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COMPETITIVE MARKET REVIEW

Proposals for consultations

DMA's RESPONSE

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DMA

The Direct Marketing Association (DMA) UK Ltd is the largest trade association in the communications sector, representing both users and suppliers of direct marketing. We represent the majority of the major users of postal services and our client membership base represents the largest Royal Mail customer group. We represent all aspects of the supply side of postal services from mailing houses to consolidators and from agencies to data bureaux. We welcome this opportunity to contribute to this competitive market review.

ROYAL MAIL'S DOWNSTREAM ECONOMIES OF SCALE

Postcomm proposes to continue to promote and monitor RM's access arrangements. To ensure transparent costing and pricing, Postcomm proposes a greater degree of separation by pipeline activity in RM's regulatory accounts. Postcomm is also considering whether to include access products within the price control from April 2006.

Royal Mail does benefit from considerable economies of scale in downstream activities. This also acts as a major barrier to entry for end-to-end competitors. By virtue of the economies, a headroom effect is created which makes it nigh near impossible for national end-to-end competitors to develop competing networks. Therefore downstream access is a key method of developing competition and offering customers some choice.

It is essential that Postcomm use all regulatory measures to insist a generic access code is developed, quickly and effectively. The Royal Mail DSA user guide is not an access code.

Royal Mail's national network is and will continue to be a major selling point to customers. In essence the universal service becomes an asset rather than a burden.

Although access is viable for competing operators, it does not seem viable for consolidators (with consolidation licences); this area needs addressed to ensure it is attractive to consolidators, who are the major route in attracting SMEs and new users to the postal market.

Account separation as proposed by Royal Mail is only really an efficient transposition of the spirit of the first postal services directive. Postcomm should consider full

structural separation of Royal Mail between Delivery and Sortation and Collection. Such separation would allow sortation to compete with consolidators/ integrators and Royal Mail Delivery to develop as a major service offering.

Bringing access products within the price control would be regulatory interference in a competitive environment.

ROYAL MAIL'S VAT EXEMPTION

Postcomm's advice to government, which is responsible for VAT policy, is that Royal Mail's VAT exemption is not required for the universal service and distorts a large part of the letters market. In terms of furthering its duties, Postcomm wants a solution that levels the playing field, but does not lead to a significant increase of prices. A reduced rate applied to postal services might be one way to achieve this. Postcomm will continue to provide advice and analysis to Government to ensure the effects of this barrier on the postal market are fully understood and, if feasible, addressed as soon as possible.

Royal Mail's VAT exemption is a major barrier to competition and distorts the market. The VAT issue needs to be comprehended from an EU perspective, as it will have an influence on UK solutions.

Currently the universal service providers in EU states have a VAT exemption, this has the effect of keeping postal prices lower for some customers than they would be if VAT was charged. Competitors to the universal postal providers are required to charge the prevailing rate of VAT, which ranges from 15% to 25%. Hence the competitor is placed at an unfair advantage in the order of between 15% and 25%. As many of these competitors are just breaking into these new markets, the problem is compounded.

Obviously this problem could create a series of fault lines across the EU postal services market and severely derail any hope of a vibrant competitive market.

The EU commission realised through pressure from users and operators that this problem had to be addressed as a priority. Their proposal was a draft directive to amend the original VAT directive. The commission determined that the current VAT regime distorts competition in the supply of postal services. They proposed that a low rate of VAT should be applied on postal services up to 2kg. The logic here determined that a low rate of VAT would result in a insignificant increase or no increase in the price of stamps because the universal service providers would reduce their cost base through their ability to reclaim

significant input VAT and would balance the increased cost through a lower level of VAT. It should be stressed that this logic only works for a low level of VAT. If the standard rate were applied, between 15% and 25%, then there would be significant increases in the price of stamps. Therefore consumers and business users would lose out. The draft directive was approved by the European parliament subject to some changes. The approval is a key development, as it now appears that consumer damage is no longer an issue.

One of the changes proposed by parliament was the extension of the application of the low rate on postal services from 2kg to 10kg. Perhaps the most important revolved around those organizations, such as charities, which cannot reclaim VAT. The parliament proposed that such organizations are not faced with additional financial charges as a result of this directive, for example, by adopting special provisions on reimbursement mechanisms. The parliament does not refer to financial services organisations, which in some member states cannot reclaim VAT.

These organizations (financial services, charities, education) are all major users of mail. Currently, faced with a choice of purchasing postal services from a universal service provider which are VAT exempt or choosing a private postal operator, charging VAT at anywhere between 15% and 25%, all things equal, the customer will probably not choose the private operator. Hence any solution must make accommodation for those organizations that do not reclaim VAT.

The draft directive has a long way to go. It has to have unanimity across the member states and that includes the new 10 member states from the eastern block. It is essential, though that an effective level playing field of VAT treatment is introduced. It allows customers to benefit from increased choice and innovative services from competing operators in an efficient and competitive EU postal services market.

It is essential that UK goes alone on this issue forcing the pace. Such a solution should encompass:

- Removal of RM's VAT exemption
- Introduction of a low rate of VAT, probably 5%, on items up to say 2kg, with the standard rate beyond this
- Rebate system put in place for charities and financial services, to allow for their inability to reclaim VAT
- Interim provision of VAT only being charged on trunking for new operators

- No VAT on stamps

POTENTIAL ANTI-COMPETITIVE BEHAVIOUR

The impact of anti-competitive behaviour by Royal Mail could be disproportionately high at the current early stage in the development of competition. Postcomm is planning to increase its resources devoted to this issue in order to take a more proactive approach to ensuring anti-competitive behaviour does not occur (or is dealt with quickly). Postcomm will also take steps to raise awareness within the industry of its processes for addressing complaints.

Royal Mail continues to act in their best interests and this includes dragging their collective heels on access. Royal Mail's attitude to market opening is quite negative and can be construed as anti-competitive. The following are areas that need examination:

- The application of RM's DSA guide
- Inconsistencies of application on mail presentation criteria
- The switch within Mailsort from an aggregation of posting over 20 days to a requirement that the rate of postage is calculated on what is posted per day. In a nutshell Royal Mail can vary the postage rate on a daily basis whilst also stipulating when a working day ends.
- The quick and effective introduction of an access code

Postcomm need to use their existing powers, within the licence and PSA 2000. Rather than considering and talking about resource, Postcomm should act within their existing powers.

CUSTOMER INERTIA

Postcomm's market research suggests that customers are not generally well informed about the liberalisation of the market and alternative choices. This may reflect the current early stage of the liberalisation process and a strong brand loyalty to Royal Mail. Postcomm intends to undertake a programme of visits and events aimed at raising customers' awareness of the market opening timetable and competition.

The problem with market awareness of market opening and competition is that it will be a function of the level of competition, choice and offers. Therefore if the level of

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competition is low, the awareness will probably be lower. Customers will be interested if there are viable offers, which benefit them. They will not use competition just from a philanthropic perspective. A programme of visits and events are well intentioned but Postcomm's resources are probably better spent by resolving market barrier problems, such as VAT and access code.