

Overview of Ofcom's review of Royal Mail Regulation

June 2017

- Section 1 – Background
- Section 2 – Findings
- Section 3 – Parcels Regulation
- Section 4 – Access Framework
- Section 5 – Summary & Next Steps

Our Duties

The Postal Services Act 2011 set Ofcom a duty to secure the provision of a universal service

In undertaking this duty we must have regard to the need for it to be:

- Financially sustainable
- Efficient within a reasonable time period and remain so

2012 Framework

Greater commercial and operational flexibility, subject to certain safeguards

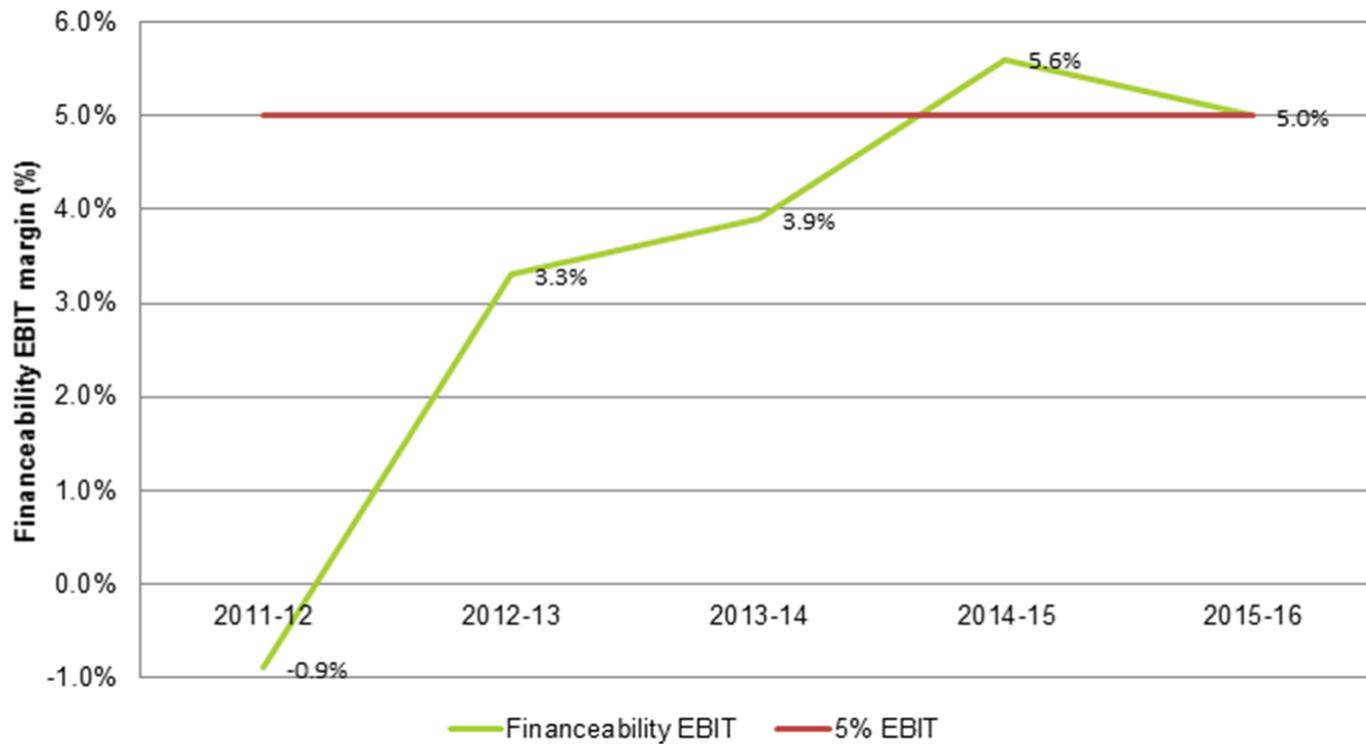
- Monitoring
- Ensuring a basic, affordable universal service is available to all
- Competition

Our Review

- Changes in End to End Competition
 - Universal Service under threat?
 - Wider Issues
 - Efficiency
 - Parcels Market
 - Whistl withdrawal from market

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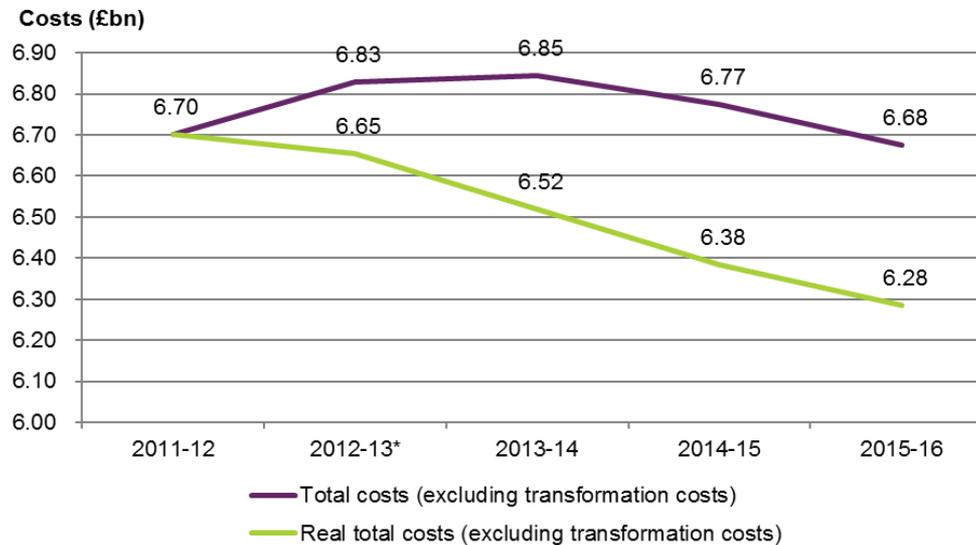
We considered whether USO provided by Royal Mail is financially sustainable



And we looked at its efficiency

- Efficiency Performance

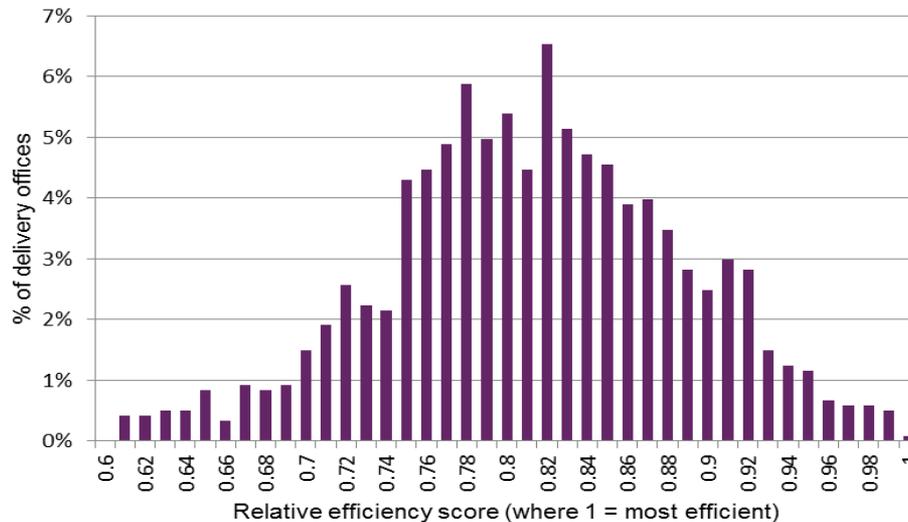
Total real and nominal costs excluding transformation costs



Focus on Delivery

- Up to 2.5% hours efficiency per annum possible over the next three years
- Greater automation
- Increased flexibility in working time
- Greater separation of indoor and outdoor tasks

Delivery Office efficiency distribution



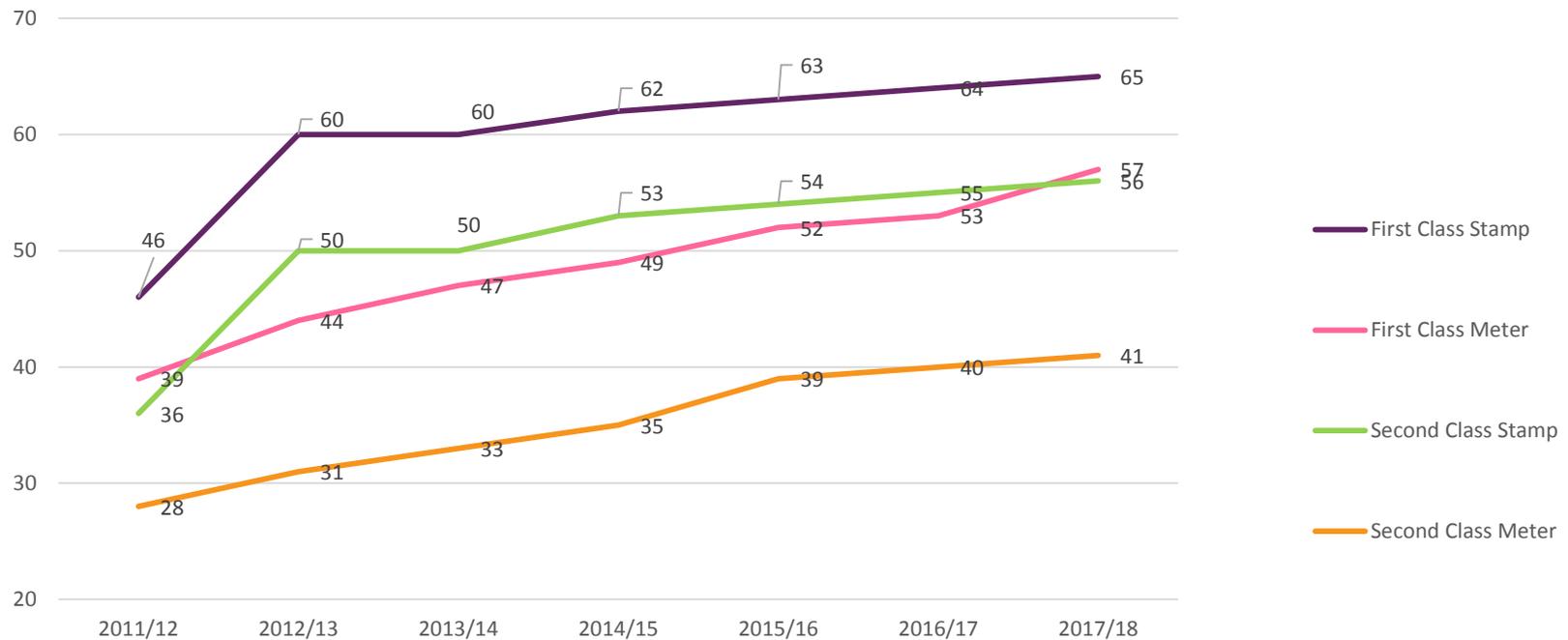
Incentives for Efficiency

- Volume Decline
- Competition
 - Access
 - Parcels
- E-substitution
- Privatisation

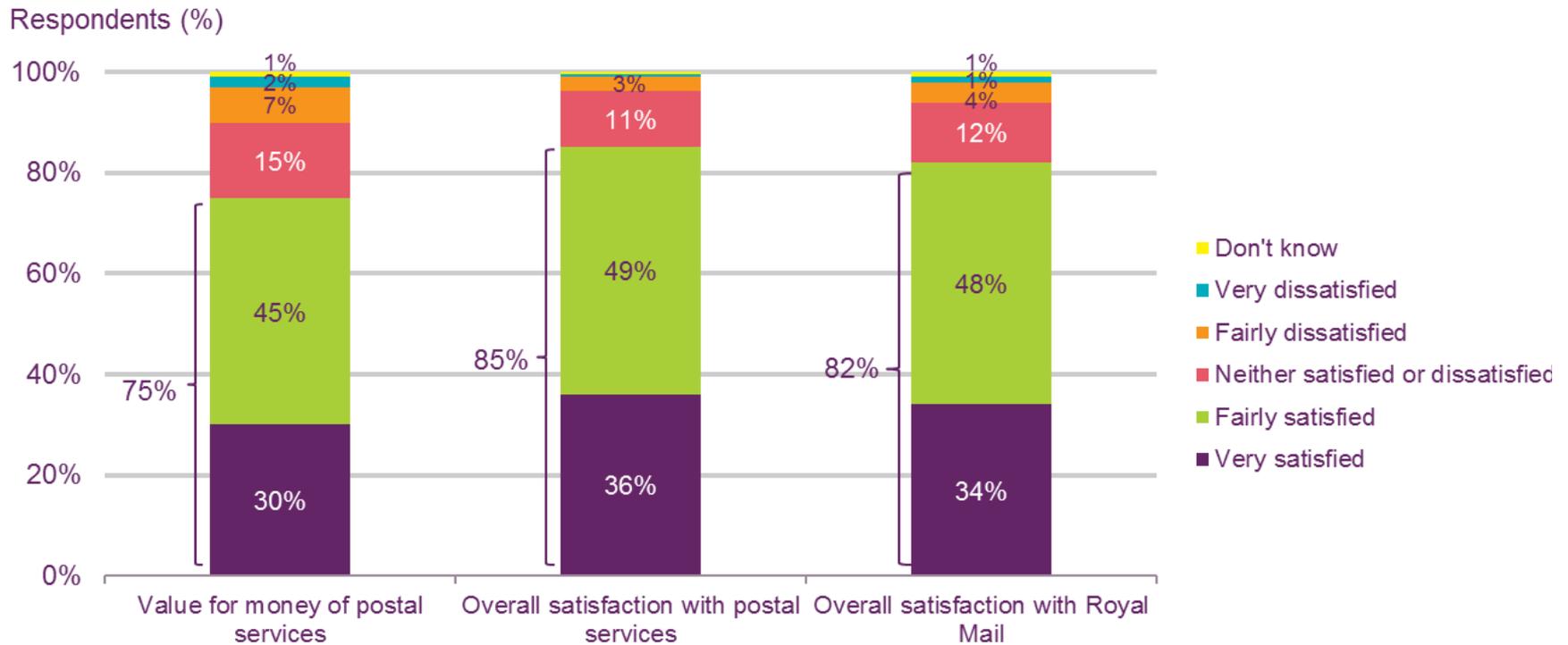
We looked at the impact on mail users

Prices have increased conservatively

pence



And satisfaction levels are high



Source: Ofcom Residential Postal Tracker 2016

We concluded that the current regulatory approach remains appropriate

- The re-introduction of price controls would be inappropriate
- While Royal Mail may have the ability and incentive to increase prices and profitability at the expense of efficiency savings, it has not done so
- On the contrary, our analysis shows Royal Mail is making returns at the lower end of the 5-10% EBIT margin range, some progress on efficiency and not raising prices as much it could, against a backdrop of increasing customer satisfaction
- Therefore, we consider that both the provision of a financially sustainable universal postal service and the interests of consumers are best achieved by continuing to afford Royal Mail pricing flexibility, subject to certain safeguards
- Having carried out this fundamental review, we propose that the regulatory framework should remain settled for a further five years from the date we close the review, i.e. from 2017 to 2022
- We will continue to closely monitor the market and retain the right to intervene

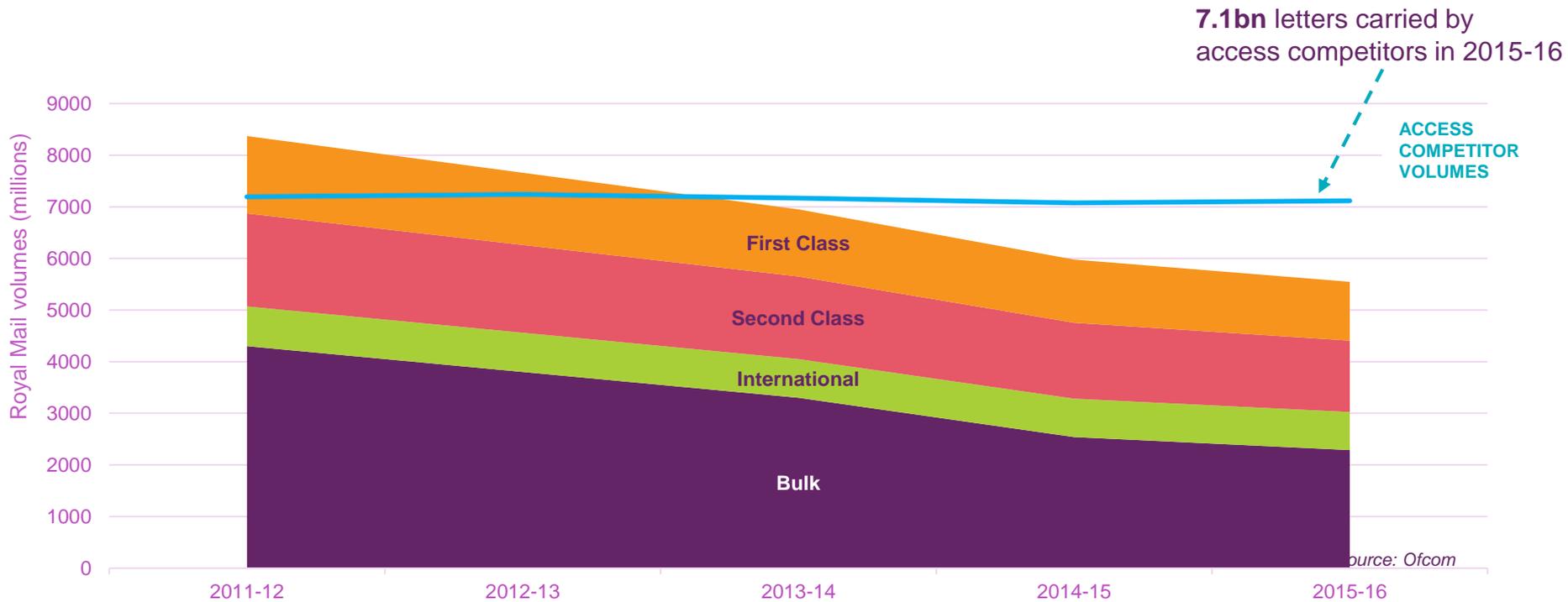
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Parcels Regulation

- We believe competition best serves consumers' interests
- The UK has one of the most competitive parcels markets in the world
- However, Royal Mail retains high revenue and volume shares for single piece and light-weight bulk parcels
- We propose to protect consumers by retaining the safeguard cap on Second Class parcel prices
- We also propose to retain the current position on standard universal service parcels, i.e. that tracking is not included

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UK access volumes have largely remained stable as overall volumes have declined



Access Framework

- Retain Access pricing principles
 - Zonal prices to reflect zonal costs
 - National price to equal weighted average zonal prices
- Royal Mail cannot implement pricing and non-pricing changes with less than ten weeks' notice on the basis of general agreement set out in its standard terms and conditions to a shorter period. Specific agreement is required
- Requests for new access products will be closely monitored to ensure a timely response is provided by Royal Mail

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Summary & Next Steps

- Given declining letters market and increased competition in parcels, Ofcom decided not to impose new price controls on Royal Mail's retail or wholesale prices
- We consider the provision of a financially sustainable universal postal service and the interests of consumers is best achieved by continuing to afford Royal Mail pricing flexibility, subject to certain safeguards.
- The regulatory framework should remain settled until 2022.
- Net Steps include
 - Ongoing Monitoring
 - Regulatory Reporting
 - Consideration of cross subsidy between letters and parcels