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Tony Spencer
Deputy Director, Competition & Regulation
Postcomm
Hercules House
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22 October 2007

Dear Tony

REVIEW OF ROYAL MAIL'S PRICING FLEXIBILITY

I am writing on behalf of magazine publishers to express the industry's serious concerns about Postcomm's proposal to allow Royal Mail greater flexibility to increase prices, in particular the proposal to increase the "re-balancing sub-cap" from 3% to 8.5%.

Overview

As a general principle, PPA believes that the price control is in place to offer customers and new market entrants a level of stability and certainty in a developing marketplace and to offer protection against potentially anti-competitive behaviour by a dominant market player.

We believe Postcomm's proposal to offer greater pricing flexibility by allowing changes to the sub-cap re-balancing thresholds undermines a fundamental principle of this price control by potentially destabilising the market and creating business uncertainty, with very little justifiable reasoning from Royal Mail or Postcomm for doing so, given that the price control already contains mechanisms to safeguard Royal Mail's interests in relation to its pension deficit and volume risk.

Implications for Presstream

Using the price control formula as the basis for calculation, should Royal Mail choose to maximise this greater flexibility in terms of Presstream, publishers could be facing increases of as much as 12-13% from April 2008 – significantly above the rate of inflation.

Increases of this magnitude would be on a par with zonal pricing and what is worse, publishers would have only 3 months notice before implementation. This would pose a serious threat to the viability of some magazines.

Whilst as part of previous submissions made to Postcomm we have outlined the reasons why significant price increases (and implemented within unacceptably short timescales) would have a dramatic impact on publishers' businesses, we would like to take this opportunity to reiterate these points:

- Budgets are set, subscription models are built and investment is made on the basis of assumptions which reflect likely increases in RPI;
- Over the last few years, it has become increasingly difficult for publishers to generate sustained investment in subscription marketing while the fulfilment costs are seen to be so volatile;

- In addition, controlled circulation titles (accounting for 70 per cent of all business magazines) by their very nature are free to recipients and therefore publishers cannot pass on additional postal costs to readers, nor is it feasible to pass on these costs to advertisers;
- Faced with potential increases on the scale outlined above, publishers would be forced to take mitigating action to avoid a total collapse of the business model;
- This might involve reducing distribution levels in certain areas; switching promotional expenditure back to the newsstand; accelerating the delivery of some content online; and reducing paper weights and print formats. Both magazine and DM-related traffic would be further reduced, leaving higher fixed costs for Royal Mail.

We fail to see the long term benefits of such a strategy for any party as higher prices will ultimately lead to reductions in volume, in turn triggering higher prices, leading to reduced volumes and so on, eventually making the entire proposition untenable and posing a threat to the maintenance of the USO.

We note that Postcomm recognises in its consultation that Royal Mail's costs are higher than forecast, owing to its failure to achieve the required efficiency savings and that Royal Mail is taking two years to take out costs from its business which it was supposed to remove in one year. What is more, as previously stated, PPA has had no real indication from Royal Mail that it is seriously tackling cost issues within its own business, despite the fact that we have indicated that we would be happy to work with Royal Mail to help it realise those savings. We believe that customers should not be required to pay, through higher prices, for management failure.

We are also aware that in Royal Mail's response to Postcomm's zonal pricing consultation, it now concedes the need for a longer notice period before implementation (12 months), should zonal pricing be approved. We therefore assume that this same principle would apply to a change such as the revision to the sub-cap, where price increases of a similar level to those under zonal would be a possibility. In view of such a possibility, if Postcomm was to approve the level of sub-cap flexibility being proposed, publishers would require a minimum lead-in time of 2-3 years.

Whilst we acknowledge that some competition for magazine delivery is now beginning to emerge, it is still very much at an embryonic stage, geographically limited and largely unproven. Postcomm must therefore ensure that Royal Mail acts in a responsible manner to customers who, as yet, have no viable alternative to its service. As a result, we strongly urge Postcomm to reject this application in favour of maintaining the current sub-cap.

If you have any questions relating to the above, please do not hesitate to get in touch.

Kind regards

A handwritten signature in black ink that reads "Nicola Rowe". The signature is written in a cursive, flowing style.

NICOLA ROWE
Director of circulation