likely that we will need to employ a range of metrics to show the changes in Royal Mail’s costs
Competition
Competition in the postal sector is one of the key safeguards of the new framework

- The Third Postal Services Directive required all EU markets to be fully opened to competition
- Competition typically leads to greater innovation, choice and efficiency
- Ofcom has a general duty to promote competition where appropriate
- Ofcom’s primary duty to secure the provision of a universal postal service takes priority where there is a conflict
In 2012/13 Royal Mail delivered 99.8% of mail volumes and retained 97% of revenues

Mail volumes (m) (15,245m items)
- Royal Mail end-to-end: 7,982
- Access: 7,239
- Other operator end-to-end: 24

Mail revenues (£m) (£7,406m)
- Royal Mail end-to-end revenues: 5,755
- Royal Mail Access revenues: 1,486
- Access operator retained revenues: 159
- Other operator end-to-end revenues: 6

Source: Royal Mail regulatory financial statements, Royal Mail Wholesale, operator returns to Ofcom, Ofcom estimates (Ofcom’s Annual monitoring update on the postal market: Financial year 2012-13)
Access competition

• Access competition is where the operator collects mail from the customer, sorts it and then transports it to Royal Mail’s Inward Mail Centres, where it is handed over to Royal Mail for delivery

• Ofcom has mandated access to Royal Mail’s network at the inward mail centres for D+2 or later letters and large letters

• Terms (including prices) for access must be fair and reasonable, and not unduly discriminatory
End-to-end competition

- End-to-end competition is where an operator other than Royal Mail undertakes the entire process of collecting, sorting and delivering mail to the intended recipients.

- TNT Post UK launched end-to-end mail services in April 2012 delivering bulk mail three days a week to each address in parts of the country.

- Currently TNT is delivering in the following areas:
  - London (central, south west, west and north west)
  - Manchester
  - Liverpool

- As of December 2013, TNT was delivering 1.2m items / week (about 0.4% of total market volumes).
Competition Act investigation

- On 21 February, following a complaint from TNT Post UK, Ofcom opened an investigation in relation to certain prices, terms and conditions for certain access services.

- This followed announcements from Royal Mail in November 2013 and January 2014 of changes to these prices, terms and conditions.

- On 9 April Ofcom announced it had decided to investigate these matters under the Competition Act 1998.
Review of pricing requirements of the access condition

• On 9 April we announced a review into the pricing requirements in the universal service provider access (USPA) condition

• In 2012 we substantially relaxed the regulation of access pricing but noted that we would need to update this as stakeholders identified issues

• In 2013 and 2014 stakeholders raised concerns about the application of the conditions and the guidance

• We consider it timely to review these requirements to ensure that they remain fit for purpose and that all stakeholders have clarity and certainty with regard to their application

• We plan to issue a consultation document this summer and to complete the review this calendar year
Our approach to end-to-end competition

- In March 2013 we set out our approach to end-to-end competition and its impact on the universal postal service.

- If we considered there was a threat to the financial sustainability of the universal postal service, we would expect to intervene unless we concluded Royal Mail had failed to respond sufficiently to competition, for example, by becoming more efficient.

- At this time we do not consider that there is a threat to the financial sustainability of the universal postal service.

- We continually monitor the market.

- We will initiate a review of the need for intervention by the end of 2015 if our monitoring regime has not already lead to a full review.
Current or planned Ofcom work
Current or planned Ofcom work

• Monitoring of Royal Mail, including regular internal reporting and annual update to the market

• Reviewing the rules for access margin squeeze including the use of LRIC as a cost base

• Completing our work on mail integrity and interoperability

• Reviewing complaint handling and redress schemes for consumers

• Review of pricing requirements of the access condition

• Investigation under the Competition Act 1998 into Royal Mail’s proposed prices for access services
If you have any further questions, please contact:
Rohit Goel, Analyst Relations and Research manager (analyst.relations@ofcom.org.uk)
http://media.ofcom.org.uk/analysts/
Key publications

- Decision on the new regulatory framework (March 2012)

- Regulation of the provision of post boxes (March 2013)

- Review of postal users’ needs (March 2013)

- Guidance on Ofcom’s approach to assessing the impact of end-to-end competition on the universal service (March 2013)

- Annual monitoring update on the postal market: Financial year 2011-12 (November 2012)

- Annual monitoring update on the postal market: Financial year 2012-13 (November 2013)

- Reports on postal efficiency (January 2014)
  http://stakeholders.ofcom.org.uk/post/report-postal-efficiency/

- Review of the pricing requirements of the universal service provider access (USPA) condition (April 2014)
  http://stakeholders.ofcom.org.uk/post/uspa-condition-review
Speaker biographies
Ed Richards is the Chief Executive of Ofcom, appointed in October 2006. Previously Ed was Chief Operating Officer, responsible for Strategy, Market Research, Finance, HR and other functions.

Strategy responsibilities included Ofcom’s strategic thinking on the communications sector and covering economic issues and consumer policy.

Ed was previously Senior Policy Advisor to the Prime Minister (Tony Blair) for Media, telecoms, the internet and e govt and Controller of Corporate Strategy at the BBC.

He has also worked in consulting at London Economics Ltd, for Gordon Brown MP, for the N.C.U. and began his career as a researcher with Diverse Production Ltd where he worked on programmes for Channel 4.

Ed is currently a Director of Thames Water Utilities Limited, a Director of Donmar Warehouse, a Governor of The London School of Economics & Political Science.
Stuart McIntosh

Stuart McIntosh joined Ofcom as Group Director, Competition in January 2008 and was appointed to the Ofcom Board in July 2008.

The Competition Group undertakes much of the economic and competition analysis undertaken by Ofcom in regulating the sectors for which it is responsible including telecommunications, broadcasting and Post.

Prior to joining Ofcom, Stuart was a Strategy partner in IBM’s communications practice in the US.

Before that Stuart held senior positions in PWC, where he led PwC’s Telecoms Consulting Practices (in both the UK and the US) and Adventis, a boutique strategy consultancy. Stuart began his career as an Economist in the UK’s Government Economic Service. He also worked for BT for a period of 4 years where he held the position of Head of Business Economics.

Stuart holds degrees in economics from the London School of Economics.
Chris Rowsell

Chris Rowsell joined Ofcom in 2003.

Currently a Competition Policy Director in Ofcom's Competition Group, Chris Rowsell joined Oftel (the previous telecommunications regulator) in 1999 and transferred to Ofcom as part of the 2003 merger. During this time Chris has worked, among other things, on quality of service and price comparison websites for both fixed and mobile telcos; the establishment of consumer codes of practice and the telecoms ombudsman; several market reviews and price controls; online copyright infringement; and regulatory financial reporting.

Prior to joining Oftel, Chris wrote for Which? magazine as their senior researcher for technology and communications.