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## **Postcomm's Competitive Market Review: Request for Stakeholders' Views**

This document is Royal Mail's response to Postcomm's request for stakeholders' views on how the postal market is developing and what else could be done to promote effective competition while ensuring customers continue to benefit from a universal service.

The response considers each of the questions listed in Annex B of Postcomm's letter to stakeholders in turn, excluding those questions specifically labelled as being for Operators or Customers. Indeed, even many of the questions not so labelled are primarily aimed at new operators or customers. Royal Mail's response to these questions is brief; more extensive answers would not be useful or appropriate.

Royal Mail has no objection to this response being made available to other interested parties.

The roman numerals used below refer to the question numbers in Annex B of Postcomm's letter to stakeholders.

### **i Development of competition to date**

The first phase of Postcomm's liberalisation programme commenced on 1<sup>st</sup> January 2003 when 30% of the UK letters market by value was opened up to licensed competitors. To date, following eighteen months of open competition, only six companies (in addition to Royal Mail) have applied for a Standard Licence, and not all of these are active in the market place.

Royal Mail considers the principal reason for this limited activity is the uncertainty about the commercial environment facing postal operators, including Royal Mail. Uncertainty is a normal characteristic of competitive markets, but the recent degree of uncertainty in the postal sector has been exceptional, affecting fundamental aspects of the business. Royal Mail has found making business projections and, consequently, strategic decisions particularly difficult during this period. Many new operators, especially those considering investments to support their business plan, will have delayed decisions until they can be made with more confidence.

Much of this abnormal uncertainty is a direct result of the time required for key regulatory decisions. Some of this time is unavoidable: fundamental decisions about the operation of the postal market should not be unduly rushed and, despite the time required, Royal Mail supports Postcomm having a consultation process. However, the process, especially the final decision, is often subject to delays, sometimes for many months. This creates uncertainty about the nature of the postal services market in the UK which has undoubtedly contributed to the comparatively slow development of competition.

Key uncertainties in the business and regulatory environment since the first phase of Postcomm's liberalisation programme commenced in January 2003 include:

- Royal Mail's terms and tariffs for Condition 9 Access and, in particular, the differentials between Condition 9 tariffs and end-to-end tariffs. This relationship is fundamental to the formulation of business strategy for both new entrants and Royal Mail.
- the products and services within the Universal Service, still undecided for bulk mail products even after publication of Postcomm's June 2004 Decision Document.
- the nature and extent of the next stage of liberalisation. While Postcomm's "*firm commitment to an orderly transition towards full-market opening*", the four year, three phase programme clearly defined in their May 2002 Decision Document is now up for review.
- the absence of a decision on Size Based Pricing, still not imminent Following Royal Mail's formal proposal in August 2003;
- the 2006 Price Control Review: until new entrants know the outcome of this review they will be concerned that Royal Mail's tariffs may be forced so low that there is no scope for competitive prices at a profitable level, In a market of reducing value.

## **ii Price Control coverage**

Royal Mail continues to believe that formal price control should be restricted to services which may not be offered without a licence. These services have restrictions on full competition and it is sensible to ensure that the extent of

competition permitted is supported by effective regulation until full competition is introduced. Royal Mail also accepts that services not requiring a licence, but part of the Universal Service, should be subject to an affordability test, but does not believe these services should be subject to any other price control.

Royal Mail believes it is important to establish criteria for a “Competition Test” so that, as soon as Royal Mail demonstrates that a product or service meets these criteria, it will be removed from price control. The criteria should recognise that, even in a competitive market, it is possible for a company to retain a high market share.

**iii, iv and v** These questions are labelled as questions specifically for (new) operators or customers.

**vi and vii** Although not labelled as for third parties, these questions ask for views on how Royal Mail is responding to competition and regulation. It does not seem appropriate for Royal Mail to comment on our own performance.

### **viii Competition’s effect on provision of a Universal Service**

To date, competition has not adversely affected Royal Mail’s provision of the Universal Service. Royal Mail is committed to ensuring that there is no detrimental effect in the future.

However, just as, to date, the development of competition and Royal Mail’s loss of market share have been much slower than expected, it is equally possible that, at some indeterminate point in the near future, they will accelerate rapidly. Royal Mail expects that rapid acceleration could be triggered by reduced uncertainty about the market.

If Royal Mail does experience a sudden loss of market share, probably concentrated in its most profitable services, the resultant rapid loss of revenue and margin would threaten the financial viability of the provision of the Universal Service. It is essential that the Competitive Market Review considers this possibility and establishes safeguards which will guarantee funding for the Universal Service in all reasonably likely eventualities.

### **ix Future development of competition**

Views about how competition will develop are inevitably speculative, but Royal Mail would expect to see:

- a steady growth in competitive activity;
- initially with relatively limited volumes, but a rapid expansion in new entrants’ market share with reduced regulatory uncertainty;

- This activity is likely to be focused on specific market areas

#### **x Access or end-to-end?**

The principal driver behind entrants' decision to concentrate on end-to-end or "upstream only" services will be the differentials between Royal Mail's access and end-to-end tariffs. The lower being the access price, the wider is the differential with end-to-end tariffs and the fewer the expected number of entrants who offer end-to-end services.

Any analysis of Access must not only take into account entrant access but also customer direct access.

**xi** This question is specifically for (new) operators.

#### **xii Restrictions to the development of competition**

The downward regulatory pressure on Royal Mail's tariffs is restricting the development of competition. The sub-inflation increases required by the current price control limit competitors' scope to set prices that are both competitive and profitable.

Competitors also face the risk that, from April 2006, Royal Mail's new price control may be even more severe, thereby giving them even less scope to compete profitably.

#### **xiii Ring-fencing different parts of the business**

The EU Postal Services Directive already requires separate accounts for the non-reserved services for Universal Service and non-Universal Service. Royal Mail's Licence already requires separate accounts for regulated services and prevents Royal Mail from obtaining any unfair commercial advantage from its provision of access services.

Royal Mail cannot see how further separation of its business activities would aid the development of competition or benefit customers.

#### **xiv Has Postcomm's approach been effective?**

The competitive framework is in place. Once the uncertainties listed in the response to question i above are removed, and the credibility and awareness of the new entrants improves, the development of competition will accelerate.

## **xv Reducing the 4,000 item threshold**

Royal Mail thinks that Postcomm should continue to follow its previously announced strategy and, in April 2005, the bulk mailing threshold should be reduced to open up a further 30% of the inland letter market, by revenue. This is the "Intended market opening" announced in Postcomm's May 2002 Decision Document, and the one that postal operators, including Royal Mail, have been expecting and planning for. This would provide reassurance to the market that there will be stability and continuity of policy making enabling long term planning to take place, both for competitors and customers

## **xvi Amending the "single customer, single site, same format" requirement**

Postcomm introduced the "single customer, single site, same format" requirement to reduce the risk of the 4,000 threshold opening up more than the intended 30% of the inland letter market to competition.

This risk of opening up more of the market than intended will still exist in 2005, even if the "intended percentage" has increased to 60%. As already discussed in the answer to question **viii** above, at some point a rapid acceleration of competitor activity is likely. Indeed one of the changes to the commercial environment that could lead to such an acceleration is the start of phase 2 of Postcomm's liberalisation programme.

It is, therefore, essential to retain the "single customer, single site, same format" requirement for the second phase of liberalisation. This will help ensure the market is opened up as intended and safeguard the provision of the Universal Service.

## **xvii Liberalising business-to-business mail**

Liberalising business-to-business mail would open up competition in the most competitive segment of the market and lead to a more rapid opening of the market than has so far occurred. However it would have a disproportionate effect on Royal Mail's profitability and could potentially put universal service provision at risk.

Royal Mail addresses the above five points collectively below.

**xviii Extending competition by product type,**

**xix Fully opening the market to competition,**

**xx Risk to the Universal Service,**

**xxi Opening the B2B sector in 2005; full liberalisation in 2006, and**

**xxii Other options.**

Extending competition by product type is another practicable alternative to reducing the 4,000 bulk mail threshold. In practice, the products most likely to be opened up to this form of competition are pre-sort products, particularly mailsort. However, these are already, in practice, liberalised because of the 4,000, entry threshold for use of these products.

Royal Mail objects to full liberalisation, or anything similar, ahead of the clearly defined liberalisation programme in Postcomm's May 2002 Decision Document.

Changing the "Intended market opening" programme half way through without compelling reasons will inevitably add to the already excessive uncertainty in the market. Operators, including Royal Mail, have been planning ahead on the basis of the intended programme. Changing the programme at this stage not only affects these plans, but reduces confidence in regulatory decisions, further increasing uncertainty about the business.

Furthermore, introducing full liberalisation earlier than intended is bound to increase the risk to the provision of the Universal Service. As already stated, the development of competition to date is not necessarily indicative of how it will develop in future, especially as the commercial environment becomes clearer to competitors.

When the Competitive Market Review considers alternative market opening strategies it is essential that it evaluates the likely effect of each strategy on the performance of new entrants, on Royal Mail's revenue/margins and on the financing of the Universal Service.

### **Other Comment**

Finally, Royal Mail notes from Annex A that Postcomm has "*commissioned a detailed survey of non-residential customers to identify their needs, experiences and likely future switching behaviour to inform its CMR.*" Royal Mail supports the principle of customer research in general, and this survey in particular: improved understanding of customers and their behaviour leads to better-informed regulatory and business decisions. However this process must be impartial and transparent, taking into account the views of all customers.

Royal Mail  
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