

# postwatch

## **Response to Postcomm – Competitive Market Review (CMR)**

This year's CMR is of great importance as it will inform the nature of the next price control and guide Postcomm in its decisions on facilitating and fostering competition over the short term. Competition remains the key to customer choice, innovation and better quality of services and prices.

In the period since the last CMR the market has changed little - competition is still developing slowly, companies seeking licences are often small local operators and the focus remains on down stream access as the best hope for a competitive market.

Many of the reasons we gave last year to explain the lack of competition persist. In particular:

- Barriers to entry such as those identified by Postcomm, the most important of which is Royal Mail's VAT exemption;
- The attractiveness of the Royal Mail brand;
- Lack of information about competitors and their products;
- Unwillingness to move to a new operator unless someone else has done so first - although we believe that this is easing as customers switch to access;
- Royal Mail economies of scale and scope.

Furthermore, the regulatory challenges facing Postcomm identified last year remain:

- The absence of an access code which would provide fair, transparent and non-discriminatory terms and conditions for third party access to Royal Mail's pipeline. Price controlling access will mitigate the impact of this challenge but in the absence of management separation of Royal Mail, a code is desirable in the long term because it will provide more certainty than a four year price control;
- Royal Mail's VAT exemption and other barriers to entry. We believe that competition is unlikely to develop with any great pace while the VAT differential remains.

In addition, a number of issues have become clearer, the impact of which have made fully effective competition difficult. These are outlined in turn below.

## **Barriers to fully effective competition**

### Royal Mail's pricing behaviour

The freedom given to Royal Mail to change prices has increased the pressures on operators and made it more difficult for them to compete, particularly in the downstream access part of the market. Postcomm has itself acknowledged this in seeking to control the headroom between access prices and the relevant retail tariffs.

In addition, a number of Royal Mail initiatives – such as PiP and the Product Roadmap have been trialled by Royal Mail for introduction at the same time and to coincide with the new price control. We believe that an effect of this, intentional or otherwise, will be to sow confusion and make it more difficult to understand what prices will be.

The real danger is that Royal Mail will suffocate the competition slowly over time but that this will not be apparent until it is too late. To guard against this we urge Postcomm to take a longer view than is afforded by year on year assessments by assessing the likely effect of each regulatory proposal on competition. Postcomm has already started to do regulatory impact assessments, which are extremely helpful in placing proposals in context but these are not always carried out. For example, a full assessment of the impact of Postcomm's proposals on Pricing in Proportion on competitors was not carried out. Instead Postcomm relied on the fact that greater cost reflectivity would help the development of sustainable competition at an aggregate level. We would therefore expect to see a more detailed assessment of how the final decision will impact on the development of competition.

### Postcomm's approach to regulation

Postcomm wishes to de-regulate 'where possible', which we take to mean that de-regulation will occur where competition has developed to meet the needs of users on the application of a competition test. In line with this Postcomm has proposed in its initial proposals for the price control to remove two products from the price control. While we do not disagree with the principle we believe it is too early in the market's development to consider de-regulation because competition is not strong enough to restrain Royal Mail's behaviour.

In addition, Postcomm seems determined to continue with its policy of allowing new products to remain outside the control. In these circumstances, if the Product Roadmap succeeds in providing products that meet customer needs Postcomm could end up regulating very little of Royal Mail's revenue as customers may simply abandon the price controlled products and switch to the new products which would automatically be outside the control. Royal Mail would have the freedom to set prices and quality levels as it wishes for the products outside the control but the level of competition would not be sufficient to restrain Royal Mail's behaviour. This degree of reliance on general competition law at this point seems extremely premature.

If Postcomm genuinely believes that competition has developed sufficiently at this stage to either remove products from the price control or in the case of new

products to rely on competition law, then we would expect the CMR to demonstrate that competition has developed significantly and that it will constrain Royal Mail's behaviour. If it does not and Postcomm does not change its proposals then Postcomm will be inconsistent in its approach to regulation.

#### Innovation and the lack of E-2-E competition

As expected operators have focussed on upstream operations through access agreements. This trend, in addition to other barriers to entry, has limited innovative service offerings available to customers. Until other operators are able to compete effectively throughout the market place, innovation is likely to be sluggish.

We believe that innovation should be driven by customer need and that competitors are much more likely to innovate in response to customer needs than Royal Mail. We do not regard Royal Mail's new product strategy as 'innovation' - Royal Mail appears to have developed a new product range and then consulted customers about it rather than consulting customers as to their needs first.

#### **Future Expectations**

Postwatch does not expect a major change in the market share held by Royal Mail's competitors over the next twelve months, even with full market opening on January 1. Barriers to entry are still significant; therefore in order to make competition effective we believe there are a number of regulatory measures that Postcomm could action over the course of the coming year.

#### Access to the post office network

At the moment competitive alternatives are mainly available to large users but social and small business users have no real choice of supplier and due to barriers to entry there is little evidence that competitors will provide alternative mail services in this part of the market. Small business users do not have the volumes necessary for the access products being offered at the moment and providing mail to social users would require an extensive collection network which would be expensive to build and most likely uneconomic to run. We believe that the most immediate way to increase choice for all users is to encourage mail carriers other than Royal Mail and Parcel Force to use post offices both as collection and delivery points.

The UK's 14,600 post offices form the largest retail network in the UK. Access to these branches offers postal operators a path direct to the centre of communities, whilst bringing social and small business customers more choice. Incoming postal operators would not only benefit from the location of post offices but also the counter staff's understanding of customers needs. This knowledge is particularly important for those posting high value or urgent items.

The post office network brings basic communication and financial services to the majority of communities in the UK. Postwatch is concerned that competition in the postal industry could act to the detriment to those customers who are already disadvantaged through age, health or location if competition in the mail industry weakens the viability of the post office network. It would therefore welcome the

addition of competing postal products to post offices both to bring choice to social and small business customers but also to ensure equity of access to postal services throughout the UK.

We understand that Royal Mail Group does not have any agreements in place between Post Office Limited and the rest of Royal Mail Group, which would prevent Post Office Limited from dealing with other parcel carriers. Any such agreement may be anti-competitive. From a regulatory point of view we believe that access is facilitated by Condition 9 of Royal Mail's licence as 'postal facilities' includes the post office network.

Postwatch would welcome regulatory measures that would encourage other parcel carriers to use the post office network. Postcomm must be proactive in establishing how access may be facilitated; as such certainty will encourage parcel operators to seek access. It will also be important for Postcomm to put forward its view of what terms and conditions may be appropriate in order to avoid protracted bilateral discussions between POL and parcel operators.

#### Access pricing and separation

We agree with Postcomm that access prices should be controlled and will be submitting our views to Postcomm on its proposals for price controlling access in due course.

Furthermore, we believe the current access price is too high and should be re-examined. The development of effective competition may therefore require bolder regulation in the form of management separation of the Royal Mail pipeline. This should make commercial sense for Royal Mail and provide a way for the company to get to grips with their own costs. We have previously submitted our views to Postcomm as to the form separation could take. In the coming months we ask Postcomm to undertake formal evaluations of separation arrangements alongside its proposal to price control access.

#### Monitoring Royal Mail's behaviour

Condition 7 of Royal Mail's licence allows for the provision of information to allow Postcomm to monitor Royal Mail's behaviour. At present, the wording of the condition is fairly vague and lacking in detail. In the context of its price control proposals Postcomm has proposed re-examining the utility of the condition. We will respond more fully on this question in due course but we believe condition 7 is an important tool, which should not be discarded.