



**POSTCOMM'S
COMPETITIVE MARKET
REVIEW
2005:**

**ROYAL MAIL'S
RESPONSE**

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POSTCOMM'S COMPETITIVE MARKET REVIEW, November 2005

ROYAL MAIL'S RESPONSE

Royal Mail is pleased for the opportunity to put on open record its comments on Postcomm's 2005 Competitive Market Review (CMR).

Royal Mail generally supports Postcomm's vision of a reliable, efficient and innovative postal services market, with Royal Mail as the universal service provider. However, Royal Mail has some reservations about Postcomm's approach to facilitating the achievement of this vision, primarily a result of their exaggerated perception of the threat to competition from barriers to entry. These will be covered later in this response.

Chapters 2 and 3 of the CMR are a useful analysis of the UK postal market and how competition is developing within it. Royal Mail generally agrees with the findings, in particular that "*competitive entry is gaining momentum*" and that "*Access volumes have also increased significantly, particularly since May 2005.*" Indeed, it is worth noting that, since the CMR was published, both these trends have continued, and at an accelerated rate.

Similarly, the improvement in quality of service identified in Chapter 5 has continued since the CMR was published. Chapter 5 also notes that "*Royal Mail's financial performance continued to improve in 2004/05*" and, as a result of this strong financial performance, "*the financeability of the universal service is therefore increasingly healthy.*" This was true in 2004/05, but historical financial performance is not necessarily a guide to future performance. If Royal Mail's financial performance continues to improve, the universal service will continue to be secure. However, this cannot be taken for granted, especially given the expected volatility of Royal Mail's volumes in a liberalised and declining market. The need to provide safeguards against the risks to the universal service in a liberalised market was identified by several of the respondents to Postcomm's Stakeholder survey.

Chapter 7 identifies several potential barriers to the development of effective competition, and how Postcomm intends to respond to them. Each of the significant barriers will be considered in turn:

Customer Inertia/Lack of awareness

Postcomm's 2005 business customer survey identifies some specific gaps in customers' knowledge of the competitive market but, overall, shows that the majority are aware of the competitive market, that awareness is increasing. The survey also found that entrants are becoming more active: this will also improve customer awareness, especially among those customers seen by entrants as most likely to switch supplier.

Customer inertia is inevitable in a newly liberalised market, but the chapter 3 of the CMR has identified the level of business already switched to alternative suppliers, a trend that has accelerated since the CMR was published. The UK postal services market has definitely passed the "not me first – after you" stage. Indeed, most of the respondents to Postcomm's survey that had not switched were "*happy with Royal Mail*" or satisfied "*with the cost and reliability of Royal Mail*". The implication is that these customers are aware of the alternative operators, but have consciously decided to choose Royal Mail.

Royal Mail believes that the findings from Postcomm's survey demonstrate that customer awareness of market liberalisation is already good, and will continue to improve as the alternative providers continue to market their services. Royal Mail does not, therefore, believe Postcomm's planned awareness campaign is necessary, but has no objection to it.

Royal Mail's VAT status

Royal Mail is in general agreement with Postcomm's analysis of the effects of Royal Mail's VAT exemption, particularly their thorough analysis in chapter 4 and Annex 2 of the 2004 CMR. Royal Mail continues to disagree with Postcomm's recommendation that its VAT exempt status should be removed for the reasons given in the response to the 2004 document. Simply, Royal Mail believes removing its VAT exempt status would lead to a significant increase in prices for social, and some business, customers, but would have little overall effect on the postal services market.

In any case, as the 2005 CMR correctly points out that, under current EU legislation adopting Postcomm's recommendation would require a change that must be unanimously agreed by all member states. This is unlikely in the foreseeable future.

Low margins available to alternative suppliers

Royal Mail notes that "*Stakeholders argued that Royal Mail's prices were too low*" and confirms that its price rises should be weighted towards services used by retail customers, who are currently subsidised by large business customers.

Royal Mail's pricing behaviour and potential for anti-competitive behaviour

Royal Mail continues to be disappointed that Postcomm is unduly concerned about Royal Mail's potential for anti-competitive behaviour. Royal Mail will continue to modify and restructure its product range in response to customer requirements, and to rebalance tariffs to improve cost-reflectivity. Royal Mail is willing to explain the rationale for such initiatives to Postcomm and demonstrate that they are not predatory or discriminatory. In return we expect Postcomm to only investigate initiatives where there is a demonstrable cause for concern and, when an investigation is necessary, that it is conducted in a timely and efficient manner. Prolonged investigations can delay the implementation of services, preventing customers from benefiting and limiting Royal Mail's ability to compete.

Furthermore, other operators realisation that complaints delay implementation may lead to complaints where this is the principle objective, rather than the expectation of the complaint being upheld.

Operational difficulties arising from Access arrangements

Royal Mail does not accept Postcomm's assertion that it has given "*several commitments*" to develop an Access Code. As Postcomm is aware, Postcomm's investigation into Zonal Access Pricing that was launched in December 2004 effectively made it impossible for Royal Mail to consolidate the existing access agreements into an access code because it introduced a great deal of uncertainty into the appropriateness or otherwise of key features of the access regime

(i.e. an average price for an average postbag). Until that matter is completely resolved there is no question of Royal Mail being in a position to move towards an access code.

Royal Mail does not accept the vague criticisms of its operational procedures. Downstream access mail does have some requirements that are more stringent than those for retail products, but this stems from the fact that the mail arrives at over 70 different locations, and has to be revenue protected at different sites across the country simultaneously. Royal Mail strongly rejects the implication that the requirements imposed through the access contracts are more than is reasonably necessary to allow adequate revenue protection procedures to be carried out. Furthermore, Royal Mail does not accept that it is under any obligation to provide operational equipment (principally "Yorks") as "free issue" to Condition 9 accessors, as the cost of such equipment is not included in the price charged for Condition 9 access and the use of such equipment confers no operational benefit on Royal Mail.

Royal Mail's comments on Postcomm's proposed revisions to Conditions 9 and 10 of their Licence, including the proposals for non price terms for Access, will be fully covered in its response to Postcomm's "*Final Proposals*".

Licensing/Mail Integrity regulations

Royal Mail is pleased to note that a separate licensing framework for small operators will not be considered before 2007.

Impact of Competition on the Universal Service

Royal Mail notes the "*concern expressed by SMEs, social and vulnerable user groups and train unions that the provision of a universal service may be jeopardised by competitors targeting profitable routes that are required to subsidise the provision of universal services.*"

Royal Mail shares this concern and is pleased to note that "*Postcomm will ensure Royal Mail can finance its universal service obligation*" and "*promptly review the costs and benefits of the USO if there is a significant fall in Royal Mail's volumes*".

Royal Mail acknowledges that, at the level of competition experienced to date, it has been possible to finance the USO. However, given the expected volatility of Royal Mail's volumes in the face of growing competition and falling total market volumes, it is essential for Postcomm's to monitor the provision of the universal service and identify the emergence of any credible threats in time to take counter action.

The exclusive relationship between Royal Mail and Post Office Ltd

Royal Mail notes the conclusions from Stage 1 of Postcomm's review of this relationship, and looks forward to receiving the Stage 2 report and findings.

Overall, the 2005 CMR is a thorough and well balanced document. Royal Mail's principle concern is that it exaggerates the strength of the perceived barriers to entry in the UK postal services market. This is not supported by the latest data on competitors' volumes, nor by the evidence from Postcomm's own surveys about customers' awareness of the liberalised market. If Postcomm took a more realistic view of the strength of the barriers to entry it may

conclude that some of its responses are unnecessary, for example some of its actions to preempt perceived anti-competitive action by Royal Mail, and its proposals to increase its control of Access terms. Finally it is essential for Postcomm to monitor the provision of the universal service, and be ready to act swiftly if it is adversely affected by sudden significant changes in market conditions.