2007

COMPETITIVE MARKET REVIEW + BUSINESS CUSTOMER SURVEY

SUMMARY DOCUMENT

UK POSTAL MARKET

POSTCOMM

THE UK POSTAL MARKET 2006/07

A summary of two market reports by Postcomm, the independent regulator of UK postal services.

This summary highlights the main points of two major annual publications from Postcomm about the liberalised postal market in the UK in 2007 – the *Competitive Market Review* and *Business Customer Survey*.

Printed copies of the full review and survey are available free from Postcomm at Hercules House, 6 Hercules Road, London SE1 7DB. They can also be viewed on Postcomm's website, www.psc.gov.uk

COMPETITIVE MARKET REVIEW

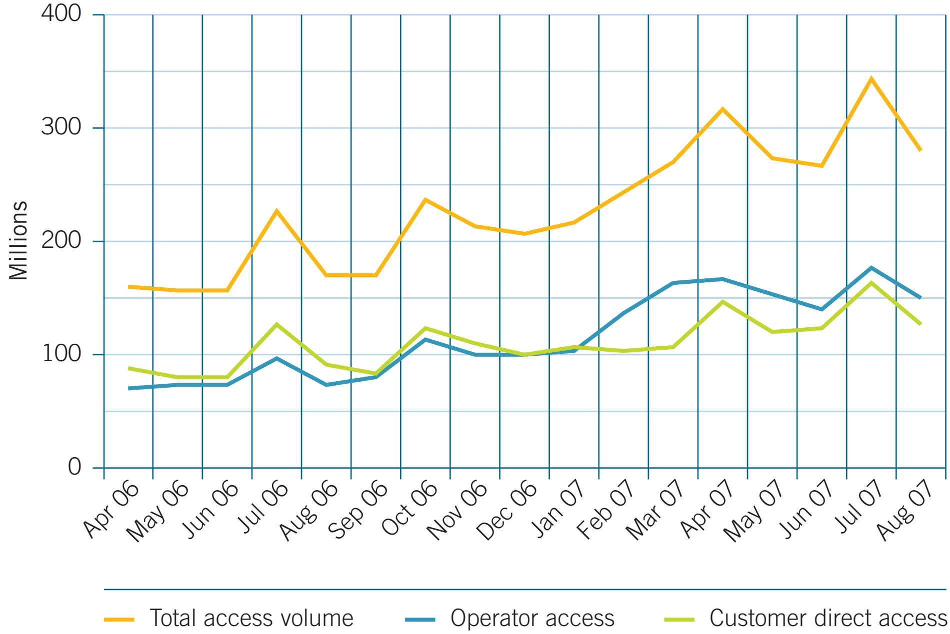
Market size and growth

The UK addressed mail market was worth around £6.6 billion in 2006/07. Mail volumes, at 21.9 billion items, were 2 per cent down on the previous year – the third consecutive year volumes have declined.[1] Media substitution may have caused the reduction in volume, but there are areas of growth that are helping to offset the decline.

Access agreements – where alternative operators or major customers collect and sort mail and pay Royal Mail to deliver it – accounted for 2.4 billion items in 2006/07. This represents 11.8 per cent of mail volumes – more than double the figure for the previous year. Access is still growing: between April and August 2007, access mail accounted for 19 per cent of Royal Mail's revenue-derived volume.

1 Based on Royal Mail operational volumes, including access. Includes all regulated and non-regulated mail, excludes door-to-door and international.

Figure 1 Monthly access volumes April 2006 – August 2007

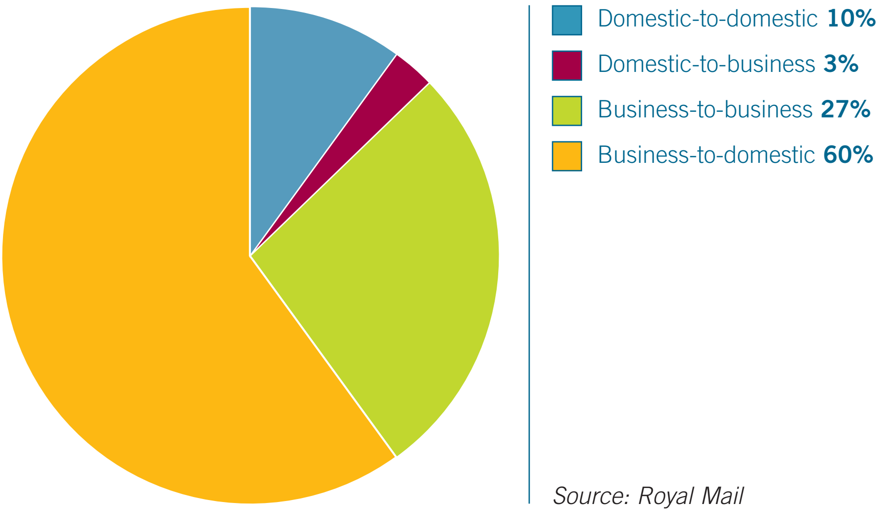


The number of end-to-end items of mail carried by alternative operators fell to 34.8 million in 2006/07, a reduction of around 4 million on the previous year.

Market segmentation

Businesses generate 87 per cent of all mail – mainly advertising, fulfilment, general business mail and transactional mail.

Figure 2 Mail flows, domestic v business



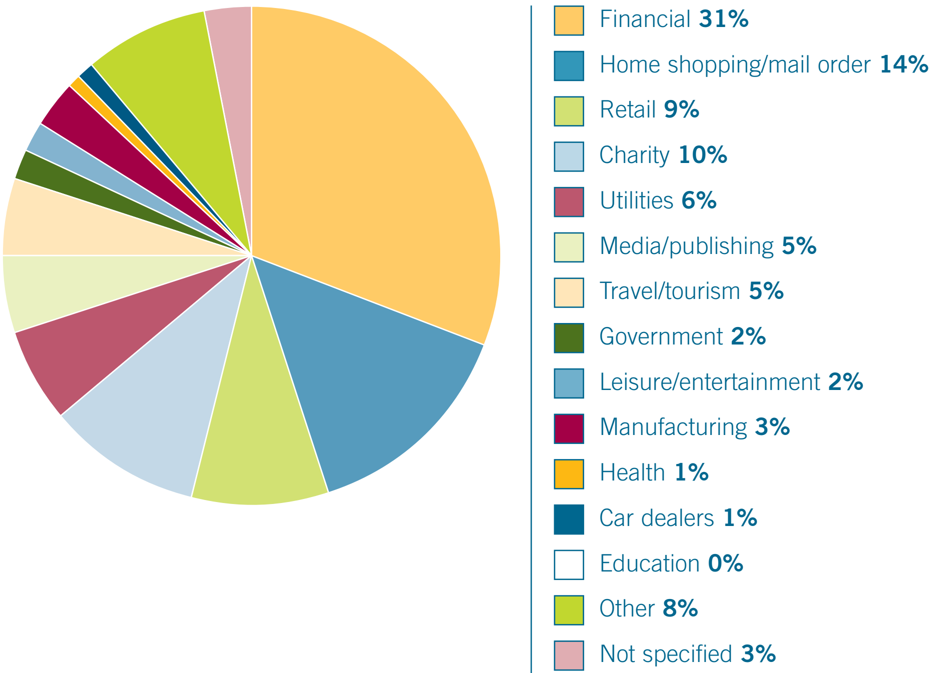
Source: Royal Mail

Despite a decline of around 2 per cent in overall direct mail volumes there are indications that, in some sectors, direct mail is growing.

Royal Mail has pointed to strong growth in certain market sectors. In the last quarter of 2006, for example, direct mail spend from building societies grew by 18.8 per cent on the same period in 2005 (included in Financial in the chart opposite), while the charity sector was up 9.1 per cent, government by 6 per cent and health by 5.7 per cent.[2]

2 'Royal Mail accentuates positive as mail volumes dip', *Precision Marketing*, 30 August 2007

Figure 3 Consumer direct mail volume share by sector 2006 (%)



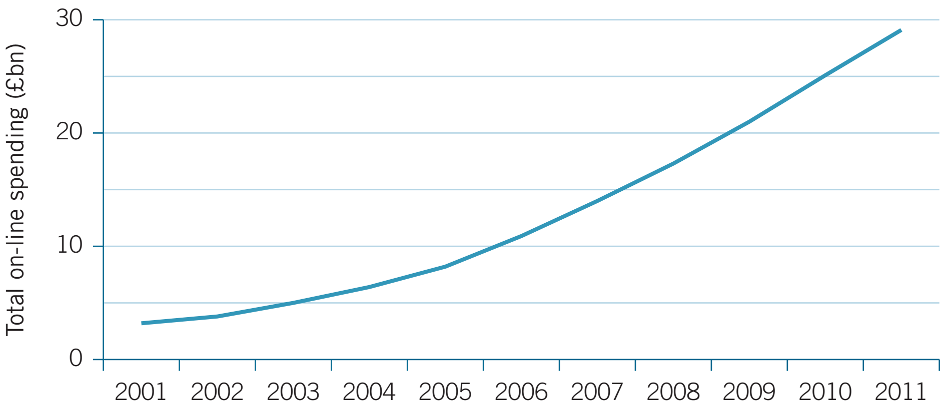
Source: DMIS

However distinctions between advertising and transactional mail are beginning to blur and are making trends in this area difficult to measure.

Transactional mail is estimated to be declining by around 2-3 per cent per year as more businesses encourage customers to receive their bills and statements on-line. Some of the decline is predicted to be offset by household growth and mail generated by internet sales. Using blank spaces on transactional mail for advertising may extend the life of transactional mail.

Fulfilment and publications are potential growth areas. E-retail is a key driver of growth in fulfilment mail, and e-retail sales are expected to continue to grow strongly (see Figure 4), which is driving growth in small parcels and packets. In publications, customer magazines have the strongest growth potential. Mintel estimates more than half of all posted magazines are customer titles and that in 2005 the industry spent more than £350 million on postage.

Figure 4 e-Retail market size 2001/11



Source: Verdict Research, UK e-Retails 2007

Mail operators

In September 2007 there were 18 licensed mail operators including Royal Mail. During the year Postcomm awarded two new long-term licences, and the UK mail market now has its first franchised operator. At present, end-to-end networks operate mainly in niche markets, although there is potential for them to grow.

Liberalisation of the market has brought an increase in specialists who offer advice and services to companies to enable them to get the best value from their spending on mail.

A recent development is the introduction of hybrid mail services. Customers send messages by email to a remote centre near the destination where a print provider turns the email into a document that is then delivered locally. Still in its infancy, hybrid mail may help companies by saving staff time dealing with outgoing mail, and the environment by reducing heavy lorry mileage.

Royal Mail's performance

Royal Mail's financial performance in 2006/07 was weaker than in the previous year. Operating profits (before exceptionals) fell to £194 million from £344 million a year earlier as a result of increased costs, falling mail volumes and constant revenues. In its regulated area, Royal Mail recorded operating losses of £29 million compared to a profit of £168 million in 2005/06.

Royal Mail's performance against the service quality targets in its licence continued to improve. In 2006/07, Royal Mail achieved 11 out of 12 of its targets (which were revised in 2006), compared to 10 out of 16 in 2005/06.

European markets

Liberalised European postal markets tend to have stable mail volumes with nationwide competition in delivery. Competitive market shares range between 8 per cent and 12 per cent in Germany, the Netherlands and Spain, all of which have had elements of liberalisation for several years.

VAT

Royal Mail is exempt from charging VAT on prices for its postal services, whereas alternative mail companies have to apply the full rate of 17.5 per cent to their prices. The European Commission believes that the UK – along with Germany and Sweden – has not properly implemented the VAT Directive on Postal Services and has begun infringement proceedings against these countries. These proceedings are ongoing and Postcomm is not a party to them.

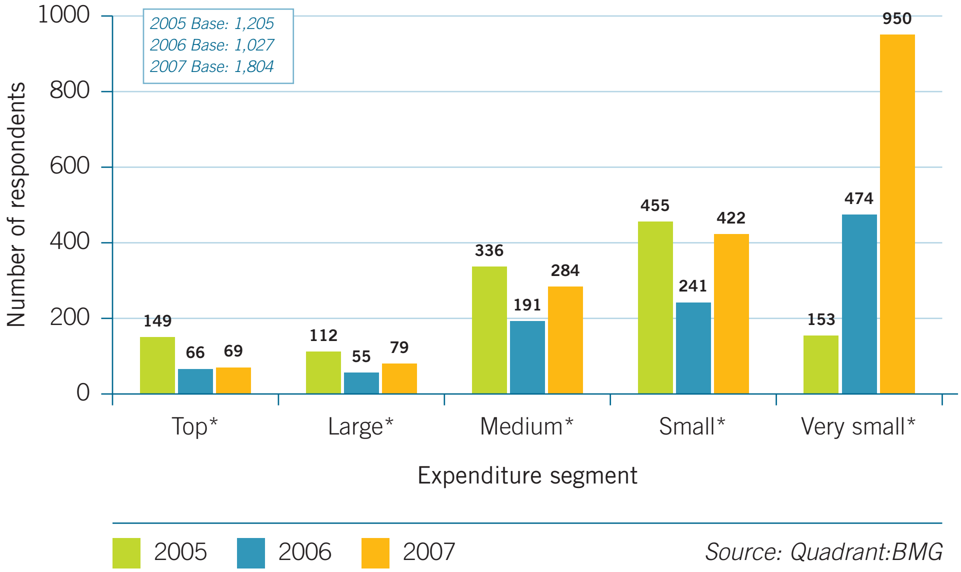
Environment

Environmental concerns range from pollution caused by heavy vehicles trunking mail long distances, to the amount of waste generated by poorly-targeted direct mail.

BUSINESS CUSTOMER SURVEY

This year's survey builds on similar surveys conducted in 2005 and 2006. At 1,804 respondents, the 2007 sample is almost 50 per cent more than last year (1,213). As Figure 5 shows, the number of respondents across all size bands has increased from last year.

Figure 5 Distribution of survey respondents by expenditure segment, 2005, 2006 and 2007



Source: Quadrant:BMG

The research, conducted for Postcomm by Quadrant Consultants and BMG Research set out to understand:

- Business customer needs;
- The characteristics of the mail market;
- What drives customers' switching behaviour, including substitution and customers' views on competition;
- Business customers' views on market developments, including innovation and efficiency;
- Views on the service provided by Royal Mail and alternative providers;
- Business customers' views on specific policy issues such as access arrangements and zonal pricing;
- Business customers' views on Postcomm.

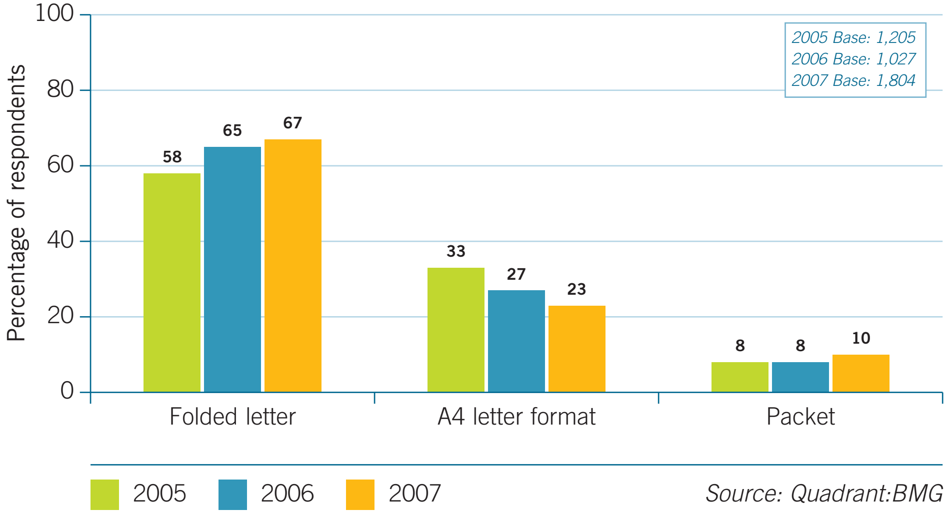
In the second year of a fully liberalised market, the research found that mail providers are improving their services and that business customers have a clearer view of what meets their needs.

Evolution

This year's survey revealed a change in mailing format for the second year in a row, with a further shift from the A4 format towards a folded letter format, indicating the impact of Royal Mail's Pricing in Proportion formula which was introduced in August 2006.

* Expenditure segment definitions: Top, spend on post = £500,000 plus pa; Large, spend on post = £200,000-£500,000 pa; Medium, spend on post = £30,000-£200,000 pa; Small, spend on post = £10,000-£30,000 pa; Very small, spend on post = £5,000-£10,000 pa.

Figure 6 Dimensions and size of items sent by businesses, 2005, 2006 and 2007



Source: Quadrant:BMG

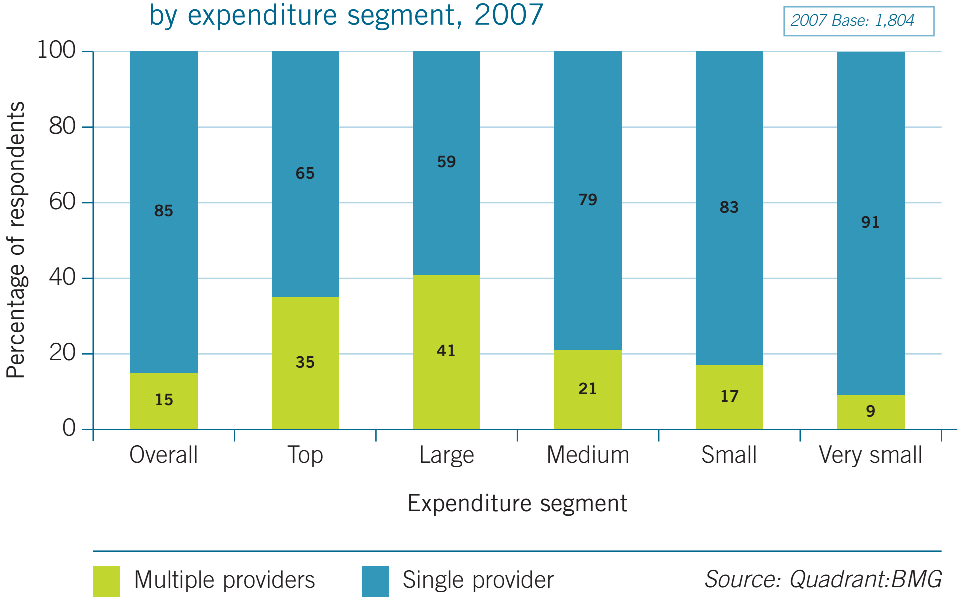
Use and awareness of alternative operators

Unlike electricity, gas and some parts of the telecoms market, where supply can be wholly and simply moved, the postal market offers the opportunity for customers to multi-source. This is likely to be the pattern in the business mail market for some time.

At the time of the survey the mail market had been fully liberalised for 18 months. Customers told us they felt they had competitive choice, access to market information and few barriers to moving mail.

Of all respondents, 15 per cent used more than one provider. It is worth noting, that among larger mailers, 35 per cent are using more than one mail operator, and competitive choice appears to be expanding to smaller businesses, with 17 per cent of small mailers using more than one provider.

Figure 7 Usage of single/multiple mail providers, by expenditure segment, 2007



Source: Quadrant:BMG

This year there was greater awareness of the better known mail service providers, with 64 per cent of larger mailers mentioning the most highly recognised brand.

Two-thirds of customers thought they could obtain provider information easily, although only one in four thought they could easily access core information such as comparative costs.

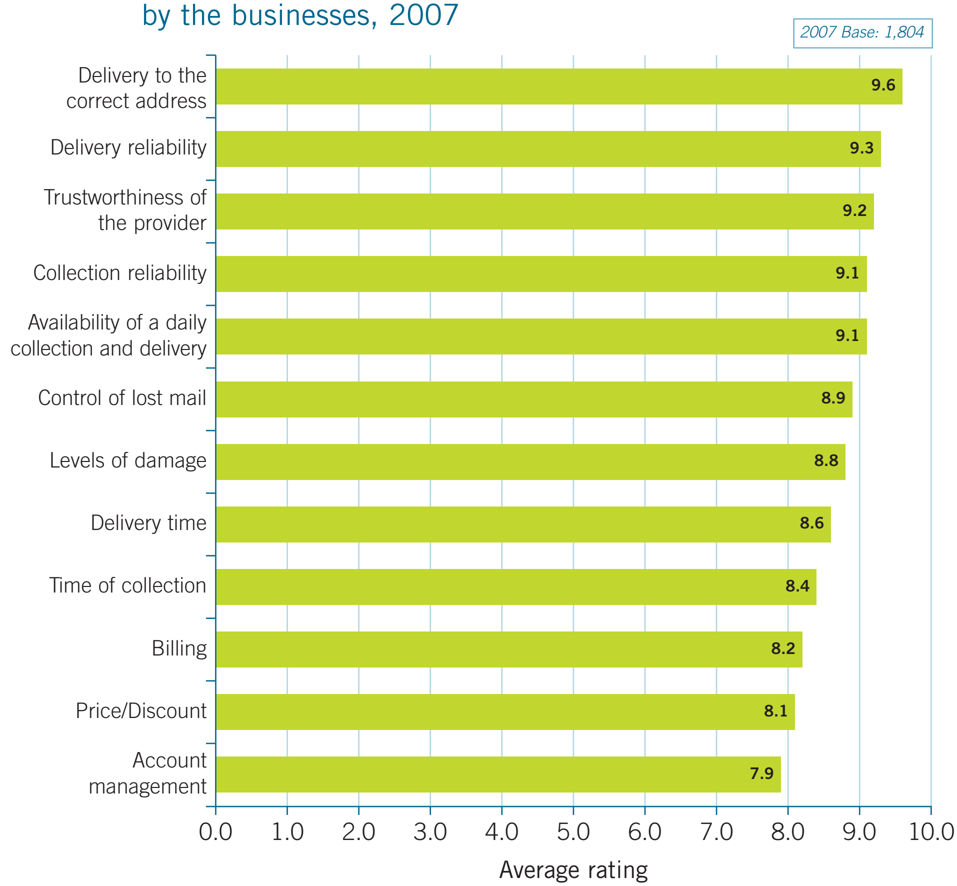
In the changing market one of the key features is the control businesses are exercising on mail spending. There has been a marked shift to different formats since Pricing in Proportion, and more use of digital options.

Service quality

All providers, including Royal Mail are perceived to have improved their quality of service since last year.

The most important service attribute was reliable delivery and collection. These were rated higher than price, billing and account management.

Figure 8 Rating of factors considered important for quality of services by the businesses, 2007



Source: Quadrant:BMG

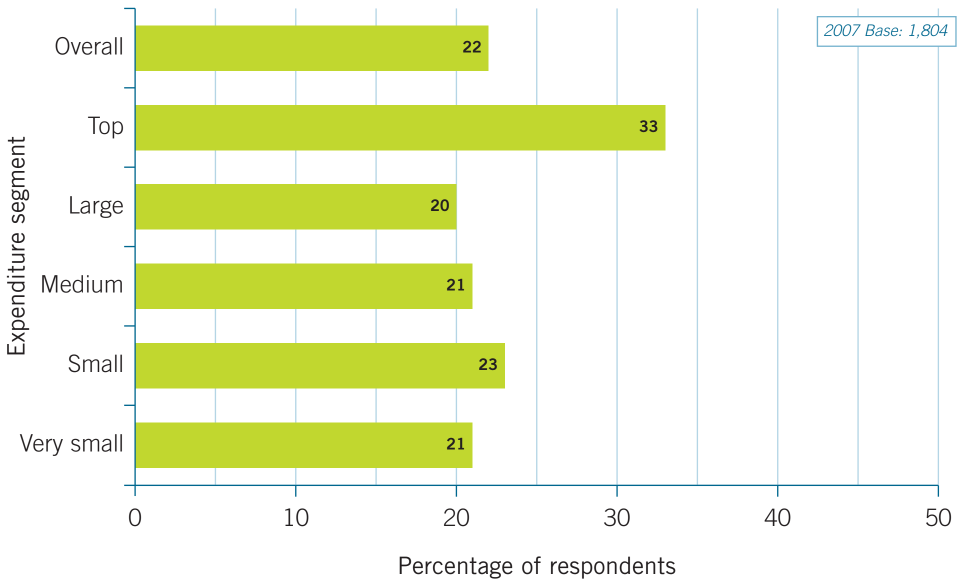
The five leading providers have consistent strengths on trustworthiness and reliability of collection.

Substitution

More than one in five (22 per cent) of respondents have moved some of their mail to other media over the past 12 months:

- Email accounted for more than 80 per cent of the substitution;
- Most substitution (54 per cent) involved individual, single-piece items; 39 per cent was transactional mail and 21 per cent was direct mail.

Figure 9 Migration to other forms of media, by expenditure segment, 2007

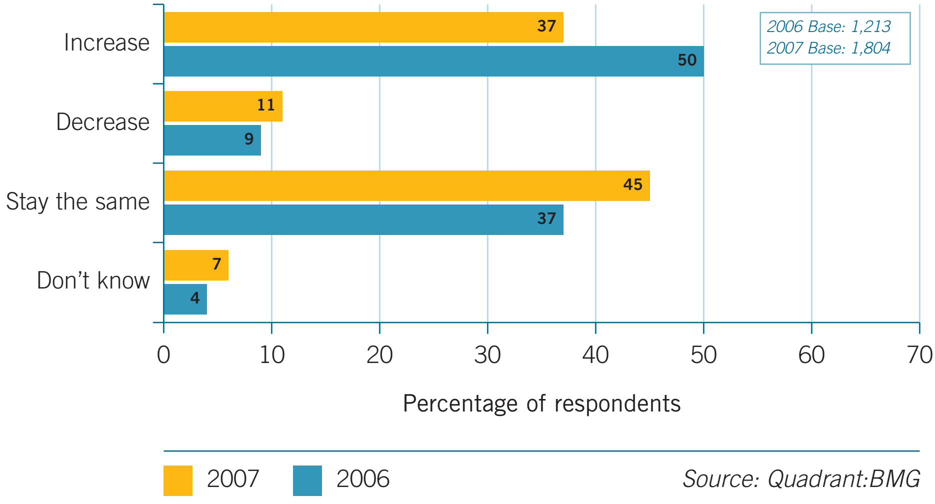


Source: Quadrant:BMG

Volume

Nearly half of organisations anticipate no change in mail volumes over the next five years; however 37 per cent of all respondents expect mail volumes to increase. Growth estimates range from 20 to 29 per cent. Of the respondents (11 per cent) that anticipate decreased volumes, the largest single factor – notably among advertising mailers – is the poor effectiveness of mail compared to alternatives.

Figure 10 Predicted change in mail volume over the next five years, 2006 and 2007



Source: Quadrant:BMG

Views on competition

Almost half of respondents (47 per cent) say they would never move from Royal Mail to another provider – a marked increase from 31 per cent in 2006. The increase is possibly because of the large number of small mailers in the sample who are less aware, less informed, and not yet targeted by new providers to the extent that large mailers have been. Smaller businesses also tend to value continuity and assurance as much as price.

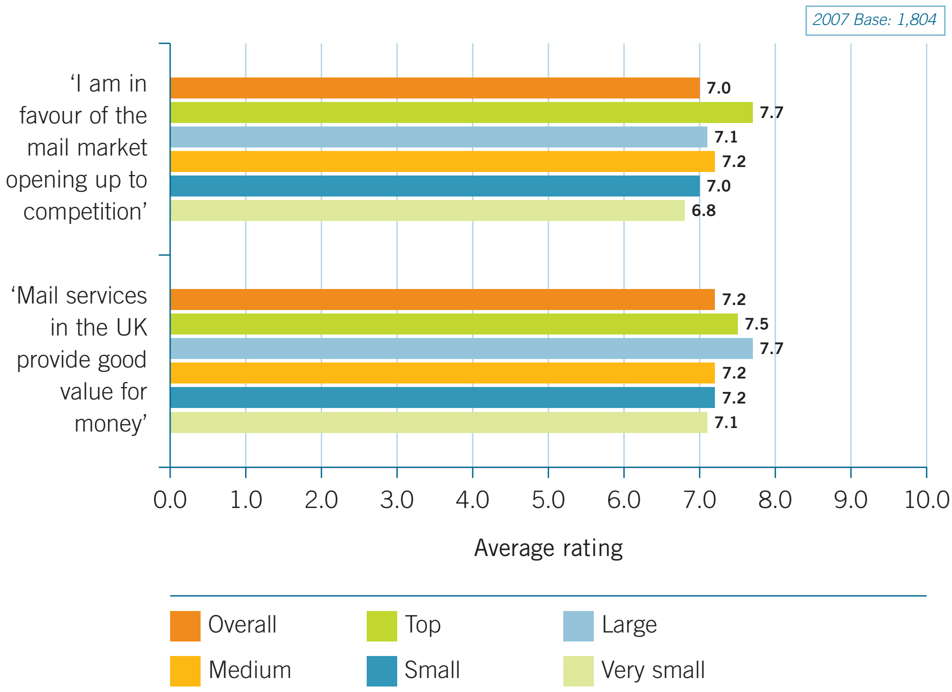
Of the top and large mailers, nearly 20 per cent say they intend to move mail away from Royal Mail in the next 12 months.

Most respondents prefer an operational model in which one company provides collection, sorting and delivery.

Customers believe competition has improved their choice of supplier and improved Royal Mail's quality of service:

- More than half (54 per cent) agreed that competition has improved choice (up from 38 per cent last year);
- 39 per cent believe competition has improved Royal Mail's quality of service (34 per cent last year);
- 15 per cent believe competition has resulted in significantly lower prices (down from 20 per cent last year);
- When asked to rate the statement 'I am in favour of the mail market opening up to competition', the rating was 7 out of 10. 'Mail services in the UK provide good value for money' achieved 7.2 out of 10.

Figure 11 Business customers' attitudes to mail market opening and mail value for money, 2007

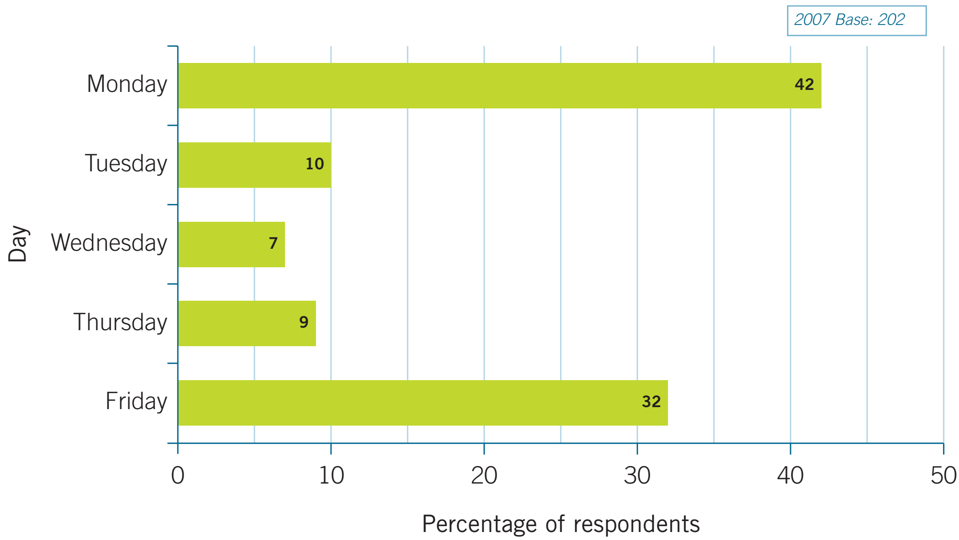


Source: Quadrant:BMG

Views on policy issues

Collection and delivery. Attitudes about the most important days for mail collection varied with the size of the mailer. Smaller mailers rated Monday and Friday, while large mailers often said Tuesday or Thursday. Almost three quarters (72 per cent) of respondents said they do not require a 6-day-a-week delivery to their recipients. The most important day for delivery was considered to be Monday, the least important, Saturday.

Figure 12 Most important day for collection, 2007



Source: Quadrant:BMG

Zonal pricing. 45 per cent of bulk mailers surveyed were aware of Royal Mail's zonal pricing proposal and of these 15 per cent said it would increase their mail expenditure.

Access. Most correspondents believe Postcomm should mandate an access code and 68 per cent believe Postcomm should control access prices.

Views about Postcomm

Across all customers Postcomm's performance is rated more highly for the protection of the interests of customers and the universal service and relatively less for the promotion of competition, although both are high.

Most business customers are sufficiently aware of Postcomm to know how best to ask Postcomm for service, advice or assistance.

There is a clear preference – 53 per cent of respondents – for Postcomm to maintain a role in controlling prices in the market and to continue to do so in the future.

Equally, a sizeable proportion of the business market expects that competitive pressure will be sufficient to control prices in future. This implies a growing confidence in self-determination among business users.

NOTES

This publication can also be viewed on Postcomm's website at www.psc.gov.uk

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