Towards solutions

Richard Hooper, Chairman, Independent Review of the Postal Services Sector

My text this afternoon is taken from a downstream access UK Mail-stamped letter I received yesterday, delivered by the Royal Mail, as I was finalising this speech:

“September 2008. Dear Mr Hooper, Please find enclosed your copy of the Final Short Form Report and Accounts....We would like to gain feedback from our clients as to whether they would be interested in receiving mailings in an electronic format....If you would consider this option, please register your interest online by visiting http colon forward slash forward slash.......”

I am going to be really exasperating. I apologise. My team and I are working hard on preparing a final report for the Government. It is the final lap. Our pulse and pace are quickening. But our recommendations will not be submitted for a few more weeks yet. So I said to Nigel [Stapleton], I could either decline his long diaried and kind invitation to speak at this annual conference of the postal great and good. Or I could go ahead and be exasperating. He preferred the latter.

So, you will not get answers from me this afternoon. But I can certainly talk about some of the questions.

It is a little over six months since we published our call for evidence. We addressed no fewer than 60 questions to the very wide range of organisations which have a direct interest in the future of postal services. Perhaps you’ll allow me to reflect a little on the work we’ve done so far, and give you an impression about which of the 60 questions seem to us, now as we are writing the final report, which of the questions seem to us to be the most important and how they fit together.

First, I want to thank all those in this room – and beyond - who have taken time to talk or write to the panel, giving your analysis of the issues, and offering ideas for the future. We set out at the beginning of this independent review to engage a wide range of stakeholders with an interest in the future of the postal service. Our list included consumers and their representatives, smaller and larger business customers, postal companies, trade unions, political parties, academics, advertising agencies, magazine publishers, government departments, the devolved administrations and regulators. And you have responded energetically. At the last count, some 200 meetings with me, with Deirdre Hutton, Ian Smith, Jon Booth and the team. Your views have been invaluable. Your evidence is the foundation for our report. We have tried to be evidence-based throughout the process.

The first 25 of our questions were about the challenges and opportunities facing this sector: the subject of our interim report. Do we stand by what we said in May – after all our work over the summer?

Yes we do. **The situation in the postal services sector in the UK is and remains untenable**. There is a strong rationale for policy change.

The most encouraging aspect of our interim report was the response. All the stakeholders agreed with our assessment – and said so in public. Given that the sector is known for the differences between the views of stakeholders, and the forthright way in which those differing views are on occasion communicated and defended, that was hugely encouraging.

If anything, I would say that the consensus has become even stronger over the last few months.

In over 200 meetings, no-one – **not one person** - has suggested to us that the universal postal service is no longer important. We prefer the term universal postal service to the rather less accessible term “universal service obligation”.

The capacity to send and receive items anywhere in the country for the same affordable price is hugely important. It is part of our social and economic glue.

But the universal postal service is under threat.

I sense that there’s more realism, now, about the challenge we face in maintaining the universal postal service.

The fact is that the postal services sector, whose health significantly determines the health of the universal postal service, is facing two big changes. And they are happening concurrently.

Post is bound to be affected by lower growth as consumers and companies look ever harder at ways of cutting their costs in harder economic times. This is cyclical change.

But the change is structural, too. I’m not referring here to the arrival of competition within the postal sector but, more important in the Panel’s view, to the arrival of competition from the digital media. I have spent my whole career working in and fascinated by the converging media and communications industries. Traditional media and communications companies like the Royal Mail, like Trinity Mirror, Johnstone Press, like ITV are under assault from structural changes in their marketplaces.

The impact of the digital revolution on the postal services sector now and in the future is the one point which did not emerge as strongly as it should have in the media coverage of our interim report back in May. We will want to make our point much more clearly this time.

Let me try and make it now. Email, the internet, and text messaging are all substitutes for the advertising, publications, social and transactional mail which have so long been at the core of the postal business.

Any mail that is digitisable is potentially a victim of e-substitution. When did you last get an airline ticket through the post? Long ago. When did you last get a letter like the one I quoted at the beginning? Probably yesterday.

Downtrading - choosing second class stamps over first class at a cost of 27p instead of 36p, or choosing email over Royal Mail at a marginal cost of zero yes zero – downtrading is the result of cyclical and structural change at work - together. Customers are under pressure to opt for cheaper products. And those products are now readily available.

The communications world has changed. And because of that, the letters market is in decline. This is a new phenomenon in the history of the postal market. I suspect that our earlier projection – of a fall in letter volumes between 1 and 3% per year - was conservative. These are risks to be managed.

But it would be wrong to assume that the future is entirely bleak. The sooner we face up to the digital revolution, the sooner we will understand how new electronic media bring new opportunities in their wake.

Yes, competition is tougher and I and my fellow Panel members are believers in competition – NOT as an end in itself but as a means to end – benefits to customers. Companies in this room are pitting their services against the likes of Google, ITV, Vodafone. But there is scope to provide complementary services. Look at the way that the BBC has embraced the Internet, reaching beyond but linking to radio and television – the standard channels of distribution. Items ordered online bring opportunities for growth and new revenues.

That's the supply story. What about demand? We have also been looking at markets through the eyes of the consumer, the customer. Their changing expectations will be central to our report.

I remember being surprised back in January that domestic consumers were responsible for generating only 13% of mail. Most of that is posted at Christmas. In Canada I believe the figure is only 3%. (There is a review of the sector going on in Canada as here.)

Surely then, businesses are the more important customers? Well not really. No less than 70% of mail is received by domestic consumers. 70%.

We're all recipients of mail. So we're all customers in one sense even if we are not paying customers. I am on the Board of Yell, the Yellow Pages company. There the user of the books or Yell.com who pays nothing is treated in one sense every bit as much as a customer as the advertiser in the books or on Yell.com who pays money. If there is no use of the books, there is certainly not going to be any advertising in them. Recipients of mail need to be made to feel like customers and be treated better – and there are services they will pay for. Compared to just 10 years ago, we as recipients of mail are subject to very different pressures. Our lives and work have different patterns. We are more alert to environmental issues and have a better understanding of how our activity is changing the planet. We access services differently and want deliveries of packets and parcels that do not fit through the letter box, on a flexible basis, at a time to suit us and in a place that suits us. The smartest companies are making that a feature which differentiates their service.

So where does the story go from here?

The most successful companies in any sector know very well that – in difficult times – organisations must change: first to survive, and then prosper.

Are we confident that postal services can adapt successfully? Adapt to the digital revolution and changing customer expectations? Adapt in a world where increasing prices alone will not generate enough revenue to compensate for falling volumes? Adapt to the opportunities opening up in e-fulfilment coming from those very same digital media which are threatening the letters business?

I have to say that I'm not confident. Not under the **current** set of policies, at least. Let me say why.

I've been asked to undertake a review of the whole postal sector. We're very conscious of that. But the truth is that one company is particularly important to the future of this market. The Royal Mail.

Alternate carriers have swiftly amassed around 40% of the bulk mail market upstream – easily surpassing expectations back in 2002. There has been much debate – some of it prompted no doubt by the review - about the speed at which competition will continue to develop in this sector and whether alternate carriers will build on their access volumes to launch their own delivery services downstream, ie end to end or bypass competition. We will set out our view about that in the final report.

But no-one expects any postal company to build a **national** delivery network any time soon. The fact is Royal Mail is the only company which currently has the capacity to deliver to every one of the 28.4 million business and home addresses in this country – and meet the requirements of the universal postal service.

Royal Mail faces a number of constraints. Constraints which limit its ability to respond to the cyclical and structural challenges now taking place in the communications market.

The Royal Mail is significantly less efficient than its European counterparts, quite a number of which we have visited as part of our work. Royal Mail has a pensions deficit which is among the largest of any company in the UK, and which is highly volatile. The relationship between the unions and the company is very difficult indeed. It has financial difficulties. Since our interim report, Royal Mail Letters reported a loss in 2007-8.

The status quo really is untenable.

We will offer more detail in the report about what would happen if there were no changes in policy. But let me leave you in no doubt today that the implications would be profound for the sector, its employees, customers and the taxpayer.

Doing nothing and kicking the issue into the long grass are not an option. (As a 20 handicapper I know more than most about the long grass).

All doom and gloom? No. I've said to many of you before, that I'm an optimistic realist. I believe that there is a strong, positive future for the postal sector if – **but**

only if – it is able to respond to the changing needs of consumers and to embrace the opportunities which new technology brings.

The question is, how do we reach that positive future?

We will certainly need changes to the regulatory regime which recognise that postal companies are competing in a wider, much more complex and rapidly changing market. But regulation won't be enough on its own.

Royal Mail's financial health is crucially important to the universal postal service, and to the future of this sector. And that is why Royal Mail's modernisation will be at the heart of our recommendations.

I've yet to find a better word than modernisation. But it is worth unpacking.

For us in the Review team, modernisation is not simply about "catching up" with the times. There is no doubt that Royal Mail is less efficient than many of its European counterparts – in Netherlands, Denmark, Sweden, Germany and France. Take walk sequencing automation for example. Adam Crozier acknowledges that and has said so in public. Improvements are central to the company's strategic plans.

Removing costs from a business is normal for any business in normal times. In a declining market with declining volumes, for a high fixed-cost network business cost reduction is crucial. There is a big question about the scale and shape of the Royal Mail's national network of mail centres, distribution centres and delivery offices which we will need to address.

But modernisation isn't just about cutting costs. It **must not be** just about cutting costs.

Modernisation is first and foremost about changing culture. It is about customer obsession and innovation: creating new revenue streams. Modernisation is about moving into higher value services as transactional mail moves online. And about having the confidence and ability and capital to do so.

There lies a good part of our story in the final report. We will be clear to set out what Royal Mail needs in order to modernise – and then set out the policies which, based on your evidence and our analysis, we believe will enable modernisation to take place more quickly.

And what are those policies?

Well, that's for the next instalment. But I can tell you that we are working hard to set out a coherent package of solutions.

Back in January, Deirdre Hutton and I, Jon Booth and his excellent team, we were all genuinely taken aback by just how complex is the business behind a very simple concept: moving items from one place to another. Ian Smith comes from the logistics world and for him this was no surprise. Nine months later, we are still learning – and continue to see new links between the many issues which we have covered: issues about prices and revenue, about cost, about culture, employment practices, corporate relationships, alignment of incentives, regulation and much much more.

Our recommendations are similarly linked. Linked by what we call “connective tissue”.

The response to our interim report was constructive. Being optimistic, we aim to get a similarly high level of consensus with our final report. Being realistic, we know that will be tricky. Agreeing a diagnostic is much easier than agreeing the solutions and actions.

There is a wonderful quote from Niccolo Machiavelli:

“As the doctors say of a wasting disease, to start with it is easy to cure but difficult to diagnose; after a time, it becomes easy to diagnose but difficult to cure.”

(The Prince published in 1532)

So it is in postal matters today in the UK. Mediaeval Italian political wisdom still relevant in the 21st Century.

We are in the middle of substantial changes. We have far from perfect information about the past. Which only makes predictions about the future more testing. But we will strive to set out the issues in a clear and compelling way for a wide audience; to bring together the evidence; and to establish a set of recommendations which respond in objective and practical ways to the challenges and opportunities which we face together. I hope you will find pragmatism, rather than ideology, in our final report.

Thank you for your attention. I hope I have not been too exasperating.