Overview of Ofcom’s review of Royal Mail Regulation

June 2017
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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

Costs (£bn)

- 2011-12: 6.70
- 2012-13: 6.83
- 2013-14: 6.85
- 2014-15: 6.77
- 2015-16: 6.68

Legend:
- Total costs (excluding transformation costs)
- Real total 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
Incentives for Efficiency

• Volume Decline
• Competition
  • Access
  • Parcels
• E-substitution
• Privatisation
We looked at the impact on mail users

Prices have increased conservatively
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.

7.1bn letters carried by access competitors in 2015-16.
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