

COMPETITIVE MARKET REVIEW

EXECUTIVE SUMMARY

PROPOSALS FOR TACKLING BARRIERS TO ENTRY IN POSTAL SERVICES

November 2005

FOREWORD

To prepare this Competitive Market Review, the Postcomm team have since July 2005 been meeting and consulting with a wide range of stakeholders. We wanted to confirm that the universal service is secure, to find out their views about how the UK postal market is developing and to hear what they think should be Postcomm's priorities to further the interests of postal users.

The main message we hear from stakeholders is that the "green shoots" of competition are starting to show through – but there is a lot to be done before they feel that they have an effective choice of mail providers. I also welcome the clear confirmation from a wide range of stakeholders that the universal service is secure and that they see the continuing introduction of competition as the best route by which ensure that this remains the case, encouraging a more efficient and customer friendly Royal Mail.

Customers tell us that they are beginning to experience the benefits of competition in terms of better quality of service and more choice. And they like what they are getting and only in a very few instances have they experienced any problems in moving away from Royal Mail. However, they also want to hear more information about what choices are available and how it works in practice to use alternative providers.

The main challenge mail users are making to Postcomm is that we should be doing more to bring the benefits of competition to their attention. Our review found that only 25% of business customers could identify 1st January 2006 as the date of full market opening. Apart from largest users, we found that most customers could not identify any alternative providers of postal services.

Postcomm will be rising to the challenge and we have a programme of activity underway - involving public meetings and seminars, newsletters and our newly launched website - to help customers who want to switch and to give potential entrants the information they need to get their licence and enter the market.

Stakeholders have also told us that they believe that, until effective competition is established, Postcomm must continue to regulate to protect their interests in terms of prices, quality of service and potential anti-competitive activity by Royal Mail. That is not the message we are hearing from Royal Mail, but it is a remarkably consistent one from all the other stakeholders!

Royal Mail's market share – nearly 30 months after Postcomm started to liberalise the market – remains at over 97%. We recognise that Postcomm's job is to tackle the barriers to the development of competition, to incentivise Royal Mail to become more efficient and responsive, and to ensure that choice and innovative services are fed through to benefit customers.

Companies who innovate and give customers what they need will succeed in a fully open market. Customers tell us that they want to see better tracking of mail, later collection times and more time certain delivery products. Thus far most customers that have switched from Royal Mail have benefited from lower prices. However, it is important for Postcomm that the benefits of competition should also be realised through better service reliability and greater product innovation because price competition alone will not ensure long term sustainable competition.

From 1 January 2006, the market will be fully open to competition. It will not be difficult for innovative and ambitious organisations - large or small -to become licensed mail operators and to take advantage of a new market opportunity, either nationally and

regionally. This means more customers will be offered a choice of who handles their mail. We do not anticipate that this will create immediate or significant changes for all customers, but we do believe that a competitive market that offers choice, quality and better value for money for all, will build over time.

We greatly appreciate the feedback from those who have either met with us, sent written responses, or participated in our market surveys. All this information is extremely helpful in guiding our policy making and in ensuring that Postcomm proactively takes the initiatives required to safeguard the Universal service and foster a competitive environment.

We remain convinced that we can deliver a “Win/Win” scenario with a much better customer experience delivered by a successful Royal Mail and a reasonable number of other profitable mail providers.

We value the feedback that you might wish to give us on the issues covered in the 2005 edition of the Competitive Market Review.

NIGEL STAPLETON

CHAIRMAN, POSTCOMM

Summary

S1. Postcomm's vision for the letters market

Postcomm, working in the interests of postal users, is committed to ensuring the provision of a universal postal service, and establishing a regulatory framework that facilitates a competitive and innovative postal market. This is central to Postcomm achieving its vision for the market of:

“a range of reliable, efficient and innovative postal services, including a universal postal service, valued by customers, and delivered through a competitive postal market”.

Postcomm believes that customers' interests will be best served in a market where **effective competition offers customers choice** and encourages vigorous rivalry, efficiency and innovation on the part of postal operators.

A successful Royal Mail, the UK's only universal service provider, is central to the delivery of this vision.

To inform its decisions on the necessary regulatory actions aimed at achieving its vision, Postcomm believes it is important that it, and all industry stakeholders, have a thorough understanding of the market and how it might develop.

This document, following consultation with the industry, contains a review of the mails market, and follows a similar review conducted in 2004. To assess market trends since the introduction of competition, Postcomm also commissioned a detailed survey of 1200 business customers (as they represent 80% of the sending market), to identify their needs, to look at their switching behaviour in a competitive market, and explore their views of Postcomm. This updated and enhanced a similar exercise last year.

Postcomm hopes that this document will raise stakeholders' awareness of market developments and the opportunities for new entrants. **Postcomm would like to encourage stakeholders' feedback on how they see the development of the market.**

S2. Recent market developments

S2.1 Market size and growth

2004/05 - Total mail volumes in the licensed area (0-350g, <£1) grew by 1.5% in 2004/05 to 20.3 billion items. This was principally driven by the rise of 1.3% in Royal Mail's volumes from 2003/04.

The most recent mail volume data that Postcomm has received from Royal Mail however indicates a number of trends not evident in the data for the period covered by Royal Mail's latest full year figures (year ended 27 March 2005).

2005/06 - Overall mail volumes are down by 1.3% in the second quarter of this financial year (2005/06) compared with the same period last year, due to a fall in Royal Mail's mail volumes. This contrasts with a long period of mail volume growth, and in part reflects the recent general slowdown in UK economic growth. There are variations within the overall decline of mail entering the Royal Mail network from source:

- Royal Mail's first and second class public tariff mail volumes are down by 4.2% and 5.3% respectively;
- Royal Mail's bulk mail (including Mailsort and Walksort) mail volumes are down by 10.8% (compensated in part by the increase in Access Mail – see below);
- Royal Mail's unsorted account mail volumes (including Cleanmail, Packetpost and Special Delivery) are up by 4.1%;
- Royal Mail's Presstream volume is up by 7.0%; and
- The category of mail that includes Royal Mail's Standard Parcels, Response Services and access has increased by over 200%, driven by the rapid take-up of access services.

The large fall in Royal Mail's bulk mail volume from source is, to a large extent, driven by customers switching volume into Royal Mail's access products when this mail enters the Royal Mail network further downstream.

Royal Mail's second quarter volume figures contrast with the first three months of this financial year, when mail volume growth was around 2.7%. It will still be some time before the underlying mail volume growth trend emerges.

S2.2 Market Share

It can be seen from Table S.1 below that Royal Mail retains a commanding market position, accounting for over 97% of the regulated market. This trend is consistent with international experience, where incumbents have continued to dominate their respective markets after the market was opened to competition.

Table S.1: Letters Market (0-350g <£1) by volume, quarter 2 2005/06

Letters Market 0-350g <£1	Market share
Royal Mail	97.2%
Alternative Providers	1.6%
Direct Customer Access	1.2%
Total	100%

Source: Postcomm estimates¹

S2.3 Scale and nature of competition

Large customers have had a choice of postal operator since the market for bulk mailings was opened to competition in 2003, and Postcomm has now issued long term licences to 14 alternative providers in addition to the 15 year long term licence granted to Royal Mail in 2001. Six of the alternative providers were granted licences in 2005.

Competitive entry has gained momentum, with alternative providers accounting for a total of **193m items in 2004/05**.

End to end volumes for alternative providers in 2004/05 were 106m, a rise of 85.9% on the same period last year.

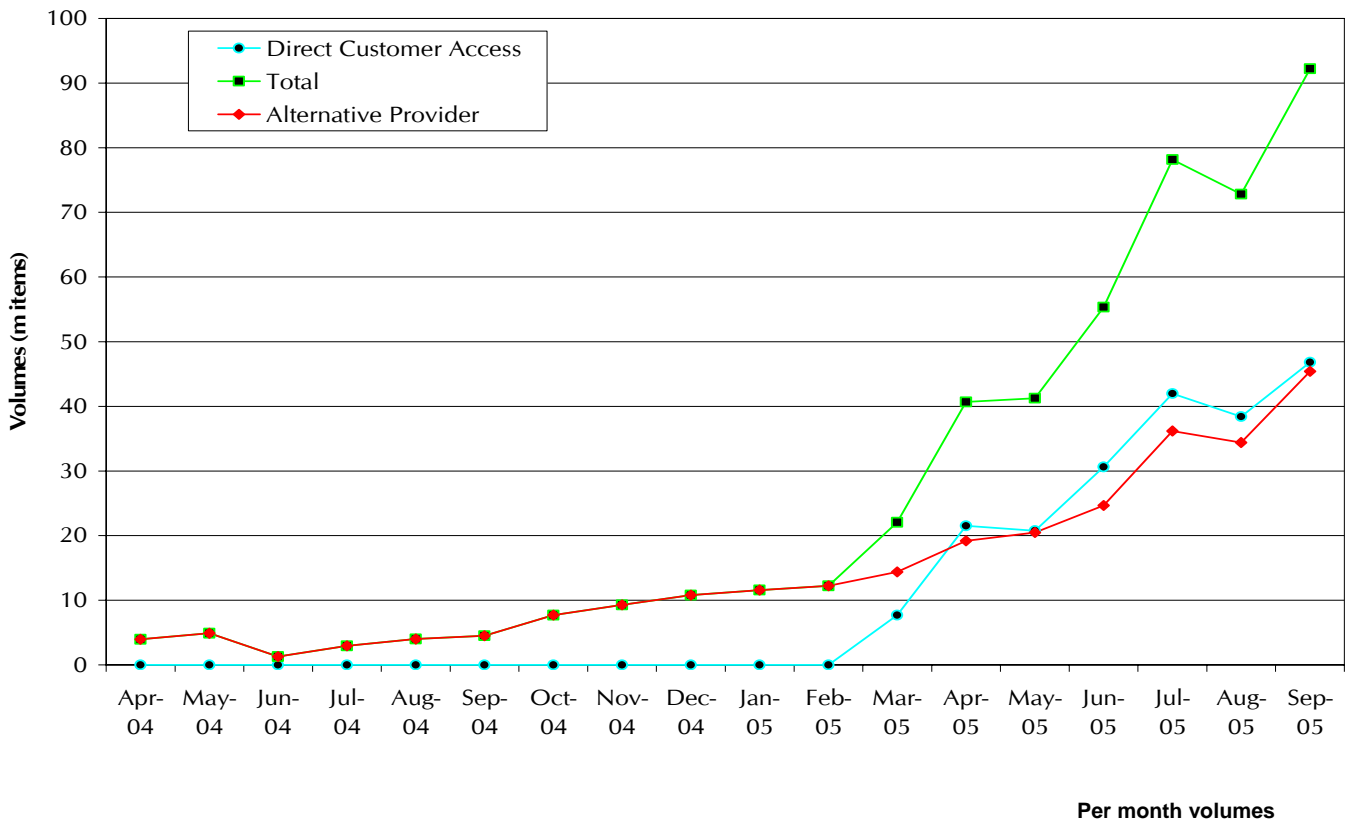
¹ Access volumes are assumed to be ½ mail items for both Access users and Royal Mail, to obtain accurate market shares.

Much of the new competitive entry is occurring through alternative providers utilising third party access arrangements to Royal Mail’s delivery network. Alternative provider access volumes accounted for 87m items in 2004/05.

Alternative providers have also targeted niche and value added services for business customers.

In addition to alternative providers, recent market data has indicated a sharp rise in direct customer access volumes (as shown in Figure S.1), with a number of Top 50 companies switching to this service although still retaining their contract directly with Royal Mail.

Figure S.1: Growth of Access Volumes



Source: Royal Mail

Total access volumes (direct customer access and alternative provider access) have already surpassed the total for 2004/05. Access volumes accounted for approximately 381m items (£51m by revenue) by the half year 2005/06.

- 52.3% of this volume is direct customer access (several licensed alternative providers do the trunking for these customers); and
- Access volumes now account for around 90m items per month (as at September 2005), with direct customer access and alternative provider access accounting for almost equal share of this amount.

Mailing houses are also increasingly seeing opportunities from access arrangements and competition to develop integrated mailing solutions for their customers (to develop “all in one services”).

- One mailing house recently agreed to allow other mailing houses to establish direct customer access through its existing agreement with Royal Mail; and
- One mailing house has developed and is currently marketing software which allows customers to compare prices of the various operators based on their mailing profiles, including whether it would be appropriate to choose a combination of different operators.

Express recently announced that it would be discontinuing end to end postal deliveries with effect from 30 November 2005. The company provided a bulk mail collection and delivery service in particular cities using its milk delivery network and Postcomm regrets their departure from the market. Unfortunately, departures are a feature of any competitive market but this nevertheless demonstrates that new entrants face a considerable challenge in sustaining a competitive pressure on Royal Mail. Postcomm has made sure there are processes in place to ensure that Express's withdrawal from the market will not affect mail already in the pipeline, and that the impact on customers is minimal.

S2.4 Innovation

Customer switching has thus far predominantly been induced through price competition. Views on whether there has been innovation in the market are mixed, although some alternative providers believe there has been. The following were examples commonly mentioned by alternative providers responding to Postcomm's consultation.

- Tracking;
- Flexibility of collection times;
- Access arrangements;
- Data quality and information provision;
- Security features;
- New pricing structures; and
- Development of a mailbox network.

The majority of customers who responded however thought that there was little or no innovation in the market, and a number commented that Royal Mail did not respond enough to customers' needs.

Customers highlighted the following as their key innovation needs:

- Tracking of mail;
- Later collection times; and
- More time-certain delivery products.

S2.5 Customer Awareness and behaviour

Over 80% of respondents to the 2005 business customer survey believed that the postal market should be opened to competition, with 52% expecting that competition will reduce mail prices; improve choice (75%); and improve the quality of Royal Mail's own service (66%). 72% of respondents believed there will not be enough competitive pressure on Royal Mail to control its prices without Postcomm intervention. Respondents expected mail volumes to rise over the next five years.

The 2005 survey results however continue to highlight a high degree of customer inertia.

- Only 8% of respondents reported using a supplier other than Royal Mail; and
- Only 25% of business customers identified 1 January 2006 as the date on which the market will be open to competition, though significantly more respondents in the financial services sector mentioned the correct date.

Business customers are also poorly informed about the alternative providers active in the market.

However, even if their level of knowledge remains low, every business customer segment shows more contact with alternative providers than a year ago.

- Within the top segment, 48% of respondents reported having been contacted by alternative providers, compared to 40% in 2004; and
- Financial services and businesses classed as "all other services" registered the most contact from alternative providers.

Business customers' willingness to switch mailings has also increased. In total 64% of respondents indicated that they would be willing to switch some of their mail to new entrants, a significant increase on the 30% of respondents who gave the same response in the 2004 survey.

Of those who have switched some of their mail away from Royal Mail, the experience of using alternative providers is positive. Some 25% of these respondents said they plan to switch more, while only 12% plan to move business back to Royal Mail.

Business customers continue to prefer end-to-end more than access. As in 2004, respondents rated:

- an integrated Royal Mail service the highest (8.2 out of 10);
- an access based service was less attractive (5.0 out of 10); and
- an end-to-end service provided by an alternative provider was preferred to access (5.8 out of 10).

What underlines this is that companies still perceive some risk from two organisations carrying their mail rather than one.

Perceptions of the price and quality offered by Royal Mail in general were also positive; with 50% of respondents who had not switched saying the primary reason was that they were generally “happy with Royal Mail”.

S2.6 Royal Mail’s performance

Royal Mail **improved its financial performance in 2004/05**. This has been largely driven by volume growth and price rises afforded to Royal Mail under its current price control.

Royal Mail quality of service performance also improved in 2004/05, after poor levels of performance in 2003/04. However, whilst performance improved in 2004/05 for all products (except first class response services), Mailsort 1, Mailsort 3, Presstream 2 and second class stamped and metered mail were the only products to achieve their licence targets. Recent quality of service data (quarter 1 2005/06) indicates that performance has improved in every product, particularly in postcode area performance.

Royal Mail’s improved performance was confirmed by the 2005 business customer survey with the majority of business customers interviewed (particularly top customers spending over £500,000 per annum on mail) believing Royal Mail’s quality of service

has increased over the past year. A number of large customers have also said that Royal Mail is becoming more responsive to customers, and has improved communication with customers through better account management.

Royal Mail recently announced that it had been consulting with business customers and is planning to bring a number of new products to the market.

S3. Key barriers to the development of effective competition and Postcomm's response

From 1 January 2006, the entire UK postal market will be open to competition. The impact of competition over the next few years is uncertain, but Postcomm expects Royal Mail to retain a strong market position due to a number of barriers to entry.

Postcomm has assessed the main barriers to entry identified by respondents and other key concerns (such as the impact of competition on the universal service), and outlined proposals for minimising their impact on the development of competition.

S3.1 Customer inertia/ lack of awareness

The 2005 business customer survey and responses to the competitive market review consultation continues to highlight a high degree of customer inertia. Please see section 7.2.1 of the main document for further detail.

S3.1.1 Postcomm's response

Postcomm believes it has a role in improving the awareness and confidence of customers and potential operators about market opening. This means that Postcomm is working with Postwatch and others to raise awareness of the opportunities for companies as well as to address their concerns.

As part of Postcomm's communication strategy in the run up to full market opening on 1 January 2006 and beyond Postcomm is:

- talking to customers, and potential and competing market entrants, at a national and regional level. Postcomm is, for example, visiting organisations all over the country to identify examples of how competition is already working in practice and how it should develop;
- explaining full market opening to the full range of stakeholders through briefings with the business, trade, consumer and regional press, and also TV and radio;
- developing its stakeholder relationship management and market intelligence capability to inform better the market and Postcomm's decision making process;
- Using the new Postcomm website (www.psc.gov.uk) to ensure it helps customers who want more information on the choices available in the market, and gives potential operators the information they need to come into the market. The website provides details about all operators in the market including contact names, phone numbers and web links;
- Publishing brief quarterly market updates, as part of the Postcomm newsletter "Commentary" which keeps stakeholders in touch with developments on consultations and key regulatory decisions; and
- Postcomm encourages all mail operators to promote their services to a wide audience.

S3.2 Royal Mail's VAT exempt status

Royal Mail's VAT exempt status continues to be highlighted as one of the main barriers to entry for alternative providers and as a serious barrier to switching by VAT exempt business customers. Royal Mail is currently exempt from charging VAT on services it supplies to customers. In contrast, alternative providers, including those licensed to provide competing postal services, are required to charge their customers VAT at the full rate of 17.5%.

Alternative providers need to overcome an approximate 13% price disadvantage against Royal Mail (not 17.5% as Royal Mail's prices implicitly include its input VAT, which it is unable to reclaim) before any discount to encourage VAT exempt customers from switching. Alternative providers are, therefore, less able to target VAT exempt companies, which include some of the largest bulk mail customers, including banks, financial institutions, and some charities. Postcomm believes that over 40% of Royal Mail's business customer base is VAT exempt.

S3.2.1 Postcomm's response

VAT policy is a matter for Government, not Postcomm. The UK Government must operate within the constraints of the common VAT regime of the European Union.

Postcomm's remit from the Government's White Paper "Post Office Reform: A World Class Service for the 21st Century", was to review all Royal Mail's special privileges including its VAT exemption and to make recommendations to the relevant Government departments responsible for making a decision to maintain, amend or abolish these privileges.

Royal Mail's VAT exemption is not required for the provision of the universal service, and continues to significantly distort competition. Postcomm reaffirms its support for a solution that meets two basic principles:

- a level playing field for operators; and
- no significant price rises for customers.

Two options that would meet these principles are extending the exemption to other operators or applying a reduced rate to all operators. Postcomm is aware however that either of these options would require legislation to amend the current European Directive and any solution must be a long term goal.

Alternative providers have said they would welcome the opportunity to meet HM Treasury to express the difficulties they face first hand. HM Treasury has said it would be willing to listen to the alternative providers on this issue. Postcomm will therefore facilitate dialogue between HM Treasury and alternative providers.

Postcomm, in coordination with Postwatch, will also gather further evidence on the impact a reduced VAT rate would have on charitable groups.

Postcomm will continue to monitor the distortion caused by Royal Mail's VAT status, and continue to develop further analysis. Postcomm also offer to assist HM Treasury in assessing the impact of Royal Mail's VAT status on postal services.

S3.3 Low level of margins available to alternative providers

Alternative providers (and potential entrants) argued that the margins available in the letters market were not attractive enough for them to risk substantial investment and therefore discouraged entry. Alternative providers thus supported retail price rises for Royal Mail products.

Royal Mail, trade unions, and suppliers to the industry argued that Royal Mail's retail prices needed to rise because there was a lack of investment in Royal Mail. Price rises would encourage investment and lead to innovation that was critical to the growth of the postal market. However, Royal Mail argued that most of the price rises should be borne by the retail customers who, it contends, are subsidised by large business customers.

S3.3.1 Postcomm's response

Postcomm notes the observation by some stakeholders that Royal Mail's prices are among the lowest in Europe. This observation must, however, be treated with caution because all cross-border comparisons are inherently difficult. Although Royal Mail's retail stamp prices are lower than most other European countries the same does not apply to all mail tariffs. Also, the population density is higher in the UK than in most European countries, which allows for a lower cost delivery structure. Royal Mail handles over 80 million items every day through a network that reaches all residential and commercial addresses in the UK. This gives it a significant unit cost advantage in certain activities such as delivery, where high fixed costs are spread over a large volume of items. Economies of scale mean that it is possible for Royal Mail to be inefficient but at the same time overwhelmingly cost competitive compared to any

operator without Royal Mail's scale wishing to establish a rival daily nationwide delivery network.

Postcomm recognises the benefits of Royal Mail's economies of scale to postal users, in terms of keeping unit costs (and hence prices) lower than would otherwise be the case. Postcomm has accordingly pursued downstream access to Royal Mail's network for other providers. This approach enables competition upstream, whilst recognising and sharing Royal Mail's advantage downstream. Alternative providers can access Royal Mail's delivery network at a price where both parties should be able to make a profit.

The issue of the appropriate level of margins (to encourage access and end-to-end competition) is being considered as part of the 2006 Royal Mail price control and service quality review. As outlined in its 2006 price control initial proposals published in June 2005, Postcomm supports, in principle, cost reflective pricing. Viable competition in the long run must be based on genuine efficiency, innovation and customer service, and not on business models that rely on Royal Mail's prices being out of line with its costs.

To ensure greater protection of access products, Postcomm has proposed to take access prices within the 2006 price control. Final proposals for the price control will be issued later in 2005.

S3.4 Royal Mail's pricing behaviour

Alternative providers expressed concern that Royal Mail is attempting to "muddy the waters" and create uncertainty in the market with the introduction of zonal pricing and its product "road map". They argued that:

- this was an attempt by Royal Mail to create confusion amongst customers, and squeeze out alternative providers; and
- Royal Mail had too much freedom to introduce new products (i.e. new products are not regulated under the price control).

S3.4.1 Postcomm's response

The issue of zonal pricing is being considered as part of the 2006 Royal Mail price control and service quality review. Postcomm's views will be outlined in its final proposals for the price control which will be issued later in 2005.

Also as part of the price control review, Postcomm is considering changes to the notification process under Condition 7 of Royal Mail's licence, under which Royal Mail must continue to notify new products and publish price changes.

S3.5 Operational difficulties arising from access arrangements

A variety of operational barriers were mentioned by alternative providers and direct access customers. These included:

- stringent mail specifications leading to greater rejection of mail;
- difficulty with meeting Royal Mail's forecasting requirements;
- use of Royal Mail equipment: Customers complained if they signed a direct access arrangement, they could no longer use Royal Mail's equipment, while some alternative providers said they did not want to use Royal Mail's equipment claiming it was inefficient but were forced to acquire it; and
- Royal Mail's access window only allowing one delivery to go into a mail centre at a time.

S3.5.1 Postcomm's response

Currently under Royal Mail's licence it is up to Royal Mail to develop an Access Code. To date Royal Mail has not delivered on this code despite several commitments dating back to April 2004 to do so. Hence Postcomm has now proposed to take access prices into price control.

Protecting access prices within the price control will ensure more regulatory oversight and protection from April 2006. For example:

- non price terms cannot be made less advantageous;

- Postcomm proposes that a 95% next day delivery target and compensation regime remain in place for access services; and
- Postcomm proposes that Royal Mail must inform access customers of the quality of service it has achieved in delivering their mail.

For amendments to existing access contracts there is a change mechanism set out in the access contract. For new access agreements, **it is open to alternative providers, or direct access customers, to ask Postcomm to make a determination on an operational issue if they cannot agree terms with Royal Mail.** The process for seeking an access determination is outlined in **Annex 4.**

S3.6 Potential for anti-competitive behaviour by Royal Mail

Many of the concerns alternative providers and customers have raised about operational barriers and Royal Mail's pricing behaviour relate to concerns that Royal Mail has the potential to use its size and strength in the market to stifle competition through undercutting rivals, creating uncertainty in the market, squeezing margins and creating operational barriers under access arrangements.

On the other hand, a major concern from customers is that Royal Mail was "hiding" behind licence restrictions and competition law to refuse to be flexible and to vary certain services (a major complaint of large customers who want more tailor made contracts).

Alternative providers felt Postcomm's investigations into their complaints against Royal Mail took far too long, and that the regulator was not an adequate deterrent to Royal Mail.

Some alternative providers complained that when they tried to get customers to switch to them (through access arrangements) Royal Mail encouraged some customers to sign direct customer access deals.

S3.6.1 Postcomm's response

Given Royal Mail's strength in the supply of many different services and the current absence of effective competition in postal services, Postcomm recognises Royal Mail

has the scope actively or passively to prevent the development of competition. There is also significant evidence from other countries (most notably Sweden and Germany) that anti-competitive behaviour had arisen in the early stages of postal competition.

Postcomm has an established process for handling anti-competitive complaints, and this outlined in Annex 3. Postcomm intends to raise the level of awareness within the industry about its regulatory processes and principles in dealing with anti-competitive complaints. Postcomm will do this through **an industry workshop on 29th November 2005**, with the aim of ensuring industry players can more effectively evaluate Royal Mail's behaviour and interact with Postcomm. More guidance is also intended to be issued on processes and how to make a complaint, on Postcomm's website.

Postcomm recognises that publishing timescales for investigations would help increase transparency, but it has to ensure it can meet these targets to make them meaningful. The complexity of a case, and the fact Postcomm has to date conducted relatively few investigations, means it is difficult to predict how long investigations will take. Postcomm does not think it is yet able to commit to a timescale.

Postcomm recognises that its processes have to take into account the pace of market developments. This needs to be balanced with due process. Postcomm would like to complete more investigations, to establish the most effective process for making a "good" decision, rather than producing a "quick" decision, which may not be well reasoned. Against this background, it is difficult to specify how long it will take to complete a full investigation.

However, Postcomm recognises the importance of timescales to the industry and so proposes the following:

- Postcomm will aim to complete the first stage of its investigation process, the preliminary assessment, within six weeks of receiving a complaint, and publish the scope of the investigation on its website after consulting all parties if proceeding to a full investigation;

- if a complaint becomes a full investigation, Postcomm will, wherever possible, give an indicative timescale of how much longer it will take to reach a decision, four to six months after the announcement of the scope of the investigation; and
- Postcomm will review its position on timescales periodically.

Given Postcomm's finite resources to investigate anti-competitive behaviour complaints it may be necessary to alter timescales to reflect case priorities. Case priorities will be determined by considering both the scale and significance of the possible problems outlined in the complaint and the prospect of obtaining evidence and finding remedies in relation to the complaint.

With respect to direct customer access, under the European Postal Directive customers must be allowed access to the network because the Directive places this obligation on the universal service provider in favour of "users" - which includes customers.

S3.7 Licensing/ Mail integrity regulations

Smaller operators and potential entrants are concerned at the cost implications of a one size fits all regime because of mail integrity procedures (criminal record checks, investigations etc) but primarily because of the level of the licensing fee, which they argued was too high and thus a barrier to entry.

S3.7.1 Postcomm's response

The issue of a different licence for small operators was raised as part of the recent consultation on a licensing framework in a fully open market.

Postcomm has reviewed this issue, and after careful consideration believes that at this time a different licence for small operators should not be considered on the basis that:

- the proposed licence (in a fully open market) has not been shown to be a barrier at this time;
- the proposed licence contains many carefully considered safeguards for the protection of mail and mail users and making any material change at this time would be seen as diluting these safeguards and could send the wrong message to the market; and

- Postcomm will be able to actively engage smaller operators and provide advice and guidance support to help them to operate under the proposed licence.

Postcomm will monitor the level of entry of smaller operators and will propose a consultation on a revised licence for these companies should the licensing framework be shown to be a barrier to entry regardless of the efforts made by all parties to get them to engage. It is envisaged that it will require a reasonable period of time to see if such a move is necessary. This will be considered in 2007 with a view to introducing any such licence around the time of the next licence review in 2008.

S3.8 Time taken to make regulatory decisions

A number of stakeholders argued that Postcomm needs to be more open and transparent in how it makes decisions, and that prolonged regulatory decision making creates uncertainty in the marketplace, thereby hindering the development of competition.

S3.8.1 Postcomm's response

Postcomm recognises that its processes have to take into account the pace of market developments. This needs to be balanced with due process. For any regulatory decision it is important to make a "good" decision, rather than produce a "quick" decision, which may not be well reasoned.

Postcomm consulted on its decision making process in 2003 and published a decision document in March 2004². This outlined revised consultation procedures which now include four types of consultation ranging from a full three stage consultation for significant regulatory decisions to a shorter consultation for routine issues covered by statute.

Postcomm will endeavour to be more transparent in its processes, and where possible introduce timescales. Postcomm is committed to reviewing its consultation processes in 2006 to see how and where it can increase transparency and timeliness.

² "Postcomm's consultation procedures review and modification – a decision document", March 2004. Available to download at www.psc.gov.uk.

S4. Other Key Concerns

S4.1 Impact of competition on the Universal Service

A concern expressed by small and medium sized companies (SMEs), social and vulnerable user groups, and trade unions is that the provision of the universal service may be jeopardised by competitors targeting the profitable routes which may cross subsidise the provision of universal services. There was also a lack of awareness of the safeguards Postcomm has in place to ensure the continued provision of the universal service.

S4.4.1 Postcomm's response

Postcomm's primary duty is to ensure the continued provision of the universal service. Royal Mail is the only organisation that currently has the infrastructure to meet the universal service requirements of the Postal Services Act 2000. This consists of the delivery and collection at least once every working day of mail (not exceeding 20kg in weight) and the provision of a registered and insured postal service, all at affordable prices that are geographically uniform throughout the UK.

Royal Mail under the terms of its licence has an obligation to provide a universal postal service and Royal Mail's quality of service targets and compensation scheme includes a number of products under the universal service obligation (USO) to ensure that service does not decline.

Postcomm will ensure Royal Mail can finance its universal service obligation. In the current Royal Mail price control, and proposals for the price control from April 2006, Postcomm has undertaken a thorough review of the costs Royal Mail incur to finance its regulated activities, including the universal service. This includes ensuring the price control is robust and flexible enough to accommodate the impact of a range of possible market developments.

Since the introduction of competition:

- Royal Mail has increased its efficiency and improved its quality of service; and

- The financeability of the USO has become increasingly healthy, with Royal Mail making a profit of £452 million³ from its regulated business in 2004/05.

The overwhelming majority of respondents to the competitive market review consultation said there has been **no detrimental impact on the USO from the introduction of competition**, and international experience of countries that have liberalised their postal market has shown no detrimental impact on their universal service requirements.

Postcomm is committed to continue monitoring the provision of the USO, and will promptly review the costs and benefits of the USO if any of the following happen:

- there is a serious prospect of Royal Mail's financeability being at risk;
- quality of service of USO products deteriorates; and/or
- there is a significant fall in Royal Mail's volumes.

Postcomm intends to develop leading indicators of the risks identified above in order to ensure it can respond rapidly to any emerging problems.

As part of its communication strategy, Postcomm will make clear that there are a number of safeguards (such as possible re-opening the price control) to ensure the continued provision of the universal service.

S4.2 Will smaller mailers benefit from competition?

A number of smaller user groups (particularly social and vulnerable user groups) were concerned that the benefits of competition would only be enjoyed by large customers. A number of stakeholders supported alternative providers being allowed to access the post office network to provide postal services.

³ Profit from operations

S4.2.1 Postcomm's response

Competition for large mailers has already improved quality of service generally to the benefit of all customers and this trend is expected to continue.

Postcomm began a project in June 2005 to look at the exclusive relationship between Royal Mail Group and Post Office Ltd. **Postcomm believes that access to the post office network could be a key feature of opening up successfully the postal market to full competition for the benefit of small businesses and domestic customers:**

- Postcomm is of the view that Post Office Ltd should give serious attention to the opportunities for post offices arising from full market opening;
- Postcomm urges alternative providers to approach Post Office Ltd, with a view to agreeing access to the post office network; and
- Postcomm would consider on an individual basis a request for an access determination to the network if a company fails to reach agreement with Post Office Ltd, although there could be legal difficulties in making such a determination.

The findings of stage one of this project are outlined in **Annex 2**.

S4.3 Inconsistent Royal Mail daily delivery times

One of the main complaints of SMEs (as last year) was that since the introduction of the single daily delivery, there has been no certainty when mail would be delivered.

S4.3.1 Postcomm's response

This issue was raised by stakeholders as part of the 2006 Royal Mail price and service quality review consultation. In its initial proposals document published in June 2005 Postcomm said it recognised that some users, such as small businesses, value receiving mail relatively early in the day and value consistency in the time of delivery.

Postcomm also recognises that requiring Royal Mail to deliver at certain times introduces a degree of rigidity to its operations and therefore its cost structure. Postcomm proposed that there should be a standard for the percentage of delivery

routes completed each day. However, Royal Mail should also measure and publish the percentage of deliveries completed each day by their stated delivery times.

If Postcomm becomes concerned that Royal Mail is clearly not acting in the interests of users, either by changing the time at which deliveries are made or by failing to deliver a significant proportion of the mail by the time stated, then it would consider proposing a licence modification. Postcomm also proposed a standard for the percentage of collection points that are served each day. Postcomm will issue its final proposals later in 2005.

S4.4 Royal Mail's complaints handling procedure

SMEs complained of inconsistency and poor handling of complaints by Royal Mail. SMEs want a simplified, transparent and consistent complaints procedure, with targets for handling complaints.

S4.4.1 Postcomm's response

Royal Mail's complaints handling procedure is covered by Condition 5 of its licence. Postwatch agreed complaints handling arrangements with Royal Mail through a memorandum of understanding, a guide to processes and a summary of agreed processes earlier this year. Postcomm will consider whether to publish these procedures once formally notified under Condition 5 of Royal Mail's licence.

Furthermore, the recent redesign of Postcomm's website (www.psc.gov.uk) now includes a "how to complain" section, which lists contact details for all licensed operators, as well as a direct link to the relevant part of the Postwatch website.

S5. Conclusions

Although the breadth of entry so far is encouraging, and entry through access arrangements has seen a significant rise in the past year, competition is still only in its formative phase due to a number of barriers to entry.

A reduction in the barriers to entry identified by stakeholders, and assessed in **Chapter 7**, is likely to encourage both the speed and level of competitive entry to the benefit of all customers.

S6. Postcomm's consultation and next steps

Postcomm invites views from stakeholders on the policy proposals contained in this document. **Responses should reach Postcomm by no later than 31 January 2006** (contact details can be found on p4 of the main document). Postcomm will publish its decisions in relation to the specific proposals in this document in early 2006. This consultation and a consideration of the responses to it will also help Postcomm formulate its Forward Work Plan for 2006/07.