

Richard Hooper CBE  
Chair  
Independent Review of the UK  
Postal Services Sector  
BERR  
1 Victoria Street  
London  
SW1H 0ET

T 0207 259 1201  
F 0207 730 3044  
E millie.banerjee@postwatch.co.uk

28 March 2008

Dear Richard

**Independent Review of the UK Postal Services Sector: Postwatch response to first nineteen questions.**

I enclose Postwatch's response to the first nineteen questions from the review panel.

Postwatch believes the review to be very timely. The postal market is at a critical stage of its development, and a full and agreed recognition of the challenges and opportunities it faces can only be to the benefit of all connected with the industry.

As by far the largest player in the market, Royal Mail has a dominant influence on the industry's future. That being so, Postwatch is encouraged that Royal Mail acknowledges the need for change in both its customer focus (or lack of it) and its internal culture. These are huge tasks: little less than a revolution in Royal Mail's thinking and approach is called for. We believe also that Royal Mail must act quickly to address problems in these areas.

This is not to understate the key influence of the industry regulator, Postcomm: clear and rational regulation is also crucial if the postal market is to develop coherently.

The needs and interests of its customers must be factored in at every point of Royal Mail's Transformation Plan. We will provide our detailed views on the customer experience in our next submission of evidence to the review.

Clearly a major challenge for Royal Mail is declining mail volumes. But this must not be used as an excuse or hiding place for lack of investment or a decline in customer service. Quite the reverse: if Royal Mail is to ride out its problems it (and other operators) must reinvigorate mail as an attractive medium to communicate, advertise and deliver goods.

Royal Mail's actions will fundamentally influence the direction of the mail market in both the short and long term. A financially healthy, customer focused Royal Mail is required for the industry to survive and thrive. The words it has used in its submission to the review are a start; now they must be backed up by action.

Yours sincerely

A handwritten signature in cursive script, appearing to read "M. Banerjee". The signature is written in black ink on a white background.

Millie Banerjee  
Chair

# Questions for consultation

---

## Terms of reference No 1:

- ▶ “assess the impacts to date of liberalisation of the UK postal services market, including on the Royal Mail, alternative carriers and consumers”

- 5.1 The first of our terms of reference is diagnostic. As well as considering the impact of [liberalisation](#), we will also evaluate how postal services have been affected by structural developments in the wider communications market, including the use of the internet, email and text messaging on mobile telephones. We will also consider whether lessons can be drawn from international experience, where Governments have faced similar opportunities and challenges.
- 5.2 Our definition of the postal services market is set out in [Annex A](#). Other words highlighted in this text are defined in the glossary at [Annex B](#).

## Questions about overall objectives

- Q1. What do you consider to be the essential aims of, and vision for, a postal service in the 21<sup>st</sup> century?

A liberalised postal market should be vibrant, innovative, focussed on the needs of social and business customers, and providing a range of products from the specialist narrowly targeted; to the broad “value” products which offer all UK addresses reasonable access to delivery, collection and input of letters, packets, parcels and valuable or express items. It should also be viewed and developed as an integral part of the wider communications market. With the continued growth of competitive offerings (some of them “free”) especially from mobile texting, email, and webcam communications the industry needs to get to the point where it is spending more effort on promoting itself and its services to the customers (senders and recipients) and less on introverted protectionism. In order to achieve this, regulation and control has to be appropriate and simplified and there needs to be greater freedom for the operation of the market.

Postwatch is guided fundamentally by a particular vision of the market which is customer-centric and by a set of principles that are customer-focussed, including:

- Protected and customer focussed universal service
- Protected customer needs of the vulnerable
- Effective competition
- Level playing field (VAT)
- Balanced regulation
- Sizeable mail volumes

Our vision for the UK postal market is of a dynamic and thriving industry in which all customers benefit from a universal level of provision, controlled prices, improving quality of service, greater choice of provider and products, and increasing innovation.

We believe that this vision can best be realised through a combination of:

- a well defined and adequately funded universal service obligation that continues to meet changing customer needs and protect the interests of vulnerable users;
- a level playing field so that competition is fostered, the incumbent is challenged, choice exists and all players have to be efficient to stay in business;
- empowered customers who are aware of their service options, and the associated prices, from various service providers, and know how to exercise choice;
- an incumbent that is sufficiently profitable to be able to modernise its network and reduce core costs for itself and others who access the network;
- a range of competitors that deploy a variety of business models to maximise customer choice and challenge the incumbent; and
- a competent, independent, visionary regulator.

Postwatch believes that through innovation, customer focus, increased efficiency and exploitation of new mail streams Royal Mail's letters business can generate significant profit. This will protect and sustain the universal service, which is crucial to meeting the needs of consumers and to the success of the competitive postal market. At the same time Royal Mail must focus on offering real value and promote the benefits of mail such as targeting. Indeed, as well as stimulating the market in terms of volume Royal Mail must grow it in terms of value, taking account of recent and rapid trends in electronic communication and activities such as e-fulfilment.

Social consumers, and most especially vulnerable consumers, need the universal service obligation to be protected. This does not mean that its scope and funding cannot be reviewed in the light of changing circumstances over the next decade, but it does mean that the USO must reflect properly-determined consumer needs and be adequately funded.

Royal Mail has responded to the new competitive environment by commencing a programme of rebalancing of tariffs in order to achieve more cost-reflectivity. While we understand the logic of aligning prices more closely to costs, we believe that this has to be done in a phased manner in order that services remain affordable to all consumers.

Competition has already started to reduce Royal Mail's market share and this has happened at a time when overall mail volumes have ceased to rise and look likely to experience a gradual but sustained decline. While we certainly favour a level playing field, reduced barriers to entry and greater competition, such changes must be introduced gradually with proper regard to the impact on social customers and the implications for the funding of the USO and in a manner that ensures that competitors are not undermined before they have properly

established themselves.

Given that competition is so new and fragile and that the postal market has so many differences from other regulated markets, we see a continued need for a sector-specific regulator and indeed sector-specific expertise in consumer representation (wherever that might be located organisationally).

Finally, in considering the main issues in the current market and looking at the postal market through the 21<sup>st</sup> century Postwatch believes that there are four key customer based messages.

These are:

- The universal service must be preserved that is reflective of customer needs (particularly for vulnerable users)
- Royal Mail's rebalancing activity must be gradual and only where there is a regulatory need
- Separation should be viewed in the context of what problem one is trying to solve and it must be fair, reasonable and non-discriminatory
- Evidence-based regulation will continue to be relevant

## Questions about liberalisation

Q2. What has been the impact of **liberalisation**, so far, on:

(a) **social consumers** sending and receiving mail;

It could be argued that social users have not benefited from liberalisation as no competitive alternative exists and social users have endured continual price rises in recent years. However, distinguish mail senders from recipients and some recent initiatives, such as Safeplace, may be considered a benefit. The recent commercial focus of Royal Mail and resultant increase in quality of service is a perceived benefit to social users but these instances may be due to the threat rather than the actual existence of competition.

(b) **SMEs** sending and receiving mail;

There are no obvious benefits to the SME from competition. Little competition exists for this sector although this may change over time with competitive offerings trickling down from the existing large volume products. One key benefit of Royal Mail's pursuit of cost reflective pricing has resulted in meter mail users qualifying for a discount in postage costs, however, this is tempered with the initial investment and upkeep of franking machines. Recent Postwatch research<sup>1</sup> showed that there was limited uptake of alternatives to Royal Mail in the market with only 5% of those surveyed using a competitor to Royal Mail.

(c) **large companies** sending and receiving mail.

---

<sup>1</sup> Current & future postal needs of SMEs (Postwatch 2008)

in terms of the price of services, the choice of services to suit particular needs, and the quality of service.

Large mailers have been the primary beneficiaries of competition in the mail market through more choice and competitive prices. Sending mailers have a choice of operator although no real change has taken place from the recipient's point of view. Postal market economics is volume driven and the better margins exist at the high volume end resulting in competition focusing in this large mailer area. Choice exists but to what extent this choice is innovative or there is a varied choice is limited as other operators tend to offer similar products to Royal Mail.

Q3. What has been the impact of liberalisation, so far, on:

- (a) people in rural areas;
- (b) people with disabilities;
- (c) senior citizens;
- (d) people in areas which receive relatively little mail.

It is difficult to separate these groups as there have been little or no developments in the mail market and these groups, in the mail market context, are not totally exclusive. One element these groups have in common is that they have experienced above inflation price rises year on year since liberalisation. The commercial focus of Royal Mail and the drive towards cost reflective pricing in a competitive market has meant changes to the pricing structure i.e. Pricing in Proportion (PiP) and Zonal Pricing. It can be argued that replacing a weight-based system with one that also requires consideration of thickness and size introduces complexity for vulnerable customers such as the elderly. Furthermore, we believed that Royal Mail's application to introduce Zonal Pricing would have had a detrimental effect on those residing in rural areas.

Q4. What has been the impact of liberalisation on Royal Mail?

Recent figures have shown that Royal Mail's market share is decreasing, however, even though switching exists Royal Mail's market share remains significant (over 99%) and it continues to deliver mail to the final mile. The main question should not focus on the impact of liberalisation on Royal Mail but how it intends to react to liberalisation and the competitive environment that is developing. Liberalisation itself may not have had any effect on Royal Mail, however, the resultant competition and threat of competition appears to have changed Royal Mail's focus to a more commercial one. The competitive threat has coincided with (we do not know the reason and we should not speculate) taking costs out of the business, introducing more cost reflective pricing and, on the whole, transforming Royal Mail into a more efficient 21<sup>st</sup> century operation. Some key activities as a result of the impact are as follows:

- cost reflective pricing drive (Pricing in Proportion)
- more efficient (significant job cuts and more flexible working patterns)

- Retail and wholesale split

There are several areas on which Royal Mail must focus if it is to maximise its opportunities in the competitive marketplace and deliver value for customers. It must:

- stimulate market **growth** where possible and minimise decline where not;
- **transform** in order to **compete** in the marketplace;
- drive **innovation** and **efficiency**;
- use **intelligent technology** to greater effect;
- exploit and adapt the **existing network** to customers' advantage; and
- add new **value** to mail as a communications medium.

This paints a picture of a Royal Mail more flexible, entrepreneurial and creative than we have generally seen since liberalisation. The settling of the strike and the funding package which Royal Mail has received from the Government provide an unrepeatable opportunity to make a reality of this vision.

Royal Mail is entering a period of real change, during which it will need to refocus and diversify while continuing to address the nation's mailing needs by providing an affordable and reliable universal service. The company now faces the challenge of reassessing its priorities and focusing on those areas where it can add value and make profit by satisfying customer needs and meeting changing demands.

Q5. What has been the impact of **liberalisation** on **alternative carriers**?

The impact of liberalisation on alternative carriers may be viewed in terms of opportunity. Liberalisation has provided existing companies that operate in logistics or mail industries with an opportunity to extend operations and compete with Royal Mail through Access or by offering niche services.

One further impact is the issuing of licensing and how that has developed through the liberalisation process. Postcomm have relaxed particular aspects to encourage alternative carriers to enter the market and granting licenses for significant periods (10 years) creating regulatory certainty.

Q6. To what extent has competition emerged since postal services were liberalised, and what kind of competition has developed? Please consider:

- (a) the collection and delivery of letters, packets and parcels
- (b) **transactional mail**, **direct mail**, **social mail** and publications
- (c) services for large businesses, **SMEs** and social consumers

The primary source for this is Postcomm's Competitive Market Review which gives a detailed year on year snapshot of the market, enabling the industry to view the development of competition. However, some niche services and

unlicensed activities have emerged including postal consultants who seek the best deals for large mailers and environmentally minded printers who eliminate the need for transporting mail by utilising a network of printers throughout the country.

Competition has largely centred on the collection of letters, packets and parcels through Access arrangements whilst the delivery is undertaken by Royal Mail and this 'final mile' part of the postal pipeline could be viewed as a 'natural monopoly'. Access is the primary form of competition that has developed and two types of Access exist, Down Stream Access (DSA) and Direct Customer Access (DCA).

Although the UK market has been fully liberalised, it is debatable whether this has generated much real competition. Whilst significant mail volumes are handled upstream by other licensed operators, these are all passed to Royal Mail for 'final mile' delivery via access agreements. This could well be described as 'work sharing' rather than as competition. There is little profit in this activity, which in turn gives little incentive for investment leading to innovation.

Other points to draw out are that little end to end competition exists (1% of total volumes) and other than the possible introduction of urban services by TNT, further competition in this area is unlikely given the current VAT distortion. Royal Mail currently retains 99.2% market share and continues to deliver the majority of mail through Access arrangements.

Q7. Has [liberalisation](#) made an impact on any other groups?

The effects of liberalisation do not appear far reaching and other than Royal Mail, other operators and large mailers (including mailing houses) no other group has been noticeably affected. However, the ripple effect of liberalisation has been met with considerable opposition from the CWU and it has been affected due to its member base decreasing as a result of significant job losses at Royal Mail.

Both charities & financial institutions are affected by the VAT exemption and, as a result, do not experience the same competitive offerings as other large mailers. VAT exempt customers send more than 35% of the UK's business mail. More options for delivery will become available because access to VAT exempt customers' important volumes will enable investment e.g. in sorting machinery which allows SME's to access hitherto inaccessible discounts.

It is important to note that competition is not homogenous across the UK. Parts of Scotland and Northern Ireland, primarily rural or low volume areas, experience little or no competition from licensed operators and this is unlikely to change due to the economic or geographical nature of these places. In this respect competition is not a level playing field and those in rural and less populous areas may never see any benefit, from a senders point of view, from competition.

Q8. Have Royal Mail and new entrants been able to compete effectively and fairly?

It may be too early to say as little real competition exists and that we may know more about how current competition has worked in practice with the outcome of Postcomm's recent Access review. However, from what we currently know it appears that due to the fact alternative carriers operate in the market and they are winning significant mail delivery contracts then the answer is yes. Postcomm's recent Interim Review highlighted that, after considering arguments from both Royal Mail and alternative carriers, the Access price was fair and that there was an opportunity for others to compete with Royal Mail.

Postwatch is not aware of any major instances of anti-competitive behaviour to suggest there are unfair practices taking place in the market and no suggestion that the regulatory environment favours anyone in particular. However, VAT remains a key barrier to the promotion of effective competition and, although there have been recent endeavours through access to bypass the VAT requirements, it is a barrier to all market operators competing on a fair basis. By resolving the current distortion for competing services, competing operators will have the opportunity to invest in services and end-to-end networks, thereby benefiting consumers (as senders and, more particularly, as recipients of mail) and business mail users.

Q9. What can we learn about [liberalisation](#) in the UK from international experience?

International comparisons are notoriously fraught with difficulties given the ownership, geographical, regulatory, political and mail traffic/composition differences of liberalised countries. We note Postcomm's international comparisons of the USO and Royal Mail's comparisons with other EU countries on price. We raise a note of caution with this approach. It is almost always possible to cite an international example to support one's case, whether on services delivered or on price. But we must be aware of the geographical, political and competitive context of each country – which means it is difficult to make any valid comparisons at all. Moreover, different EU countries set different criteria for mail categories in terms of weight, size and product definition. So certainly we should learn lessons from overseas, but we should be cautious about direct comparisons.

One important point to note is that Postcomm has recently relaxed the licensing requirements for new entrants and, as is evident in Germany, liberalisation led to the development of a large number of small operators initially, most of which have disappeared.

**Questions about structural changes**

Q10. Which changes in the communications market do you consider have had an impact on postal services:

- (a) internet;
- (b) email;
- (c) text messaging on mobile telephones;
- (d) others?

and

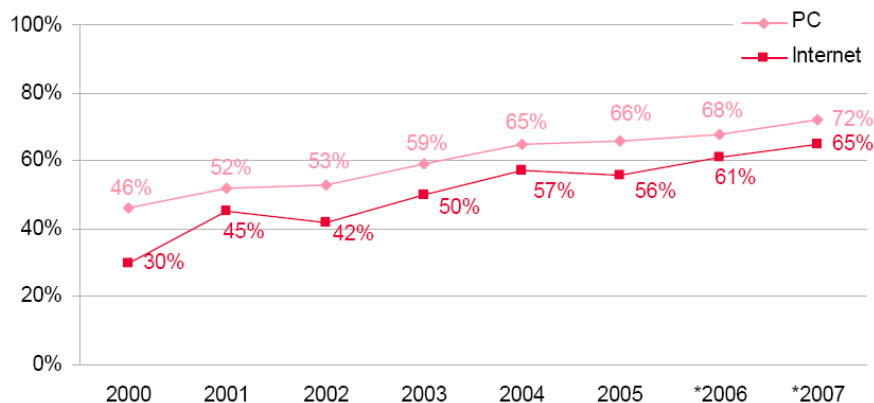
Q11. Can you quantify these changes?

Each of the above has had an impact on the postal services market and technological changes in terms of e-communication will continue to affect physical mail volumes.

The internet has increased the number of e-fulfilment items and but also led to a decrease in the amount of transactional mail as a result of an on-line banking, bill paying etc.

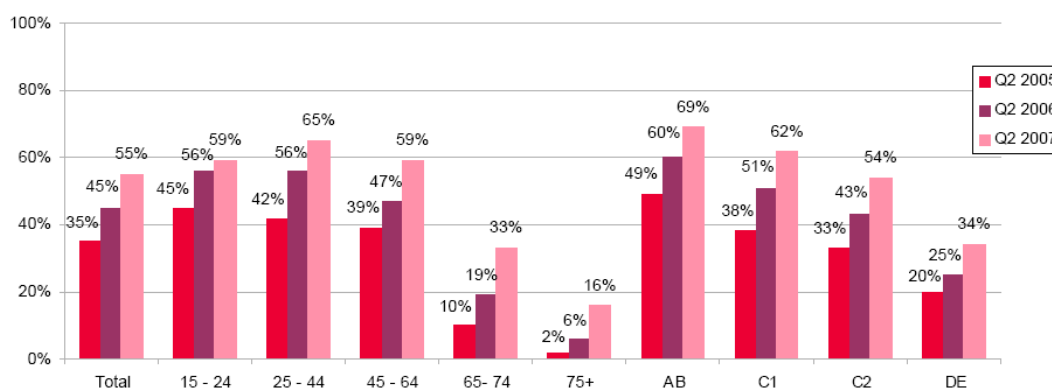
It may be that the increase in internet penetration is slowing down. Whether or not this is so (and the evidence is mixed), the households without internet access are generally those of poorer families, older people and people with disabilities. For many such customers electronic communication and transactions are unlikely to replace physical mail in the short term (see figures 1 & 2). Additionally, concern over on-line security and data may lead to some slowdown in e-substitution in this area.

Figure 1: Take-up of the Internet at home



Base: All adults 15+<sup>10</sup>. \*Q4 data for 2001 to 2005, Q2 data for 2006.  
Source: Ofcom communications tracking survey

Figure 2: Age and Socio-economic profile of those who have broadband access at home



Base: All adults (Q2 2005, 2206) (Q2 2006, 2439) (Q2 2007, 2265)  
 Source: Ofcom communications tracking survey

In order to ensure those customers on low income are able to access postal services, there should for the foreseeable future be a backstop of an affordable service at a uniform tariff to every address in the UK

Email has had an impact in reducing transactional mail, both business and social.

It is difficult to distinguish the overall effect of text messaging in terms of e-substitution, although due to the high and continuing usage of this communication form there is likely to be a small impact (reduction) on other social users volume (e.g. sending greeting cards). Younger age profile customers are higher users of texts and emails. The new emerging free video communication services (e.g. Skype) may also have an impact in the early part of the 21<sup>st</sup> century.

Attitudes to environmental concerns are likely to continue affect volumes of transactional mail. Continued migration to e-communication is likely to occur not just for convenience and cost reasons but also due to consumer attitudes to the sustainability of 'paper items'.

Q12. What is the relationship between e-fulfilment and e-substitution in terms of their impact on:

(a) volume of postal business?

At this point in time the rise in e-fulfilment volumes is not yet offset by the decrease in transactional volumes.

(b) value of postal business?

Although volumes are declining the comparative value of the e-fulfilment items may mean that the value of postal business revenues decline by a lesser proportion than volumes.

The amount of e-fulfilment has increased and is likely to continue growing as internet penetration rates increase. If E-fulfilment (packet) strategy is the focus of operators products and services then this could provide significant additional value. The value of the e-retail market is approx £18bn and predicted to reach £30bn by 2011. (Fig 2.9: Postcomm Competitive Market Review 2007).

Q13. What has been the impact of e-fulfilment and e-substitution for the following:

(a) social consumers sending and receiving mail;

#### Sending

e-fulfilment – some increase due to social customers sending ‘ebay’ packets.  
e-substitution – a significant number of residents pay bills electronically (40%) and about a third make complaints or enquiries to businesses electronically. This is reducing transactional volumes.

#### Receiving

e-fulfilment – a large increase in receipt of on-line ordering packets. Increased requirement for ‘delivery convenience’ options.  
e-substitution - some decrease in transactional mail, although billing and bank statements still advised by post. Direct marketing volumes will decrease as it becomes more targeted. Consumer magazines – no significant e-substitution although some change expected as companies (e.g. Reed Elsevier, Haymarket) increase online offerings.

(b) SMEs sending and receiving mail;

Bulk mailers can be SMEs but these are categorised in the large companies section.

#### Sending

e-fulfilment - for those SMEs undertaking e-fulfilment (online ordering) there will be increased use of postal services, together with a requirement for reliable (tracked) products with delivery options and good quality ‘mail integrity’. There will need to be a good provision of access points.

e-substitution – more billing and invoicing is likely to be done online, although there is still a requirement for using the post for invoices

#### Receiving

e-fulfilment – for SMEs who order items online the impact will be similar to social customers.

e-substitution – more invoicing/payments undertaken online but there is still a requirement for reliable mail deliveries, within a one hour time slot and by 12 noon (Postwatch/Accent research 2008)

(c) large companies sending and receiving mail;

### Sending

e-fulfilment – unlikely to effect this mail stream.

e-substitution – decreasing volumes of transactional mail with associated lower spending and revenues (will effect viability of mailing houses).

### Receiving

e-fulfilment – will have the same impact as all other types of receiving customers.

e-substitution – similar effects to SMEs where more transactional mail is substituted online but there still a requirement for mail delivery with service levels for delivery times.

(d) Royal Mail;

Volumes are decreasing, affecting revenues and unit costs. However, revenues could increase if Royal Mail put increased focus on 'packet strategy', meeting users needs in this growth area.

(e) **alternative carriers?**

Increase in courier style delivery services due to e-fulfilment and delivery convenience requirements, but in terms of bulk mail these companies with access arrangements will be competing for decreasing volumes.

### **Terms of reference No 2:**

- ▶ **“explore trends in future market development and the likely impact of these on Royal Mail, alternative carriers and consumers”**

5.3 The second of our terms of reference is forward-looking. This section considers the factors (whether economic, technological, environmental or social) which may change the business environment in which mail companies operate in future, irrespective of changes made to the way in which postal services are provided.

### **Questions about future scenarios**

Q14. What does international experience tell us about the challenges and opportunities facing the UK market?

International experience, as previously mentioned, is a difficult area but lessons can be learnt and it may be posed that there are many studies available world wide relating to the postal industry but we are not learning adequately from these (e.g. postal kiosks). Challenges are common across all jurisdictions with falling mail volumes, other media, threats to the USO and funding of the USO being of

considerable importance. However, opportunities do exist for incumbent postal operators and new entrants alike. The postal environment in Europe and across the globe is changing and with these challenges comes the opportunity of reinvigorating the mail media and integrating it in the modern technological world to ensure the USO is preserved.

Q15. What factors might encourage – and discourage - the use of electronic services as an alternative to the postal service, for:

The postal industry is competing with several other industries: the transport business, media distribution systems, and e-commerce. Most importantly, new online services by banks, energy providers, other utilities, or e-business platforms have created new options for consumers to send 'mail' across the internet. It has become increasingly difficult for those operating within the traditional postal market to compete with what are perceived as more efficient and cost-effective, and more speedy, methods of communicating, and with this lack of growth there has been little appetite to innovate. Younger age groups are showing away from post almost entirely.

(a) [transactional mail](#);

Transactional mail has fallen due to the drive to switch people to online alternatives. The level of internet penetration is such that many customers have switched to more convenient, and environmentally friendly, online statements and billing. This migration has been further encouraged by utility companies who have offered incentives to customers to switch to e-billing.

(b) [direct mail](#);

Environmental, cost effectiveness and rates of return would be key considerations in this area. Direct mail has the advantage of being a targeted advertising medium and moves to higher value 'repeat' direct marketing affiliated to electronic offerings could maintain the relevance of post.

(c) [social mail](#);

Time (priority), convenience and whether or not a physical item is required to be sent as many have replaced the common letter with an email.

(d) publications (such as magazines);

Cost is a significant consideration here as if the cost of sending the magazines becomes considerable then companies will switch to alternative means. Additionally, should advertising revenue fall then this would have a major impact on the magazine industry.

Q16. In particular:

- (a) what advantages might consumers ascribe to paper mail, as the volume of electronic mail increases?

There is an obvious physical advantage should something be sent requiring a signature, as well as for packets and parcels generally. Additionally, social users may have an emotional attachment to some items such as a letter or a birthday card while there are benefits surrounding the portability of physical mail.

- (b) how far is environmental policy and regulation likely to affect the market, in either a positive or negative way?

Any impact environmental policy will have on the industry will be viewed on its own merits. Environmental policy will become more important in the postal market as time passes and issues gain pace. We have already seen some debate around direct mail and the use of paper and vehicles in the industry and subsequent impact on the environment.

- (c) to what extent can the postal sector successfully provide complementary services to other media channels, including broadcasters and companies advertising on the internet?

It is hoped that the mail industry will seek and exploit opportunities with other media integrating the physical aspect of mail with online services and broadcasters. It is through this innovation that mail, as a key communications medium, will be able to survive as online/broadcast services still require the physical product to be delivered and it is here the mail market will be able to provide effective, complementary and hopefully flexible solutions.

- (d) what innovations are likely, or possible, in the development of IT hardware and software, with implications for the postal sector?

We have recently seen companies such as Viapost come to the market offering a convenient, cheap and environmentally friendly service to customers but it remains to be seen whether or not this model will be sustainable in the long term. This already exists with the BFPO 'e-bluey'.

- Q17. Is it possible to provide evidence for these factors, as a basis for preparing projections for the future of the mail market?

Difficult to provide evidence as these factors may have a positive or negative effect on the market and the market is notoriously difficult to predict regardless. Some factors may be a stimulus for substitution and also a stimulus for growth.

- Q18. What factors may limit the ability of companies to enter the market, or their market share:

- (a) in providing **upstream** services?
- (b) in providing a **downstream** service?
- (c) other services?

A level playing field is imperative and by far the biggest obstacle to this is the VAT exemption enjoyed by Royal Mail. We believe that Postcomm must address key barriers to entry over the coming period so as to enable competition to develop. Other key factors we believe include:

- Decreasing mail volumes and consequently retraction of the market
- Incumbent behaviour e.g. clear motivation for new products, potential for anti-competitive behaviour
- Lack of margin due to price e.g. cost reflectivity changes, potential for predatory pricing

The infrastructure required to operate a downstream service and the lack of profitable margins without significant mail volumes to make such a venture viable would deter companies from entering this area. Downstream is a high cost area and an extremely difficult area to enter as a huge network would be required to compete with Royal Mail who enjoy economies of scale in this high cost area.

A licensed operators inability to understand the needs of its target customers within the mail market with its product offering and little subsequent innovation or product development would inhibit market entry or the gaining of market share.

The lack of radical innovation on the part of Royal Mail and new operators since the market opened fully in 2006. The incentive to innovate is therefore not strong and competitors within the market who use access tend to provide almost identical products to those of Royal Mail. However, innovation has taken place, with some end to end operators looking at new ways to protect mail and to offer track and trace facilities to provide customers with comfort and confidence in the service.

Another barrier may be regulation. Postwatch worked with Postcomm and Royal Mail to assist genuinely innovative products through the regulatory approval process and supported the relaxation of Trials Requirements and the exclusion of some products from Condition 7<sup>2</sup>. We believe the process of getting products to the market is now more efficient as a result, both for Royal Mail and for customers.

The lack of margin available within which to make a profit through Access may inhibit entry in the upstream. The only real scope for competitors gain is on the access margin resulting in a distinct lack of competitive gain for consumers, non-bulk mail senders and little pass through to recipients. Any 'squeeze' on this margin would not incentivise market entry and may force existing operators to cease operations.

---

<sup>2</sup> Provision of information to users of postal services

Any anti-competitive behaviour by Royal Mail, such as predatory pricing, would have a negative impact and hinder the entering of new companies or the introduction of services to the mail market. Furthermore, Royal Mail's pursuit of cost reflective pricing and price rebalancing could result in the introduction of pricing strategies that create a scenario within the market effectively excluding potential entrants. Postwatch identified this as a possible side effect of the introduction of Zonal Pricing, In the form proposed by Royal Mail in 2007.

Regulation, in particular an onerous licensing framework, may prove a hindrance for new market entrants and deter new entrants or disincentivise existing market players.

An operators inability to adjust to the market which results in an unsustainable business model would inhibit it introducing services or developing within the market e.g. Express Diaries.

Q19. Are there three broad scenarios which you believe would provide a useful framework to test policy options? (Scenarios should focus on economic, environmental, social and technological changes outside the mail market, assuming that current policy is maintained in relation to the postal sector). Please give your own projections for the volume and cost of mail under each.

Across all potential scenarios, regardless of any external changes, mail volumes will continue to drop on a year on year basis and it is the rate of this decline, and range of products available, that may be decided by external factors and if e-fulfilment mail streams are not exploited and grown. Additionally, prices for social users will continue to increase and prices for business customers will continue to fall. Again the rate of these increases will be set by Royal Mail's price control which is influenced by factors such as the RPI.

### Economic

A general economic recession would have an impact on the RPI and have a significant bearing on Royal Mail's future price control. Any impact on consumer spending may result in the reduction of direct mail campaigns which would put further downward pressure on mail volumes. As a result Royal Mail may find itself in a precarious financial position resulting in the need for a very generous new price control to rebalance prices quickly or a reopening of the current control to address any financial difficulties immediately.

### Environmental

Consumer attitudes to environmental concerns could affect both volumes (decreasing) and costs (increasing) as the mail industry involves the physical movement of 'paper items'.

It will require all parties of the industry and supply chain to adopt and actively promote changes to operations and products to meet these changing attitudes

and to maintain both volume and revenues (e.g. green direct and unaddressed mail products and changes to traditional postal direct marketing approaches).

However, growing customer requirement for delivery of packets ordered online will continue to increase volumes. First class services require increased logistics (trucks and importantly the air network) with associated carbon footprint. The industry and consumers will need to balance needs and this will include environmental concerns.

### Social and technological

A key aspect of the social and technological impact is the level of e-substitution. The level of e-business is increasing, running alongside telephone communication. The rate of change will be dependent on a range of issues including the level of internet penetration (and broadband access) as well as changing demographics as all generations experienced in IT use. It is likely, however, there will still be some citizens who will not be significant users of IT. It is also worth noting that some consumers are concerned about security of online transactions and increased identity fraud and may continue to rely on transactional mail.