



**Application for a Direction from
Postcomm
for exemption from Condition 7
for Tailor Made Incentives (TMIs)**

17 August 2007

Application seeking a Direction from Postcomm for exemption from Licence Condition 7 (2) & (3) for Royal Mail's Tailor Made Incentives (TMIs)

1. Overview and rationale for the application

1.1 Royal Mail's Tailor Made Incentives (TMIs) offer postage credits to, most commonly (if not exclusively), mailers of advertising material (Direct Mail) in order to share the risk they face when using mail in an innovative manner. These postage credits can be applied against tariffs for licensed or non-licensed services. Currently under Conditions 7(2) and 7(3) of Royal Mail's Licence, Royal Mail is required to notify Postcomm of changes to tariffs (including discounts and credit facilities) at least three months in advance of those changes coming into effect. Royal Mail must also, under Condition 7 (4) publish these details as soon as is reasonably practicable. However, TMIs have been treated somewhat differently for several years. The background to this is set out below along with the rationale for now applying for an exemption.

Background

1.2 To date, in relation to the application of Condition 7 to TMI arrangements, Royal Mail & Postcomm have operated under a pragmatic arrangement. Royal Mail makes its "Internal TMI Policy Manual for Account Handlers" (The TMI Policy) and also details of each TMI awarded in accordance with the TMI Policy available to Postcomm.

1.3 Since May 2004 Royal Mail has provided Postcomm with the details of each TMI once it has been through Royal Mail's internal approvals procedure¹. These notifications provide Postcomm with additional information to that required by Condition 7, e.g. the reason for the TMI and the customer name. The notifications have not, to date, been published but have enabled Postcomm to check adherence with the TMI Policy and also to monitor trends in the issuing of postage credits for licensed and non-licensed services.

1.4 For almost 3 years, Postcomm respected the confidential nature of these documents (as they related to the activities of Royal Mail's customers) and both parties have been happy to work together on the basis outlined above both before and after the Licence modifications in May 2006 when C7 (3) and its accompanying three month period was introduced.

¹ Although Royal Mail has records to show that TMI notifications were made as early as in January 2004 in the licence period previous to this one.

- 1.5 Unexpectedly, Postcomm then wrote to Royal Mail on the 9th March 2007 asking for Royal Mail's TMI website to include additional information such as that which was included in Royal Mail's internal policy for the award of TMIs.
- 1.6 A meeting was held at Postcomm's offices on 22nd March 2007 and over the next two months both parties tried to negotiate text that would meet the publication needs of Postcomm whilst enabling Royal Mail to continue to offer TMIs as before (and without incurring the C7 (3) three month time lag in place since May 2006 but which had not been enforced, or even indeed mentioned, by Postcomm).
- 1.7 On 28th June 2007 Postcomm wrote to Royal Mail asking for the full range of potential postage credits available to be published in order to comply with Condition 7 or for Royal Mail to seek a formal exemption from the notification obligations for each TMI. For further detail, please refer to the chronology of events relating to informal notification of TMIs set out in Annex A.
- 1.8 Postcomm have not at any stage, either during the course of the informal notifications of TMIs, or in the more recent round of talks, expressly required that TMIs are notified 3 months in advance and Royal Mail welcomes this as it is of the view, particularly given the scale of the award of a TMI that 3 months' notice prior to the mailing is not appropriate².
- 1.9 Conditions 7(2) & (3) provide the means for Royal Mail to apply for a Direction granting an exemption from the requirements of Conditions 7 (2) & (3), (and therefore, by implication also from the publication requirements of Condition 7 (4) also should the exemption be granted). Royal Mail therefore applies herein for a Direction for existing and future TMI postage credits (i.e. discounts off tariffs for certain licensed and non-licensed services) to be exempt from the obligations contained in Condition 7 (2) & (3). If this exemption application is successful, Royal Mail will be in a position to continue formally to disapply the C7 (3) pre-deployment time lag that would otherwise render TMIs, in almost all cases, ineffective as a sales tool. Royal Mail would also be in a position to maintain the ability to match the postage credit to the individually assessed risk of the mailing being undertaken by a customer.
- 1.10 As a general overarching statement, the exemption (if such a direction is given by Postcomm) would most importantly allow Royal Mail to continue to encourage innovation within the direct mail industry as a whole, through providing customers with face-to-face contact with the sales force. Without this basis for discussion, Royal Mail feels sure that the industry as a whole would suffer due to a loss of apparent interest by a market player to cultivate the medium of post. In this context, Royal Mail would draw Postcomm's attention to the prevalent trend of declining postal volumes overall.

² While it is uncertain whether it is the case that this has been a deliberate stance on the part of Postcomm, it is certainly welcome as Royal Mail is certain that such a time lag for TMIs would mean that they could only very rarely, if ever, be deployed because such a delay would be unacceptable to customers.

1.11 The application for an exemption from the requirements of Condition 7, triggered largely by the concerns expressed above is therefore made on the basis of the following five points;

- TMIs, as short term one off incentives, do not themselves have a long term impact on Royal Mail's market share (the overall value of TMIs is so intrinsically small as to be de minimis)
- TMIs lead to the growth of the Direct Mail industry as a whole
- TMIs maintain Royal Mail's ability to understand customers' current needs and to enhance the selling relationship
- Publication of the range of available incentives undermines the ability to discuss the most appropriate value to the customer on a case by case basis (taking into account all the facts)
- Royal Mail 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

1.12 Royal Mail welcomes the fact that Postcomm has operated a pragmatic process for the notification of TMIs over the last three years. Royal Mail further welcomes the fact that Postcomm has indicated in discussions that applying for exemption may continue to allow customers to test the use of mail in innovative ways. Royal Mail's view is that, given the nature of TMIs, the current (albeit informal) method of notification was a proportionate regulatory response to the interpretation and application of Condition 7.

1.13 Royal Mail's view is that there are good arguments that it is appropriate for the regulatory constraints under Condition 7 (2), (3) and therefore (4) to be disapplied completely from the award of Tailor Made Incentives to customers.

1.14 However Royal Mail is willing to continue to provide Postcomm with a version of the TMI policy in advance of any changes taking effect and also to continue to provide the current level of detail³ on each TMI, in confidence, as and when they are approved in order to give Postcomm confidence in the application of the TMI Policy in a consistent and non discriminatory manner.

³ See Annex C

- 1.15 The application is therefore made for a Direction that Royal Mail's Tailor Made Incentives (TMIs) are exempt from the notification obligations of Condition 7 (2) & (3) (and by implication from Condition 7 (4)), and for Royal Mail consequently not to be required formally to notify or publish its award of postage credits as a result of a TMI being offered under the TMI Policy.
- 1.16 Alternatively Royal Mail would accept a Direction simply obliging Royal Mail to continue the current process of notification regarding TMIs to be maintained.

2. Postcomm's policy objectives and TMIs

2.1 As stated above in paragraph 1.2, the Licence makes provision for Royal Mail to apply for an exemption from Conditions 7 (2) & (3) and by implication from 7 (4). Specifically, Royal Mail's Licence Conditions 7(2) & (3) states:

"Except as Postcomm after consultation may by direction determine and subject to paragraph 5, the Licensee shall submit to Postcomm and to the Council a statement setting out –

- (a) details of the tariffs (including discounts and credit facilities), standards of service and compensation arrangements under which the Licensee offers to provide licensed services and non-licensed services (other than postal services offered under the Parcelforce brand which were offered on 1 April 2006 or which may be offered subsequently and which are substantially similar to those services),*
- (b) details of the general conditions of, and the physical provisions for, access to such services offered by the Licensee,*
- (c) details of any services offered by the Licensee specifically for customers who are blind and partially sighted, disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas,*
- (d) a summary of the Licensee's performance against its standards of service in the year for which it most recently has become due to submit an annual report to Postcomm under paragraph 16 of Condition 4 of this Licence. [Condition 7 (2)]*

Except as Postcomm after consultation may by direction determine and subject to paragraph 5, the Licensee shall notify Postcomm and the Council promptly in writing of any changes to the matters referred to in any statement submitted pursuant to paragraph 2 not less than three months before any such changes come into effect. [Condition 7 (3), emphasis added]

2.2 Postcomm's Business Plan 2007/08 includes, under the second of three top priority workstreams, the following;

"..we are considering our long-term regulatory framework, ensuring that it promotes effective competition and innovation."⁴ [Emphasis added]

As TMIs enable customers to use mail in an innovative manner, Royal Mail welcomes Postcomm's willingness to consider an exemption application for TMIs.

⁴ Pg 13 Business Plan 2007, issued 2nd April 2007

Furthermore Postcomm states its policy objectives as follows⁵:

“To regulate (price and quality of service) only where it is necessary to safeguard customers’ interests. Regulation will be targeted at those parts of the market where competition can least be expected to *protect and benefit customers*. (S32). [Emphasis added]

Postcomm have not, to date, considered the publication of TMIs to be essential for the protection or benefit of customers. Royal Mail is keen to maintain this position and recognises that a Direction is the formal route for obtaining exemption from the strict application of Condition 7 (2, 3 & 4) or, alternatively, for maintaining the status quo, i.e. the existing informal arrangements.

⁵ Source: Royal Mail Price Control and Quality of Service: Final Proposals for Consultation (December 2005).

3 Royal Mail's Tailor Made Incentives

- 3.1 It is Royal Mail's policy to offer tailor made incentives ("TMIs") to encourage customers to trial the use of mail services where otherwise they might not, or might have continued to use existing services without considering a more innovative approach for their mailing campaign. Therefore, and as the Policy describes, the award of a TMI is intended to reflect the risk a customer takes in deciding to:
- (i) promote new products using mail as opposed to other media
 - (ii) advertise existing products to a new and clearly defined target group of customers; or
 - (iii) run a mixed media campaign.

The mailing activity must be new to the postal services market not merely new to Royal Mail.

TMIs may also be offered in certain circumstances, to encourage customers to trial the use of a more expensive mail service than the one they normally use for advertising their products.

TMIs comprise postage credits that enable customers to offset some of the risk they accept by using Royal Mail services in this innovative way. In deciding what level of postage credit to offer, Royal Mail takes account of the level of commercial risks accepted by the customer (whether medium or high – no reward is made for a "low risk" move as it would not be appropriate or in keeping with the Policy) as well as the prospect of incremental growth in mail volume if the trial encourages the customer to make additional similar mailings. Royal Mail attaches the greatest importance to ensuring that its TMI Policy is deployed compliantly and it is essential that each application for a TMI be reviewed against the Policy criteria in a consistent manner internally before any postage credit is offered.

As mentioned above, Postcomm has been furnished with Royal Mail's TMI Policy Manual, most recently in December 2006 when changes were made that took effect in March 2007⁶, such that the basis upon which the credits are offered is open to transparent view by Postcomm.

⁶ i.e. the revised Policy, once notified, came into effect 3 months later, in full adherence to Condition 7(3), as with any new tariff or product.

4 Royal Mail's basis for exemption TMs from the obligations of C7 2 & 3⁷

4.1 TMs, as short term one off incentives, do not themselves have a long term impact on Royal Mail's market share (the overall value of TMs is so intrinsically small as to be de minimis)

TMs are designed to show customers the benefits of mail over other communication media. They allow customers to share the financial risk of a new mailing in order to mail new groups, to mail existing customers using different services, or to promote services that have not been promoted previously by mail. Once the benefits of mail have been demonstrated by the short term "experiment" with the new mail product, customers are free to decide if they wish to fulfill their stated intention of continuing to use mail in this way. Where they do, they can use the postage credit issued. As postage credits expire 6 months from their award, TMs cannot be said *per se* to have a long-term effect on the market. Similarly Royal Mail's TMs are unlikely to have an effect on the overall competitiveness of the postal market, as the value of the postage credits issued, per product, equates to less than 0.9% of the revenue generated by that product on a per annum basis.

4.2 TMs leads to the growth of the Direct Mail industry as a whole

As mentioned, TMs are used predominantly, if not exclusively for Direct Mail. Once a customer has made a mailing utilising a TM they are not obliged to make any further mailings with Royal Mail. It is acceptable for customers to make mailings through any postal operator. TMs serve to keep the profile of mail as an advertising medium in general terms high on customers' agenda, thereby growing the Direct Mail industry as a whole to the benefit of the overall postal services market. Whilst TMs granted in 2006/07 are expected to lead to an additional £5m⁸ of postage revenue (which would otherwise have been spent on other advertising media), customers are under no obligation to post with Royal Mail. Since the introduction of the new TM Policy Royal Mail has seen an increase in the number of TMs approved indicating that customers are increasingly encouraged to test the use of mail as a communication medium⁹.

4.3 TMs maintain Royal Mail's ability to understand customers' current needs and to enhance the selling relationship

The award of a TM in accordance with the Policy affords RM the opportunity to discuss and understand an individual customer's needs, thereby significantly enhancing the commercial relationship and recognition of the

⁷ And, by implication from Licence Condition 7 (4)

⁸ Source: Royal Mail's TM System based on TMs approved 2006/07

⁹ See Annex B

usefulness of postal services overall in any advertising campaign. In particular a TMI is an extremely valuable tool in providing an opportunity to meet with client marketers at an early stage of their planning process for forthcoming seasons in order to discuss what their objectives are; from customer recruitment targets through to customer retention and customer "winback", and to identify areas where there may be the possibility to test activity to help them reach those targets.

In addition, 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. This knowledge allows Royal Mail to support the client further by demonstrating expertise through the use of Royal Mail media consultants and providing market research unique to Royal Mail, such as the Home Shopping Tracker survey, which can help them to achieve their marketing objectives.

Without the TMI process, Royal Mail does not gain an in depth an understanding of what clients' objectives are, how they plan to achieve them and how Royal Mail could subsequently support them either through testing new activity, products, or combining multi media approaches. Without it, Royal Mail anticipates, it would have reduced effectiveness in enabling customers to meet their marketing goals for the current and future seasons.

By way of indicating the usefulness of TMIs currently, the following customer quotation is particularly helpful to Royal Mail's case:

"The Royal Mail TMIs have enabled us to try a variety of different mailings, which we may not have considered without the help of a TMI. This has the benefit of not only increasing our spend with Royal Mail, but ultimately increased our revenue¹⁰"

¹⁰ Source – Castle Cover: Marketing Production Manager.

4.4 Publication of the range of available incentives undermines the ability to discuss the most appropriate value to the customer on a case by case basis (taking into account all the facts)

TMI's are offered on the basis of risk sharing in order to encourage customers to innovate either with the use of mail on its own or as a part of a wider communications strategy. No TMI would be available for a mailing where the customer was not, to some degree, taking a new risk. For e.g. a mailing of an existing product but to a new group of customers would be considered medium risk, while mailing a new group about a new product could be considered high risk. Royal Mail accepts that these differences may merit an individual assessment of the risk taken for each scenario, and so it provides (internally) for a range of discount values so that the level of risk can be accurately reflected each time in the offer that is made by the Sales Manager in question. If Royal Mail were to fail in this application for exemption and Condition 7(2) and (3) were to be applied strictly for the first time (and therefore the entire range of possible incentives made publicly available under Condition 7 (4)), there would, Royal Mail is confident, be two negative outcomes:

- (i) no engagement or discussion enabling Royal Mail to understand customers' requirements in order to encourage the innovative use of mail (and identify trends in demand generally)
- (ii) the inability to continue to match the incentive to the risk on an individual basis would mean that all customers would argue that they were entitled to the highest level of incentive.

The former is key to Royal Mail and the industry commercially. The latter concerns Royal Mail particularly 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 who wished to have the maximum benefit available from a TMI.

In fact, it is highly likely that, should this application fail, Royal Mail would cease from awarding any TMIs altogether to the detriment of its customers and the wider Direct Mail Market.

4.5 Royal Mail competes with other mail, communication media and advertising providers who are able to negotiate a small discount for their services as part of the normal course of winning business

TMI, by their nature are only offered where a customer has a choice as to whether or not to make that communication. For example a bank could not be offered a TMI for statement mailings that they had to make under FSA rules (there would be no new audience and no new product being marketed). In the majority of, if not all, cases TMIs are used for Direct Mail. Advertisers and the media buying agencies that advise them have a wide array of media available to them including, outdoor, TV, radio, internet, incentives (sampling/giveaways) and press as well as a range of postal operators also offering Direct Mail. All of these media channels are able to flex prices in order to be attractive to the buying agency and Royal Mail would like to be able to use TMIs in order for mail to better compete with these other media, i.e. they encourage customers to test mail as a medium for communicating with their customers so that this element of the market expands through innovative use that might not otherwise have been identified.

5 Conclusion

5.1 Given the small scale of TMI postage credits and the fact that they are used to share the risk, with a customer, of an innovative new use of mail in order to grow the mail market as a whole, Royal Mail believes that it is a proportionate regulatory response for TMIs to be exempt from the strict obligations of LC 7 (2 & 3), and by implication from LC7 (4) and seeks a Direction from Postcomm.

5.2 However, if an exemption cannot be so directed, Royal Mail would suggest an alternative, namely to continue to provide Postcomm with details of changes to the TMI Policy ahead of those changes taking effect and also to inform Postcomm of the details of each TMI as they are approved under a formal Direction.

5.3 If Royal Mail were to find itself in that position such that:

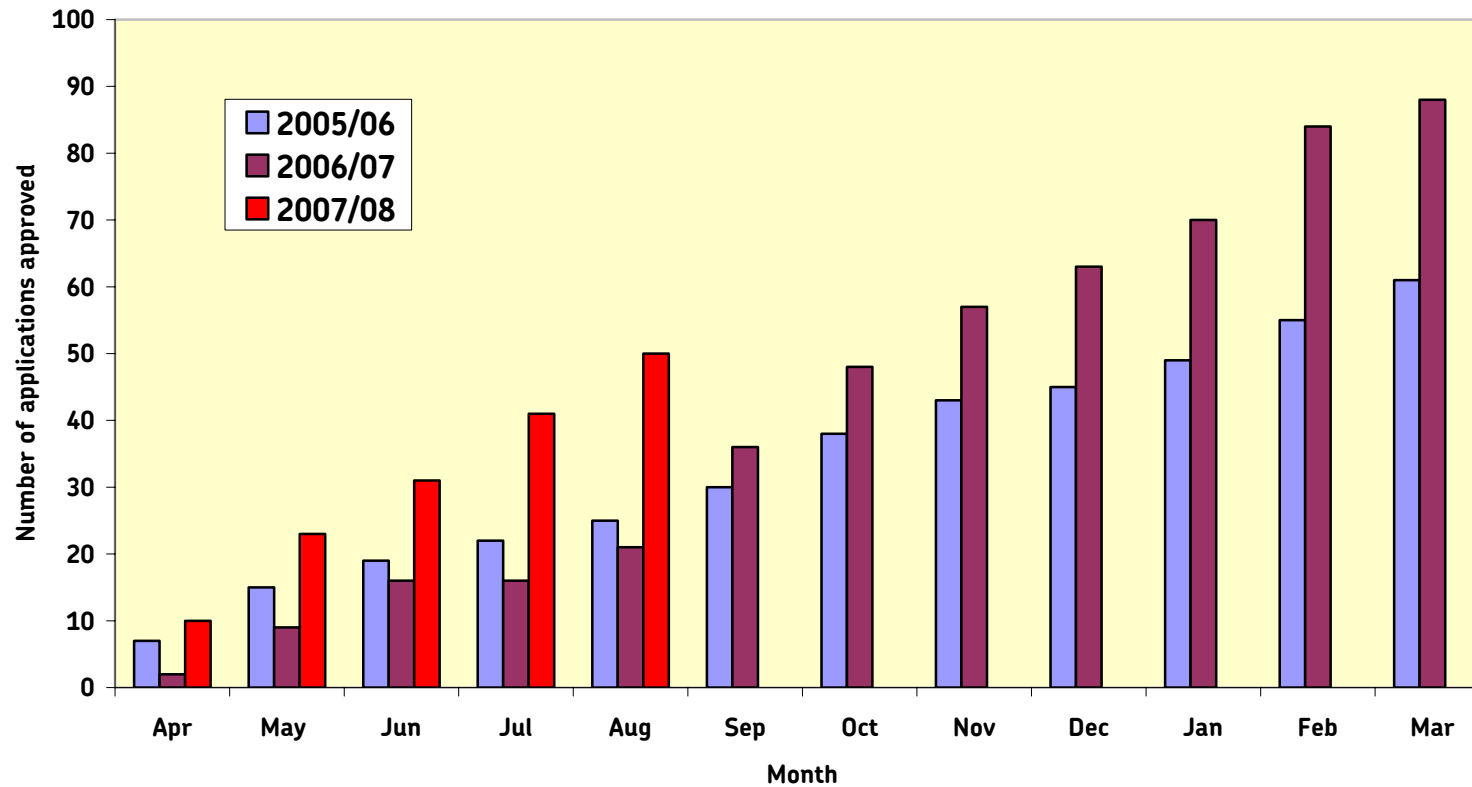
- no individual contact with the customer or tailoring of the incentive could occur, or
- the pre-deployment time lag of 3 months needed to be applied, or
- the full range of postage credits available would need to be published,

it is highly likely that Royal Mail would withdraw TMIs as its use as an innovative tool would be lost. This would be unfortunate for customers as well as the wider postal market.

Annex A – Chronology of events relating to informal notification of TMIs

Date	
23/03/2001	Postcomm introduces Royal Mail's Licence requiring Royal Mail to notify details of the tariffs (including discounts and credit facilities) under C7
01/04/2003	Postcomm amends Licence but no changes to C7
19/05/2004	Royal Mail starts to notify Postcomm of individual TMIs (first occurrence but there is evidence of some earlier notification in January 2004)
22/09/2005	Royal Mail notifies Postcomm of revised TMI Policy
15/11/2005	Revised TMI Policy goes live
06/02/2006	Royal Mail makes last TMI notification until prompted by Derek Sibley at Postcomm to account for this practice ceasing.
03/04/2006	Derek Sibley (PSC) calls Ian Cawthron (RM) to ask why no TMIs have been offered
04/04/2006	Royal Mail recommences TMI notification and makes assurances that problems caused by staff changes will be rectified.
21/04/2006	Royal Mail presented to Postcomm making a statement that Royal Mail proposed to continue following the existing TMI notification process. This proposal was not questioned by Postcomm, either during the presentation, or subsequently.
24/04/2006	Postcomm query maximum discount values and average TMI discount value
27/04/2006	Royal Mail confirms that TMIs for Mailsort 1400 items up to 150g were no longer available which had an effect on the average value.
08/05/2006	Postcomm question whether customers have been made aware of the withdrawal of TMIs for Mailsort 1400 items up to 150g.
19/05/2006	Royal Mail confirms that no customer communications have been made, as it is Royal Mail's policy only to notify Postcomm of the revised Policy.
25/05/2006	Postcomm modify Condition 7 to introduce 3-month notice period.
18/07/2006	Postcomm write to Royal Mail concerning TMIs amongst other matters simply state, ' We will continue to review TMIs in relation to any potential anti-competitive behaviour by Royal Mail'.
12/12/2006	Royal Mail informs Postcomm and Postwatch of revision of TMI Policy and makes new policy document available to them. Details of changes added to websites
12/03/2007	New TMI policy live 3 months later
09/03/2007	Postcomm wrote to Royal Mail asking for the range of postage credits, which can be awarded under the TMI Policy, to be made public.
22/03/2007	Meeting held between Postcomm and Royal Mail to discuss potential ways forward
30/03/2007	Royal Mail proposes revised web text regarding TMIs
27/04/2007	Postcomm wrote to Royal Mail rejecting the revised text and asking for TMI postage credit values to be made available as per the range in Royal Mail's internal TMI Policy or for Royal Mail to seek an exemption from Condition 7.
18/05/2007	Royal Mail suggested further web text amends in an attempt to avoid the need for an application for exemption.
06/06/2007	Postcomm wrote to Royal Mail rejecting the revised text and asking for TMI values to be made available or for Royal Mail to seek an exemption from Condition 7.
20/06/2007	Royal Mail agrees to submit a C7 exemption application in August 2007.

Annex B – TMI Monthly performance report (cumulative)



NB Figure for Aug 2007 is as of 12th Aug 2007

Annex C – Example of TMI Notification made to Postcomm

Company Name	xxxxxxxxxxx Co Ltd
TMI Number	XXXXX-00XXX0
A. TMI Gross Rev.	£100,000
B. TMI Credit Value	£5,000
C. TMI Net Rev	£95,000
D. TMI Percentage	5%
E. Product Used	Mailsort 3 700
F. Number of items	x,xxx,xxx
G. Weight of Item	xxgms
Reason For TMI	New product or service