

Royal Mail, Licensed  
Postal Operators,  
Postwatch, Trade  
Associations and other  
interested parties  
Direct Line:  
Email:

Date:

28 February 2008

020 7593 2160

Michelle.Koretz@psc.gov.uk

## **ROYAL MAIL'S APPLICATION TO EXEMPT TAILOR MADE INCENTIVES FROM CONDITION 7 LICENCE REQUIREMENTS**

1. Postcomm is consulting on an application from Royal Mail to exempt it under Condition 7 from publishing on its website certain details relating to Tailor Made Incentives (TMIs).
2. For some time now, Postcomm has been in discussions with Royal Mail over the information it publishes in relation to TMIs and its obligations under Condition 7 of its licence. On 17 August 2007, Postcomm received an application from Royal Mail to exempt TMIs from the full requirements in Condition 7 (see **Annex A** for the application). Postcomm entered into further discussions with Royal Mail in relation to its application (see **Annexes B and C** for further submissions made by Royal Mail to support its application) and wrote to a selection of TMI customers and competitors (via the Mail Competition Forum) to seek initial views on the application.
3. This letter outlines Postcomm's proposal that it is "minded to" issue a Direction allowing Royal Mail an exemption from Condition 7 in relation to TMIs. It sets out Postcomm's reasoning for proposing an exemption and the information it will expect Royal Mail to publish in relation to TMIs.
4. Postcomm would welcome views from interested parties on its proposals before making its final decision on this matter. Responses to this consultation should be received no later than **Friday 30 May 2008** either by email to [michelle.koretz@psc.gov.uk](mailto:michelle.koretz@psc.gov.uk) or by post to Michelle Koretz, Competition Case Assistant, Universal Service and Customer Protection Directorate, Postcomm, Hercules House, 6 Hercules Road, London SE1 7DB.

## **Background**

### ***Condition 7 of Royal Mail's licence***

5. Condition 7 of Royal Mail's licence requires Royal Mail to notify Postcomm about the launch of new services, and changes to existing services, three months before they are introduced. It also requires Royal Mail to publish information about such changes as soon as practical after notification.
6. The information that Royal Mail is required to submit (and publish) comprises details of tariffs (including discounts and credit facilities), standards of service, and compensation arrangements for both licensed and non-licensed services.
7. Under Condition 7, Royal Mail can apply for an exemption from these notification and publication obligations and Postcomm has the power to direct alternative or no notification and publication requirements. Condition 7 also allows Postcomm to direct alternative notification and publication requirements without an application from the licensee, subject to consultation.
8. Condition 7 was amended with effect from May 2006 as part of the licence modifications driven by the review of Royal Mail's price control. The rationale behind the change was to ensure that customers and, in particular, competing operators are informed *ex ante* about market developments and are therefore in a position to make prompt complaints to Postcomm if they are concerned about potential anti-competitive effects arising from new or amended services offered by Royal Mail.
9. Condition 7 is applicable in the case of TMIs because under the scheme postage credits (a rebate from standard postage rates) are made available and Conditions 7(2) and 7(4) require Royal Mail to publish details of the tariffs (including discounts and credit facilities) under which Royal Mail offers to provide licensed and non-licensed services.

### ***Tailor Made Incentives***

10. TMIs are a scheme offered by Royal Mail which it regards as encouraging customers to make further use of postal services for marketing and promotion purposes.
11. If Royal Mail considers that customers are using its services in an "innovative way" (against certain criteria) they are given a rebate from standard postage rates relating to the innovative mailing activity (a percentage of the value of the mailing) in the form of a postage credit. The postage credit is paid into the customer's Royal Mail credit account after

postage and payment of the full price for the TMI-related mailing. Royal Mail claims that the postage credit is not a discount on the TMI-related mailing, but is a credit that can be redeemed against any future mailing with Royal Mail.

12. The calculation of the postage credit depends on the service that the customer wishes to use (in relation to other services previously used) and Royal Mail's assessment of the level of commercial risk involved in the proposed activity.

### **Royal Mail's application**

13. Royal Mail has applied for an exemption from Condition 7(2), Condition 7(3) and by implication Condition 7(4) regarding the notification and publication of information relating to TMIs.
14. The information Royal Mail currently publishes in relation to TMIs is available in **Annex D** to this document. Currently Royal Mail does not publish details on how postage credits are calculated or the range of postage credits available under TMIs. Royal Mail does however notify Postcomm of all changes to its TMI Internal Manual Policy For Account Handlers (the TMI Internal Manual), which does include these details, and updates Postcomm when new TMIs are awarded to individual customers (giving details of the TMI postage credit awarded in each case).
15. Royal Mail, in its application, notes (see **Annex A**, paragraph 5.2) that if an exemption cannot be directed, Royal Mail would suggest that it continues to provide Postcomm with details of changes to the TMI Internal Manual ahead of those changes taking place and also to continue to inform Postcomm of the details of each TMI as they are approved.
16. Full details of Royal Mail's application can be found in **Annexes A to C**. Below is a summary of Royal Mail's reasoning for requesting an exemption.

***Royal Mail claims that TMIs, as one-off incentives, do not have a long term impact on Royal Mail's market share and that the overall value of TMIs is small.***

17. Royal Mail claims that:
  - A TMI can be granted for a single mailing only, which may be posted in several separate stages over the duration of a TMI campaign. The average duration of Royal Mail customers' TMI campaigns for the financial year 2006/07 was under 12 weeks. The mailing may however include a "follow up" chaser to non responders, although this is also limited (see below);

- Only 30% of the overall “target audience” volume which the customer wishes to test its innovative mail shot against may qualify for the application of the TMI postage credit. The target audience is a closely defined group of mail recipients;
- Of that 30% of the target audience volume, only a further 30% “slice” of that number can qualify for the TMI postage credit on any follow up chaser mailing;
- The level of credit is limited to a maximum of 30% and that the average value of TMI credit as a percentage of total TMI mailing revenue was 8% for the financial year 2006/07;
- Postage credits have a limited life and expire 6 months from their award;
- Once the benefits of mail have been demonstrated, customers are free to decide if they wish to continue to use mail in this way and to choose which posting operator shall be their provider;
- For many products there has been limited TMI activity;
- The value of postage credits issued, per product, equates to less than 1% of the revenue generated by that product on a per annum basis;

***Royal Mail claims that TMIs lead to the growth of the Direct Mail industry as a whole.***

18. Royal Mail claims that:

- TMIs are used predominately for Direct Mail and that once a customer has made a mailing utilising a TMI they are not obliged to make any further mailings with Royal Mail;
- TMIs serve to keep the profile of mail as an advertising medium, in general terms, high on customers’ agenda;
- TMIs granted in 2005/06 and 2006/07 were expected to lead to an additional £2.7m and £5m respectively of postage revenue for Royal Mail, which would otherwise have been spent on other advertising media<sup>1</sup>;
- The TMI process provides customers with better information about running a direct mail campaign and an incentive to think positively about including mail within their marketing mix; and
- Since the introduction of the new TMI Internal Manual, there has been an increase in the number of TMIs approved indicating that customers are increasingly encouraged to test the use of mail as a communications medium.

---

<sup>1</sup> Royal Mail has acknowledged in its submission dated 4 September 2007 (see **Annex B**, paragraph 5) that it cannot confirm if these estimates were achieved with Royal Mail or with another postal operator or indeed made at all and that it is not possible to see an exact direct and measureable effect on overall direct mail volumes, given that small increases in spend as a result of TMIs could be countered by other factors affecting customers use of direct mail.

***Royal Mail claims that TMIs maintain Royal Mail's ability to understand customers' current needs and to enhance the selling relationship.***

19. Royal Mail claims that:

- The award of TMIs allows Royal Mail the opportunity to discuss and understand an individual customers' needs (evidence by statements from Royal Mail Account Handlers);
- TMIs provide an opportunity to meet with client marketeers at an early stage of their planning process for forthcoming seasons in order to discuss what their objectives are; and
- The TMI process facilitates a detailed understanding of customer communications activity as it requires in depth knowledge of intended marketing activity from both the coming season and from past activity.

***Royal Mail claims that publication of the range of available incentives undermines its ability to discuss the most appropriate value to the customer on a case by case basis (taking into account all the facts).***

20. Royal Mail claims that:

- If the entire range of possible incentives were made publicly available, customers would no longer engage with Royal Mail enabling it to understand customers' requirements in order to encourage the innovative use of mail, such that Royal Mail would cease from offering TMIs altogether; and
- If the entire range of possible incentives were made publicly available all customers would argue that they were entitled to the highest level of incentive, which concerns Royal Mail from a compliance perspective as it could fuel concerns by competitors that Royal Mail could not be certain it was not applying similar conditions for non-equivalent transactions and thereby potentially discriminating in the approach it took to customers.

***Royal Mail claims that it competes with other mail, communication media and advertising providers who are able to negotiate minor discounts to their services as part of the normal course of winning business.***

21. Royal Mail claims that:

- TMIs, by their nature, are only offered where a customer has a choice as to whether or not to make that communication and notes that advertisers and the media buying agencies that advise them have a wide array of media available to them as well as a range of postal operators also offering Direct Mail; and
- Royal Mail would like to be able to use TMIs in order for mail to better compete with other media, such as outdoor, TV, radio, internet, incentives (sampling/giveaways) and press.

## **Summary**

22. Royal Mail summarises its application by stating that it believes that exempting TMIs from the obligations of Condition 7 would be a proportionate regulatory response, given the small scale of TMI postage credits and the fact that they are used to share the risk with the customer, of an innovative new use of mail in order to grow the mail market as a whole.

## **Postcomm's view**

23. Postcomm has considered Royal Mail's application and initial views from a selection of TMI customers and competitors (via the Mail Competition Forum).

## ***Postcomm's initial assessment of Royal Mail's application***

24. Due to a lack of information, Postcomm has not taken a view on which market TMIs compete within and therefore how competitive that market is. However, Postcomm notes that TMIs are only granted for single 'innovative' mailings and that the value of the postage credits issued, per product, equates to less than 1% of the revenue generated by that product on a per annum basis.
25. Postcomm has also learnt that TMIs are important to customers and that some customers would be reluctant to undertake the risks involved in testing new innovative mailing strategies without the offer of TMIs.
26. Given the above, Postcomm proposes that requiring Royal Mail to publish the maximum credit available (currently 30%) will offer sufficient transparency in relation to the credits available on TMIs without lessening Royal Mail's ability to engage with customers individually.

## ***The proposed Direction***

27. Given the above analysis, Postcomm is proposing, subject to consultation, to direct Royal Mail to continue to provide Postcomm with details of changes to the TMI Internal Manual ahead of those changes taking place and also to continue to inform Postcomm of the details of each TMI as they are approved. Postcomm is proposing to require notification of any changes to the TMI Internal Manual three months before they are introduced.

28. Postcomm is proposing that Royal Mail, in addition to that already published (see **Annex D**), must also publish the following information on its website:

- Further information on the criteria for the granting of TMIs, to include the need for customers to demonstrate their intention to make mailings of a similar nature to the remainder of the target audience within 12 months of their last mailing under the TMI; the provision that if a customer wishes to target a cold / lapsed list of names and Royal Mail is unable to obtain the previous mailing lists the customer must provide written assurance that the addresses have not been mailed within the last 12 months; plus Royal Mail's definition of what constitutes a "target audience";
- An explanation of the general rules and processes for awarding TMIs, to include the terms on which a customer may make a single mailing that may be posted in different stages, the fact that the maximum period of time a TMI trial can last is 6 months (in exceptional cases 12 months but this must be fully justified by the customer), the stipulation that a TMI application must state the expected number of responses and response rate and how the postage credit will be paid to the customer;
- An explanation of when a TMI will not be permitted;
- The fact that the minimum postage credit available is £300 and that the maximum postage credit available may not exceed £150,000.
- The maximum percentage of postage credit available on TMIs (currently the level of credit is limited to a maximum of 30%);
- On an annual basis, the average value of TMI credits as a percentage of total TMI mailing revenue for the preceding year;
- On an annual basis, the overall value of TMI mailing revenue for the preceding year;

29. Postcomm reserves the right to review the situation as and when necessary. The making of the proposed Direction would not preclude Postcomm from considering TMIs and their compliance with Condition 7, Condition 11 or indeed any other condition within Royal Mail's licence in the future, should it so wish to.

## **Questions for consultation**

30. In order to fully inform its final decision, Postcomm would welcome views on the following issues.
- a. Do you support the proposed Direction to exempt Royal Mail under Condition 7 from publishing certain details relating to TMIs on its website? Please outline your reasons why or why not.
  - b. If you do not support the proposed Direction, would the publication of further / the full range of postal credits be of value? Please provide evidence of what additional benefit(s) publication of any additional information would bring to you.
  - c. What harm would you suffer if Royal Mail does not publish these / the full range of postal credits? Please provide evidence of any harm / loss you may suffer as a result of the Direction.
  - d. Do you believe that the other additional information that Postcomm is requiring Royal Mail to publish will give you a sufficient understanding of how TMIs operate? If not, what further information would you require?

## **Next steps**

31. Postcomm has decided that the appropriate period for consultation on this matter is 3 months.
32. Following the deadline for responding to this consultation, Postcomm will assess the responses and meet interested parties as necessary.
33. All comments received will be placed in full on Postcomm's website at [www.postcomm.gov.uk](http://www.postcomm.gov.uk) unless respondents indicate that all or part of their response is confidential.
34. If you have any questions or if you would like to arrange a meeting with Postcomm to discuss any aspect of this letter, please do not hesitate to contact me.

Yours sincerely

Michelle Koretz  
Competition Case Assistant,  
Universal Service and Customer Protection Directorate