
Review of postal regulation

Consultation

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[Review of postal regulation](#) – Welsh translation

CONSULTATION:

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1. Overview

This document sets out Ofcom’s proposals for the regulation of postal services from 2022 to 2027. Our proposals aim to support the financial sustainability and efficiency of the universal postal service, promote competition and improve protection for consumers.

Postal services play a key role in our society. They are used by almost everyone in the UK on a regular basis, from online shopping deliveries, to receiving important medical correspondence, to sending cards to friends and relatives.

Postal users’ needs and the postal markets that serve them are changing. The number of letters sent by consumers and businesses continues to fall, but parcel volumes are growing rapidly as we continue to communicate, shop and live differently. The Covid-19 pandemic accelerated these trends and highlighted the importance of postal services for residential customers and businesses across the UK. In the years ahead, moving towards a net zero economy and adjustments in the labour market are likely to bring further challenges.

Postal operators continue to adapt to these changes. For parcels services, competition has increased, especially for online shopping. This is spurring innovation in response to consumers’ changing needs. Royal Mail, like other operators, is evolving its business, while also maintaining the provision of a universal postal service.

The regulation of post is underpinned by the ‘universal postal service’, which requires the delivery of letters six days a week and parcels five days a week to every address in the UK at uniform, affordable prices. Beyond this, the current regulatory framework for post was set in 2012 and last reviewed in 2017. It reflects Ofcom’s legal duties,¹ and allows Royal Mail significant commercial freedom to provide the universal postal service and other postal services in order to meet the reasonable needs of users and adapt to the challenges facing the market. It also seeks to promote competition in the wider postal market and to protect consumers from harm. We are reviewing whether this framework remains fit for purpose and effective for the next five years (from 2022 to 2027).

In doing so, we have set ourselves the following objectives:

- Ensure all postal users have access to simple, affordable and reliable postal services that meet their needs. This applies not only to universal services users but also wider postal users, including all users of parcels and letters services, and both senders and receivers.
- Support a financially sustainable and efficient universal postal service.
- Support effective competition in the wider postal market for the benefit of consumers, but with targeted interventions to protect consumers where necessary.

We recognise that there is significant market uncertainty ahead and there remain several risks to the long-term financial sustainability of the universal postal service. It is particularly important, in this context, that Royal Mail delivers on efficiency improvements and modernises its operations to respond to the growing demand for parcel delivery. The main drivers of a financially sustainable and efficient universal postal service are within Royal Mail’s control, and we consider it important that

¹See Section 2 of this document.

Royal Mail continues to have commercial flexibility so that it is in a position to meet the challenges it will continue to face.

What we are proposing – in brief

Maintain the current overall framework for regulating Royal Mail in relation to the universal service. This will continue to provide Royal Mail with commercial flexibility to adapt to changing circumstances and market uncertainty, and a stable regulatory environment. This stability and flexibility will support investment and innovation, and create the conditions to allow Royal Mail to continue to transform into a modern and efficient business for the digital age, securing the long-term financial sustainability of the universal service.

Retain all existing safeguards to protect consumers, including our high quality of service standards. We will ensure access to affordable basic postal services by maintaining the existing safeguard cap on second class letters, large letters and small parcels.

Increase our understanding of Royal Mail's longer-term sustainability outlook for the universal service and require it to report publicly on its longer-term efficiency plans.

Continue to promote effective competition in the wider postal markets, by continuing to impose only limited regulation when necessary for the protection of consumers or competition. We plan to maintain the current scope of access regulation but not extend it to small parcels. We also do not intend to bring tracked products (First or Second Class) into the scope of the universal service. This recognises the adverse impacts that these regulatory changes could have on end-to-end parcels competition.

Introduce new targeted consumer protections for parcel services, given some customer experience issues we have found. Parcel operators need to make substantial improvements in customer service and complaints handling, so we are proposing new guidance on how complaints should be handled. We are also proposing that parcel operators be required to have policies in place to better meet the needs of disabled consumers, as our research has found disabled consumers are more likely to experience delivery problems and are more likely to suffer harm as a result, compared to consumers without disabilities.

Next steps

We invite responses to the questions raised in this consultation, which are summarised in Annex 4, by 5pm on 3 March 2022. Details on how to respond to this consultation are set out in Annex 1. We intend to publish our statement on the future regulation of postal services in Summer 2022.

2. The postal services market and our proposed approach to regulation

Since our last review in 2017, the postal market has undergone significant change as demand continues to shift from letters to parcels. Although there is uncertainty around the pace of change and the long-term effects of the pandemic on the postal market, this trend is expected to continue over the review period.

Our aims for this review are to ensure postal users continue to have access to affordable and reliable postal services that meet their evolving needs; support a financially sustainable and efficient universal postal service; and support effective competition in postal services for the benefit of consumers.

To achieve this and taking account of the changing market context discussed below, we are proposing broadly to continue with our current approach to postal regulation. This provides commercial flexibility to postal operators, including Royal Mail, and promotes effective competition in both the bulk letters and parcels market. It recognises that there remain several risks to the long-term financial sustainability of the universal postal service and that Royal Mail needs to deliver on efficiency improvements and modernise its operations to respond to the growing demand for parcel delivery. It is for Royal Mail to manage its business and to take a long-term view in securing the financial sustainability of the USO, using the commercial flexibility that our regulation provides. Our framework recognises the importance of the universal postal service and contains several safeguards which we consider will remain important over the next review period.

However, there are some areas where we are proposing to enhance the regulatory framework. We propose to strengthen our approach to financial sustainability and efficiency and hold Royal Mail to account for the achievement of its planned efficiency savings. We are also proposing that parcel operators should take steps to improve customer complaints handling and put in place policies that better meet the needs of disabled customers.

We are proposing that the regulatory framework set out in this consultation should remain in place for five years.

Introduction

- 2.1 Postal services play a key role in our society. The ability to send and receive letters and parcels is important both socially and economically. Postal services are particularly important to those who might be more vulnerable, such as those who are more geographically or digitally isolated from their friends and family. Postal services also provide us with the ability to interact with Government and a range of other organisations, to access a range of services and to receive goods direct to our homes.

- 2.2 The universal postal service which is provided by Royal Mail continues to play a key role for senders and receivers of mail items. It ensures that letters and small parcels are delivered to around 30 million business and household addresses in the UK, at uniform prices, regardless of destination. Consumers and businesses continue greatly to value its frequency, affordability, pricing uniformity and reliability.
- 2.3 Our regulatory framework underpins the postal market, and so it is important that our overall approach to regulation in this area remains relevant, effective and fit for purpose.
- 2.4 In this section, we:
- briefly summarise the applicable legal framework and our current approach to postal regulation (as decided in 2012, and reaffirmed in 2017);
 - explain market developments since our last review in 2017, including on volume trends in letters and parcels, and changing consumer needs; and
 - then explain our proposals on the overall regulatory framework, taking account of our legal duties and the wider market context.

Our legal duties

- 2.5 We briefly set out below Ofcom’s main statutory duties relating to postal services, as contained in the Postal Services Act 2011 (the “PSA 2011”) and the Communications Act 2003 (the “CA 2003”). The legal framework relevant to our review is set out in more detail in Annex 6.2
- 2.6 Section 29(1) of the PSA 2011 requires Ofcom to carry out its postal functions in a way that it considers will secure the provision of a universal postal service.
- 2.7 In performing that duty, Ofcom is required by section 29(3) of the PSA 2011 to have regard to the need for a universal postal service to be:
- financially sustainable; and
 - efficient before the end of a reasonable period (and for its provision to continue to be efficient at all subsequent times).
- 2.8 Ofcom’s principal duty under the CA 2003 is to further the interests of citizens and consumers, where appropriate by promoting competition. This duty, together with our general duties under the 2003 Act, also applies when we carry out our functions in relation to post.

² Annex 6 contains a description of the services that must as a minimum be included in a universal postal service (as set out in section 31 of the PSA2011). This includes minimum requirements on delivery and collection of letters (Monday to Saturday) and other postal packets, for example parcels, (Monday to Friday), a service of conveying postal packets at affordable prices with a uniform tariff throughout the UK, provision of registered and insured services, and free of charge services (such as services to blind or partially sighted persons). Exceptions to the minimum requirements and Ofcom’s role in reviewing these minimum requirements are set out in Sections 33 and 34 of the PSA 2011 (see Annex 5 for a more detailed description).

- 2.9 In performing our general duties, we are also required, under section 3(4) of the CA 2003, to have regard to a range of other considerations, which appear to us to be relevant in the circumstances, including:
- the desirability of promoting competition in relevant markets;
 - the desirability of encouraging investment and innovation in relevant markets;
 - the needs of persons with disabilities, of the elderly and of those on low incomes;
 - the different interests of persons in the different parts of the United Kingdom, of the different ethnic communities within the United Kingdom and of persons living in rural and in urban areas; and
 - the extent to which, in the circumstances of the case, the furthering or securing of the matters mentioned in section 3(1) is reasonably practicable.
- 2.10 Section 3(5) of the CA 2003 provides that, in performing its duty to further the interests of consumers, Ofcom must have regard, in particular, to the interests of those consumers in respect of choice, price, quality of service and value for money.
- 2.11 When carrying out any of our functions relating to postal services, if we were to consider that any of our general duties conflict with our duty under section 29 of the PSA 2011 to secure provision of a universal postal service, priority must be given to the latter.³
- 2.12 Additionally, pursuant to section 3(3) of the CA 2003, in performing its general duties, Ofcom must have regard, in all cases, to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed, and any other principles appearing to us to represent the best regulatory practice. Ofcom has published a set of general regulatory principles on its website.⁴
- 2.13 Finally, we have an on-going duty under section 6 of the CA 2003 to keep the carrying out of our functions under review with a view to ensuring that regulation by Ofcom does not involve the imposition of burdens which are unnecessary or the maintenance of burdens which have become unnecessary.

The Universal Postal Service

- 2.14 The Universal Postal Service is made up of three main building blocks: the minimum requirements, the universal postal service order (the “Universal Service Order”) and the designated universal service provider conditions (the “DUSP conditions”).
- 2.15 The minimum requirements, set out by Parliament in section 31 of the PSA 2011, describe the services that must, as a minimum, be included in a universal postal service (subject to the exceptions set out in section 33). The Universal Service Order, made by Ofcom under section 30 of the PSA 2011, describes a set of services that should be provided in the UK as

³ Section 3(6A) of the [Communications Act 2003](#).

⁴ See [Policies and guidelines - Ofcom](#)

part of the universal postal service. It also sets out the standards with which those services need to comply. The Universal Service Order sets out the scope of the universal postal service but does not itself impose any obligation on any operator to provide services. The obligations Royal Mail must comply with, as the designated universal service provider, are contained in the DUSP Conditions, imposed by Ofcom pursuant to section 36 of the PSA 2011.

- 2.16 In November 2020, we published a comprehensive review of the needs of postal users across the UK. It considered whether the current minimum requirements of the universal service, such as delivery of letters six days a week and parcels five days a week, still reflect what people and businesses need today. These requirements are not within the scope of this review of postal regulation, as they are set out in the Postal Service Act 2011 and can only be altered by Government and Parliament. It would be for the Government to determine whether any changes are needed to the minimum requirements and to bring any proposals before Parliament.

Our current regulatory framework

Introduction

- 2.17 In 2012, we introduced a new regulatory framework⁵ to meet our legal duties and regulatory objectives, recognising the challenges facing the postal sector and Royal Mail (as the universal service provider) at the time.⁶ We considered that Royal Mail was best placed to determine how to meet the challenges it faced. We therefore decided to simplify the regulatory regime and provide Royal Mail with greater commercial flexibility, both pricing and operational, supported by the following safeguards:

- **Affordability.** Ensuring the affordability of services as a valuable protection for vulnerable consumers, by placing price-caps on second-class letters and parcels up to and including 2kg.
- **Competition.** Promotion of competition, with minimal regulatory intervention in increasingly competitive areas.
- **Monitoring.** Designed to support and deliver the other outcomes, including, the monitoring of quality of service standards, financial sustainability, and efficient delivery of the universal postal service.

- 2.18 This regulatory framework was combined with limited regulation in increasingly competitive areas of the market (e.g. parcels).

- 2.19 Following a review of the regulatory framework in 2017, we decided that it should remain in place for a further five years.⁷

⁵ Ofcom, 2012. [Securing the Universal Postal Service](#)

⁶ Hooper, 2010. [Saving the Royal Mail's universal postal service in the digital age: An Update of the 2008 Independent Review of the Postal Services Sector](#) [accessed 13 September 2021]; Hooper, 2008. [Modernise or decline: Policies to maintain the universal postal service in the United Kingdom](#) [accessed 13 September 2021].

⁷ Ofcom, April 2017. [Review of the Regulation of Royal Mail](#) [accessed 13 September 2021].

Regulatory conditions imposed on postal operators

- 2.20 The obligations Royal Mail must comply with, as the designated universal service provider, are set out in three DUSP Conditions imposed by Ofcom (further described in Section 5 and Annex 6).
- 2.21 In addition to the DUSP Conditions, Ofcom also has the power to impose several other regulatory conditions, on the designated universal provider and on other postal operators. To date, the regulatory conditions imposed by Ofcom include the universal service provider access condition (under section 38 of the PSA 2011), the universal service accounting condition (under section 39 of the PSA 2001), the essential condition (under section 49 of the PSA 2011), and the consumer protection conditions (under section 51 of the PSA 2011). These are further described in Annex 6 and, where relevant, in later sections of this document.

Stakeholder responses to our March CFI

- 2.22 In March 2021 we published a Call for Inputs⁸ (March CFI) as the first step in this review of future postal regulation. We invited views on our approach to regulation including securing the financial sustainability of the universal postal service and the operational flexibility provided to Royal Mail to manage its efficiency measures; regulating USO letter and parcel services; how the parcel market was working for consumers; and the scope of our access regulation.
- 2.23 Respondents to the March CFI noted the changing market trends, over the previous year, and since 2017. It was noted that consumers are becoming increasingly reliant on parcel deliveries⁹ and that parcel deliveries had seen dramatic increases over the previous twelve months and during the review period due to the increase in online shopping.¹⁰ Respondents expected innovations in parcel deliveries such as Pick-up and Drop-off points were likely to continue during this review period.¹¹
- 2.24 There was general support, from respondents to the March CFI, for a flexible approach to regulation with targeted safeguards. Consumer organisations¹² placed consumers' interests first and advocated a UK-wide postal service which protects vulnerable and rural users.
- 2.25 However, some concerns were raised that the current overall regulatory approach is not working to ensure the financial sustainability of the universal postal service¹³.

⁸ Ofcom, March 2021. [Call for Inputs: Review of Postal Regulation](#)

⁹ [Citizens Advice](#) response to our March CFI (page 10)

¹⁰ [MCF](#) response to our March CFI (page 1); [Northern Ireland Consumer Council](#) response to our March CFI (page 2, 12); [Citizens Advice](#) response to our March CFI (page 6, 10, 52, 56); [Royal Mail](#) response to our March CFI (page 18, 33, 79, 81); [Post Office](#) response to our March CFI (page 3, 16); [Whistl](#) response to our March CFI (page 11, 15))

¹¹ [Citizens Advice](#) response to our March CFI (page 66, 68); [Citizens Advice Scotland](#) response to our March CFI (page 2, 3); [Post Office](#) response to our March CFI (page 2)

¹² [Citizens Advice Scotland](#) response to our March CFI (page 1, 2, 4, 10, 11, 13-15); [Citizens Advice](#) response to our March CFI (page 10, 14, 80, 82, 90); [Northern Ireland Consumer Council](#) response to our March CFI (page 3-9, 12); [Advisory Committee Scotland](#) response to our March CFI (page 2-5); [Post Office](#) response to our March CFI (page 1, 7, 18)

¹³ [MCF](#) response to our March CFI (page 1, 2, 5, 8); [CFH](#) response to our March CFI (page 3);

2.26 There was support for a five-year review period to provide stability and certainty, but subject to continued monitoring with regulatory intervention when and if required to resolve issues¹⁴.

Market developments since our last review

2.27 There have been a number of significant developments in the postal market since we first set the regulatory framework in 2012. These have included an intensification in the level of competition and innovation in parcel services, as well as ongoing letter volume decline. As set out in our annual monitoring updates since then, these trends have continued over the last five years and operators have adapted in response. These changes have been further amplified by the Covid-19 pandemic. We discuss these developments in more detail below.

Letter volumes declining

2.28 Letter volumes have continued to decline since our 2017 review of the postal market. As shown in Figure 2.1 below, in 2016/17, the total volume of addressed letters (which includes both USO and bulk letters) was 11.7bn but, at the end of the 2020/21 period, this stood at 7.8bn, a 33% decline. Revenues declined by less (approximately 20%), reflecting letter price increases.¹⁵

Figure 2.1: Addressed letter volumes, billions



Source: Ofcom / operator data

Notes: Access volumes include access parcels. It is not possible to make direct comparisons between pre- and post-2018-19 on the data in the chart due to a change in methodology (made in 2020) regarding Royal Mail data. The effect of the change in methodology was to increase reported Royal Mail end-to-end letters volumes.¹⁷

¹⁴ [Citizen Advice Scotland](#) response to our March CFI (page 1); [Northern Ireland Consumer Council](#) response to our March CFI (page 4); [Post Office](#) response to our March CFI (page 3)

¹⁵ Total addressed letter revenues declined from approximately £4.5bn in 2016/17 to £3.6bn in 2020/21. This includes Royal Mail end-to-end and access revenues, access operator revenues, and other end-to-end operator revenues. Source: Ofcom/operator data.

**Royal Mail end-to-end is an Ofcom calculation and refers to Royal Mail total letters, excluding access. Figures exclude international. Access volumes include small volumes of access parcels.*

2.29 We note that a significant proportion of this overall decline occurred in 2020/21, reflecting the major impact the Covid-19 pandemic had on mail volumes, and in particular the material reduction in business demand for letters driven by lockdown restrictions and the economic downturn.¹⁶ However, the general long term trend of declining letter volumes reflects structural changes as letter users migrate to alternative online forms of communication. We expect this trend to continue in this review period, although the pace of change is uncertain (particularly in terms of any ongoing impact from the pandemic).¹⁷ However, we consider that government and regulatory requirements for certain types of paper correspondence and difficulty in moving some customers online means that letters will continue to be important. Our expectation therefore is that letters (including bulk letters) will remain a core postal service for the period of this review despite the longer-term trend uncertainties.

Parcel services growing¹⁸

2.30 In 2016/17, there were 2.1bn parcels in the UK (including all domestic and inbound/outbound international items). By 2019/20 this had increased by 32% to 2.8bn. As illustrated in the chart below, 2020/21 saw a sharp increase in volume growth (largely due to the Covid-19 pandemic, as lockdown restrictions forced consumers and businesses to rely on postal services to deliver goods¹⁹), with volumes increasing by 48% year on year to reach 4.2bn²⁰. UK parcel market revenues stood at £14.0bn in 2020/21, with measured domestic parcel revenues accounting for £9.4bn.

¹⁶ Further analysis on the impact of Covid-19 pandemic during 2020 can be found in the 2021 Annual Monitoring Update. Ofcom, 2021. [Annual Monitoring Update on Postal Services. Financial Year 2020-21](#)

¹⁷ [3<] The most significant decreases are expected in [3<] Forecasted letters volumes based on Royal Mail's business plan and financial results.

¹⁸ For the purposes of the data presented in this section, we have defined a parcel as an addressed postal item that is delivered end-to-end and: (a) is not a letter or a large letter (as defined in footnote 11); (b) weighs no more than 31.5kg; and (c) can be lifted by a single average individual without mechanical aids. Parcel services form part of a broad set of delivery services used by residential and business consumers in the UK, such as two-person and pallets delivery (for large and heavy items) and more generally the logistics services that are used for business supply chains. In contrast to parcel services, these other services do not involve postal items.

¹⁹ Ofcom, 2021. [Annual Monitoring Update on Postal Services. Financial Year 2020-21](#)

²⁰ Letters can be up to 24cm long, 16.5cm wide and up to and including 0.5cm thick, with a maximum weight of 100g. Large letters can be up to 35.3cm long, 25cm wide and up to and including 2.5cm thick, with a maximum weight of 750g.

Figure 2.2: Total measured parcel volumes²¹



Source: Ofcom / operator data

2.31 We expect the overall UK parcel market to continue to grow during this review period, particularly driven by the Business to Consumer (B2C) segment and the popularity of online shopping. However, the rate of growth is quite uncertain, and will be affected by a range of factors and risks such as ongoing consumer behaviour (and the extent to which changes accelerated by the Covid-19 pandemic are sustained longer term), short term capacity within the parcels industry to meet demand, and the impact of innovations in industry.

The Covid-19 pandemic

2.32 As set out above, the impact of Covid-19 has been significant for postal operators. As well as affecting demand, it has posed logistical challenges and, in some instances, increased operational costs. For example, it has required the purchasing of personal protective equipment for postal workers, the expansion of vehicle fleets to accommodate social distancing and the hiring of more workers to deal with both increased parcel volumes and staff absences. Our 2021 Annual Monitoring Update²², published today, gives a detailed account of the impact of the Covid-19 pandemic in 2020/21, on the industry.

²¹ Differences in the data mean that it is not possible to make direct comparisons between data from 2018-19 onwards and that for previous years; data for 2016-17 and 2017-18 data is from restatements in official statistics publications; in 2019-20 several operators reported systems changes that altered the basis of their 2019-20 data: where this was the case, earlier data has not been restated. Data from Royal Mail Group included in the total market figure was provided on a 53-week basis for 2018-19 and a 52-week basis for other years; from 2019-20 Royal Mail moved to a new methodology for the allocation of revenues and volumes for stamped letters and parcels. Royal Mail stated that the impact of this change in methodology on its publicly reported 2018-19 revenues was to move £154m of Royal Mail's published revenues from parcels to letters on a 52-week basis, equating to a decrease of 36 million parcels. The 2018-19 industry totals presented here have not been adjusted for the change in Royal Mail's methodology from 2019-20 onwards. For further information on the change to Royal Mail's external reporting please see: <https://www.royalmailgroup.com/media/10704/royal-mail-changes-in-external-reporting.pdf>. Our estimate of market-wide parcel volumes is based on a definition that differs from Royal Mail's definition of parcels (which includes RM 24/48 large letters, some fulfilment letters and large letters), and our data is therefore not directly comparable to Royal Mail's parcel volumes; figures shown to nearest million.

²² Ofcom, 2021. [Annual Monitoring Update](#)

Changing user needs

- 2.33 As explained above, we undertook a comprehensive review of the needs of postal users across the UK in 2020, to see if the requirements placed on Royal Mail reflect what people and businesses need today. There was strong support from users for core features of the universal service. However, our research also found that users' needs are changing. Consistent with our findings on parcel and letter volumes above, we found a marked reduction in use of and reliance on letters for both residential and SME users. We also found a large increase in the use of parcels, and an increased willingness to consider and use alternatives to Royal Mail, especially for SMEs.
- 2.34 Royal Mail and other postal operators have adapted to changing consumer needs and demands over the past few years.
- 2.35 This is particularly evident in relation to parcels where, reflecting the increase in demand and competition, operators have invested and innovated their services and improved customer experiences. For example:
- Since 2017, consumer 'pick up/ drop' off locations (PUDOs) have increased. These allow consumers to collect and send parcels from collection points, such as convenience stores or train stations.²³ Some operators now also offer home parcel collection services, whereby operators will collect parcels from homes and businesses to deliver elsewhere. Some consumers find these options more convenient.
 - Services such as parcel delivery tracking, which allow customers to track the parcel through the operator's network, and Next Day Delivery have become more prevalent as consumers have higher expectations of the online shopping experience.
 - There have also been innovations in service offerings, which some consumers value. For example, SafePlace Photos, which provides the consumer and retailer with photographic evidence of place of delivery; Geo fencing, which provides a location of a delivery within a map, within a specified radius; nominated delivery windows; and inflight diversion options.
 - Parcel operators have increased investment in network expansion and redesign (for example, through increased parcel hub capacity), to improve capacity and/or service.²⁴
- 2.36 The postal industry continues to invest and innovate. Royal Mail is planning and rolling out operational initiatives and improvements to meet changing consumer needs. For example, automated parcel hubs, dedicated parcel routes and a reduction in the number of letter

²³ Collect+ operates a network of 10,000 stores and since May 2020 has expanded to process parcels on behalf of a range of parcel operators including Yodel, DPD, FedEx and Amazon. Hermes operates a network of 5,000 ParcelShops including 900 lockers which are accessible 24/7. Collect+, May 2020. [About Collect+](#). Hermes, 2020. [ParcelShops](#) [accessed 19 August 2021].

²⁴ [Hermes's response to our March CFI](#), page 2.

sorting machines.²⁵ Other parcel operators have plans to invest in their network and infrastructure including Hermes,²⁶ DPD²⁷ and DHL²⁸

European USO providers respond to changing user needs

- 2.37 The trend of increasing parcel and decreasing letter volumes is not unique to the UK. Similar trends have occurred in other developed economies. From 2015 to 2019, total letter mail across European Regulators Group for Postal Services (ERGP) countries declined by 6.5% per annum whereas total parcels increased by 9.1% per annum across ERGP countries during the same period.²⁹
- 2.38 In response to these trends, some countries have made changes to the scope of their universal services to adapt to changing consumer needs, such as changing letter delivery frequency.³⁰
- 2.39 Some European USO providers have also responded by reconfiguring their networks and operations to accommodate parcel delivery and improve efficiencies to offset falling revenue from declining letter volumes. Such changes have included:
- investing in improved machine reading and sorting technologies, through barcoding, digital address reading and automation;
 - centralisation of letter sorting centres to share resources and decentralisation of parcel sorting centres to meet customer service demands; and
 - increasing delivery flexibility by combining or separating parcel and letter delivery rounds, or varying times depending on daily volumes.³¹

Wider developments influencing the sector

Environmental sustainability

- 2.40 The Climate Change Act 2008³² commits the UK to 'net zero' by 2050, and will impact all businesses across the UK, including those in the postal sector.
- 2.41 Our 2021 Annual Monitoring Update (published today) includes a wider discussion of environmental issues and how they could impact the postal sector. We note however, the development of key environmental initiatives including plans for clean air zones in

²⁵ [Royal Mail's response to 2021 Review of postal regulation; March CFI](#), pages 23-26.

²⁶ [All you need to know about Hermes' Barnsley hub](#) (accessed 25 November 2021)

²⁷ [DPD UK gears up for record Peak with new £150m super hub](#) (accessed 25 November 2021)

²⁸ [DHL Parcel UK continues electric van roll-out across the country](#) (accessed 25 November 2021)

²⁹ European Commission, 2020. [ERGP PL II \(20\) 23 Report on Postal Core Indicators](#).

³⁰ Our review of postal users' needs set out our assessment of whether the minimum requirements of the universal postal service – including delivery frequency – reflect the reasonable needs of users. It would be for the UK Government to determine whether any changes are needed to the minimum requirements and to bring any proposals before Parliament. Ofcom, November 2020. Review of postal users' needs: Report [accessed 4 January 2021]. We consider potential changes to other elements of the universal service later in this document (e.g. in relation to tracking on parcels).

³¹ WIK-Consult, 2019. International Benchmark: Postal Operations and Efficiency.

³² As amended in 2019

Birmingham and Bristol, the Department for Transport’s proposal to pilot delivery consolidation centres (which will transfer the majority of urban deliveries to zero emission vehicles for the last mile), and continued replacement of petrol or diesel vehicles with electric vehicles by parcel operators.

- 2.42 As with the other sectors Ofcom is responsible for, we will work with Government and the postal sector as needed, in accordance with our statutory powers and duties, and monitor innovations and adaptations as the sector works to meet the UK’s net-zero carbon target.

Post Office agreements with Royal Mail, DPD and Amazon

- 2.43 Last year negotiations between Royal Mail and the Post Office concluded that their long-term mail distribution agreement (signed in 2012) would come to an end in March 2021. In December 2020, it was agreed that the agreement would be replaced by a new commercial agreement, which Royal Mail stated “provides greater flexibility for both parties to adapt to the changing ways that customers are buying and sending postal products, and to continue to innovate to provide convenience for customers”.³³
- 2.44 The Post Office has since entered into agreements with DPD (August 2021)³⁴ and a trial with Amazon (September 2021)³⁵ to provide click and collect parcel services. Further changes are likely as Royal Mail and the Post Office adopt new ways of working given this increased flexibility.

Northern Ireland Protocol

- 2.45 The Northern Ireland Protocol³⁶ has created the need for certain customs checks for goods passing between Northern Ireland and the rest of the UK.
- 2.46 Some parcel operators have introduced, or have proposed to introduce, additional charges for sending goods to Northern Ireland from Great Britain. Deliveries to Northern Ireland could also be delayed due to additional checks which may have an unintended impact on the USO.
- 2.47 In its response to the March CFI, the Consumer Council for Northern Ireland (CCNI) noted concerns about consumers in Northern Ireland.³⁷
- 2.48 Implementation of the Northern Ireland Protocol is a matter for the UK Government. We continue to engage with the UK Government, postal operators and consumer groups to advise on, and understand, the implications for the postal market.

³³ Royal Mail, 17 December 2020. [Post Office and Royal Mail reach Commercial Agreement](#) [accessed 2 September 2021].

³⁴ Post Office, 16 August 2021. [Post Office partners with DPD to roll-out ‘Click and Collect’ services across the UK](#) [accessed 9 November 2021]

³⁵ The Times, 13 September 2021. [Post Office to handle packages for Amazon](#) [accessed 11 November 2021]

³⁶ The Northern Ireland Protocol came into force in January 2021 and is part of the arrangements to implement the UK’s withdrawal from the European Union. It is intended to ensure that the UK’s withdrawal does not undermine the Belfast (Good Friday) Agreement and, in particular, to prevent checks along the border between Northern Ireland (in the UK) and the Republic of Ireland (in the EU) following Brexit. It has resulted in changes to the way goods move between Great Britain and Northern Ireland.

³⁷ [The Consumer Council for Northern Ireland’s response to our March CFI](#), page 3.

Proposed regulatory framework for postal services

Our regulatory objectives for this review

- 2.49 Looking to the future and the possible challenges that the postal sector may encounter, and taking account of our statutory duties (set out above), we consider the key outcomes and strategic aims of our regulation should be the following:
- Ensuring postal users have access to simple, affordable and reliable postal services that meet their needs;
 - Supporting a financially sustainable and efficient universal service; and
 - Supporting effective competition in postal services for the benefit of consumers.
- 2.50 To determine our proposals for this review, we have considered whether the current regulatory framework will remain fit for purpose and effective in the next review period. We have taken into account these objectives and the challenges that the postal sector is likely to face in future (including changing user needs and associated market uncertainty, as discussed above, and longer-term challenges to the financial sustainability of the universal postal service as discussed in Section 3).

Provisional view on our future approach to regulation

Our regulatory framework for postal services has worked well to date

- 2.51 We consider that the existing regulatory framework has worked well in achieving the objectives set out above. This is despite the significant market changes and developments that have occurred since 2017 as discussed above.
- 2.52 In particular, the universal postal service continued to provide users with the services they need.³⁸ In November 2020, we published our Review of postal users' needs (RUN)³⁹. The review found that most users were satisfied with the postal services they receive. For residential users, overall satisfaction remained at over 80% in the last few years, and SME users' overall satisfaction with the quality of service from Royal Mail had also increased markedly since 2012. Furthermore, although volumes are declining, bulk and single piece letters remain important to businesses and volumes remain relatively high.
- 2.53 Royal Mail has also sustained the provision of the universal postal service, broadly achieved required Quality of Service (QoS) standards and has made some (albeit limited) progress on modernising its business for the digital age. Royal Mail delivering its planned parcels strategy and cost efficiencies will be key in securing the sustainability of the universal service. However, significant risks remain.

³⁸ However, the review also found that user needs are changing, and we will want Royal Mail and other postal operators to be able to respond appropriately to these needs during the upcoming review period.

³⁹ Ofcom, November 2020. Review of postal users' needs: Report [accessed 4 January 2021].

2.54 The existing framework has also allowed Royal Mail and other operators to respond to the significant market changes that have occurred. This includes continuing to support access-based competition in bulk letters (where access operators retain a high share of volumes) and fostering competition in parcels, delivering good outcomes for consumers through increased investment and innovation and improvements in customer experience.

Our proposed framework aims to meet our regulatory objectives

- 2.55 Given that we consider that our framework has worked well to date, and mindful of the challenges that are likely to face the postal sector in the future, our overall approach to this review has been to consider whether any aspects of the current framework need to change rather than to carry out a more root-and-branch redesign of the framework. The outcome of that exercise is that we are proposing largely to maintain the current regulatory framework over the next review period.
- 2.56 Our proposed framework provides commercial flexibility to Royal Mail, with targeted regulation in relation to USO and access services, whilst allowing competitive and well-functioning parts of the market to operate with minimal intervention. It supports the USO, targeting requirements to meet the reasonable needs of users, where competition cannot deliver appropriate outcomes.
- 2.57 The universal service remains vitally important for consumers and businesses across the UK. Our proposals to retain or enhance important safeguards, including retaining the Safeguard Caps and the current QoS standards, aim to ensure that users will continue to have access to frequent, reliable, affordable and uniformly priced services, meeting their reasonable needs.
- 2.58 The financial sustainability and efficiency of the USO must be maintained to continue to meet the reasonable needs of USO users. Our proposals recognise that there is significant market uncertainty ahead and there remain several risks to the long-term financial sustainability of the universal postal service. It is particularly important, in this context, that Royal Mail delivers on efficiency improvements and modernises its operations to respond to the growing demand for parcel delivery. The main drivers of a financially sustainable and efficient universal postal service are within Royal Mail's control, and we consider it important that Royal Mail continues to have commercial flexibility to enable it to meet these and other challenges.
- 2.59 Our proposals support the objective of the universal postal service being provided in an efficient and financially sustainable way. However, improvements must be delivered by Royal Mail. Accordingly, we are proposing new measures to increase Royal Mail's accountability and reporting of the longer-term outlook for the USO's financial sustainability, longer term efficiency expectations and progress towards achieving these.
- 2.60 Finally, we believe that effective competition between operators, supported by targeted regulation for the protection of competition and consumers, will result in the best outcomes for consumers. Competitive dynamics will be undermined if the current USO and

regulated services are unduly expanded or existing regulation tightened, so we propose to keep the existing boundaries largely unchanged.

- 2.61 While our view is that the parcels market works well for most consumers, we see some specific consumer problems which need to be addressed. We consider first that parcel operators need to make improvements in relation to the handling of complaints and are proposing new guidance on complaints handling. We are also proposing that they must have policies in place better to meet the needs of disabled customers.
- 2.62 We also support the continuation of competition in the access market for bulk letter services. We consider that the current access regulatory framework is working well to provide Royal Mail with the commercial and operational flexibility to manage letter decline while supporting competition in bulk letters. Our provisional view is that it is not appropriate to extend access regulation into the parcels market as called for by some stakeholders, given the risk it would pose to competition.

We are proposing to maintain this regulatory framework for the next five years

- 2.63 We understand the need to provide certainty and stability to postal operators and other stakeholders, including investors, which can help when planning and making longer-term investment decisions and therefore encourage investment. At the same time, we recognise that the postal market is changing rapidly and that we will therefore need to review the regulatory framework following a suitable time period.
- 2.64 We therefore propose that the regulatory framework set out in this consultation remains in place for a period of five years. We believe that a five-year period provides the sector with sufficient certainty and stability, while also acknowledging that there is uncertainty ahead.
- 2.65 We considered a three-year review period but were concerned that this could create uncertainty given longer investment cycles. We are also concerned that a longer regulatory period (e.g. seven years) would be excessive given the level of change and longer-term uncertainty in the market.
- 2.66 We reserve the right to intervene and review our regulatory framework as necessary, but only if there are unanticipated major changes in the market during the review period.

Regulatory Reporting

- 2.67 An important part of our regulatory framework for the postal sector is an effective and comprehensive monitoring regime, including requirements for Royal Mail to provide Ofcom with relevant financial information. These requirements are set out in the Universal Service Provider Accounting condition (USPAC).
- 2.68 The monitoring regime allows us to assess how well the regulatory framework is working to meet our regulatory objectives. In particular, it aims to secure the provision of the universal service, incentivise efficiency improvements, maintain quality of service standards and ensure universal services remain affordable.

- 2.69 We believe the current approach to regulatory reporting has worked well. However, we will need to update our reporting requirements to reflect our proposed changes. We therefore intend to publish a further consultation on regulatory reporting requirements applicable to Royal Mail in Summer 2022, shortly after publishing our final policy statement on the future regulatory framework. This will consider any changes to Royal Mail’s reporting (including on efficiency and financial sustainability reporting) which may be necessary in light of that final policy statement, and whether other existing requirements remain appropriate. We also aim to publish a final statement on regulatory reporting requirements by the end of 2022.

Impact Assessment

- 2.70 The analysis presented in the entirety of this consultation represents an impact assessment, as defined in section 7 of the CA 2003.
- 2.71 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the CA 2003, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom’s activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the vast majority of its policy decisions.
- 2.72 For further information about Ofcom’s approach to impact assessments, see the guidelines, *Better policy-making: Ofcom’s approach to impact assessment*.⁴⁰ Specifically, pursuant to section 7, an impact assessment must set out how, in our opinion, the performance of our general duties (within the meaning of section 3 of the CA 2003) is secured or furthered by or in relation to what we propose.

Equality Impact Assessment

- 2.73 Section 149 of the Equality Act 2010 (the “EA 2010”) imposes a duty on Ofcom, when carrying out its functions, to have due regard to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct related to the following protected characteristics: age; disability; gender reassignment; marriage and civil partnership; pregnancy and maternity; race; religion or belief; sex and sexual orientation.
- 2.74 The EA 2010 also requires Ofcom to have due regard to the need to advance equality of opportunity and foster good relations between persons who share a protected characteristic and those who do not.
- 2.75 Section 75 of the Northern Ireland Act 1998 (the “NIA 1998”) also imposes a duty on Ofcom, when carrying out its functions relating to Northern Ireland, to have due regard to the need to promote equality of opportunity and regard to the desirability of promoting

⁴⁰ [Policies and guidelines - Ofcom](#)

good relations across a range of categories outlined in the NIA 1998. Ofcom's Revised Northern Ireland Equality Scheme explains how we comply with our statutory duties under the 1998 Act.⁴¹

- 2.76 To help us comply with our duties under the EA 2010 and the NIA 1998, we assess the impact of our proposals on persons sharing protected characteristics and, in particular, whether they may discriminate against such persons or impact on equality of opportunity or good relations.
- 2.77 We do not consider that our proposals will discriminate in any way against persons with protected characteristics. We also consider that our proposals (in particular, our proposal to require parcel operators to have policies and procedures in place better to meet the needs of disabled consumers) will advance equality of opportunity between persons with a disability and those without. We are therefore satisfied that we have complied with the public sector equality duty in the EA 2010, and the NIA 1998, in making the proposals set out in this consultation.

Consultation question

Question 2.1: Do you agree with Ofcom's proposed regulatory approach for regulating postal services over the next 5-year period (2022-2027)? If not, please explain the changes you think should be made, with supporting evidence.

⁴¹ [Revised-NI-Equality-Scheme.pdf \(ofcom.org.uk\)](#)

3. Financial Sustainability

Ofcom has a duty to secure the provision of a universal postal service. In performing this duty, we must have regard to the need for the provision of the universal postal service to be financially sustainable and efficient.

Royal Mail's 2021/22 to 2023/24 business plan, if successfully executed, indicates that the provision of the universal service will be financially sustainable for the duration of the plan and possibly beyond. However, significant risks remain. Royal Mail delivering its planned parcels strategy and cost efficiencies will be key in securing the sustainability of the universal service. In particular, Royal Mail must improve on its historical efficiency performance, [X].

We propose to continue to allow Royal Mail considerable commercial flexibility, providing the levers to best respond to market risks and support undistorted competition in parcels. We also plan to maintain the current scope of access regulation but not extend it to small parcels. We think this stability and flexibility will support investment and innovation, and create the conditions to allow Royal Mail to transform into a modern and efficient business for the digital age, supporting the long-term financial sustainability of the universal service.

To better inform our duty to have regard to sustainability we propose to strengthen our monitoring regime by requiring annually a five-year financial forecast from Royal Mail. Furthermore, given the importance of efficiency to ensuring long-term sustainability, in Section 4 we propose to strengthen our efficiency monitoring.

- 3.1 In this section, we first set out current regulation and the stakeholder responses to our March CFI. We then discuss the current outlook for financial sustainability and our proposed regulatory approach to supporting sustainability, in light of this outlook. We then set out our proposals to strengthen our monitoring approach.

Current regulation

- 3.2 Ofcom is required by section 29 of the PSA 2011 to carry out its functions in relation to postal services in a way that it considers will secure the provision of a universal postal service.⁴² In performing this duty, we must have regard to the need for the provision of the universal postal service to be financially sustainable and efficient. This includes the need for a reasonable commercial rate of return for the universal postal service provider on any expenditure incurred by it for the purpose of, or in connection with, the provision of a universal postal service.

⁴² See Annex 6 for an overview of the relevant legal framework. The Universal Service Obligation (USO) is imposed on the universal service provider by any Designated Universal Service Provider Condition (DUSP Condition), with the services as defined by Ofcom as part of a universal postal service order (Universal Service Order).

Commercial rate of return

- 3.3 A key principle underlying our approach to financial sustainability is that to attract capital to invest in the universal service, there needs to be a reasonable expectation that a rate of return commensurate with the level of risk within the business is available. Provided there is a reasonable expectation of making a commercial rate of return, the business should be able to attract and retain capital from debt and equity investors to invest in the delivery of a sustainable universal service.
- 3.4 When undertaking previous reviews of the regulatory framework for postal services, we have granted Royal Mail considerable commercial and operational flexibility to adapt to the changing market environment. This reflected our view that Royal Mail was best placed to manage the long-term financial sustainability and efficiency of the universal postal service.
- 3.5 We believed this flexibility would enable Royal Mail to make commercial decisions to appropriately manage mail volume decline and would best support the universal postal service.⁴³ We also imposed a monitoring and regulatory reporting regime as part of our safeguards in recognition of the potential risks to users of the postal service arising from increased commercial flexibility, and in order to incentivise the delivery of a sustainable and efficient universal postal service. This regime includes (amongst other things) monitoring of Royal Mail's quality of service, financial performance and efficiency.

The Reported Business

- 3.6 In previous reviews, we decided to assess the financial sustainability of the universal postal service by considering whether the Reported Business could expect to earn a reasonable commercial rate of return. The Reported Business is the regulatory entity which contains the universal postal service network and all the products provided through or in relation to that network. This network also provides non universal service products such as access and bulk mail. Royal Mail PLC is the holding company for a group of companies, including Royal Mail Group Limited (Royal Mail). The Reported Business is contained within Royal Mail as part of the RMUK business unit.⁴⁴ We refer to Royal Mail PLC and the group of companies it holds collectively as the Relevant Group.
- 3.7 In 2017 we concluded that the Earnings Before Interest and Tax (EBIT) as a percentage of total revenues (i.e. EBIT margin) for the Reported Business⁴⁵ remained the appropriate measure of the rate of return of the Reported Business to provide an indication of medium to longer-term financial sustainability of the provision of the universal service. We considered that an EBIT margin in the range of 5-10% was appropriate and consistent with

⁴³ Ofcom, 2012. [Securing the Universal Postal Service - Decision on the new regulatory framework: Statement](#); Ofcom, 2017. [Review of the Regulation of Royal Mail: Statement](#).

⁴⁴ Previously this business unit was referred to as UKPIL.

⁴⁵ We refer to this particular measure as the 'financeability EBIT margin'. We explain how it is derived in more detail in Annex 8.

the need for Royal Mail to earn ‘a reasonable commercial rate of return commensurate with the level of risk within the business’.⁴⁶

- 3.8 We also decided to continue to monitor the performance of the Relevant Group to assist us in our financial sustainability assessment. We considered the Relevant Group important for our assessment as this is the level at which the company manages its cash and makes investment decisions, and is the level at which its creditors, analysts, and investors consider Royal Mail’s financial health. In 2017 we supplemented our monitoring with additional financial health metrics that would assist us in understanding the Relevant Group’s ability to meet its financial obligations.⁴⁷

Stakeholder responses to our March CFI

- 3.9 In our March CFI we set out our initial view that the existing regulatory approach towards sustainability and the range of measures we use, were likely to be appropriate for the next review period. In its response to our March CFI, Royal Mail stated that we should:⁴⁸

- a) Enhance the approach to monitoring financial sustainability to include equity metrics - Royal Mail submitted that it would be helpful to understand Ofcom’s view on both its dividend and capital allocation policy;⁴⁹
- b) Enhance the monitoring regime to include “tramlines”. Royal Mail defined tramlines as thresholds for the metrics we use in our assessment and proposed that we should use these as trigger points for identifying financial sustainability concerns;
- c) Provide a clearer statement of the interventions and supportive action that Ofcom could take to secure the provision of the universal service; and
- d) Consider stakeholders’ demands for progress on environmental sustainability for the regulatory framework.

We address these points in the rest of this section.

- 3.10 Several stakeholders also raised the importance of efficiency for a sustainable universal service. We deal with these comments in the efficiency section.⁵⁰

⁴⁶ Ofcom, 2012. [Securing the Universal Postal Service - Decision on the new regulatory framework: Statement](#), paragraph 5.47 [accessed 3 March 2021].

⁴⁷ These included, amongst other considerations, FFO/Net Debt, EBITDA/Interest (interest cover) and the Viability Statement Royal Mail publishes.

⁴⁸ Royal Mail response to our March CFI.

⁴⁹ Royal Mail’s capital allocation policy sets out its approach to capital management. This is how it allocates its capital between investing in the business for growth, supporting its credit rating, paying dividends, and M&A activity.

⁵⁰ Advisory Committee for Scotland response to our March CFI, page 2; Consumer Council NI response to our March CFI, pages 5-6; CWU response to our March CFI, page 6; Mail Users’ Association Response to our March CFI, page 4; Professional Publishers Association response to our March CFI, pages 1-2; UKMail response to our March CFI, page 1; Whistl response to our March CFI, Section 4; [§<].

3.11 As noted in Section 2, we also recognise the growing importance of environmental sustainability. For a more detailed discussion, please see this year’s Annual Monitoring Update.⁵¹

Current outlook for financial sustainability

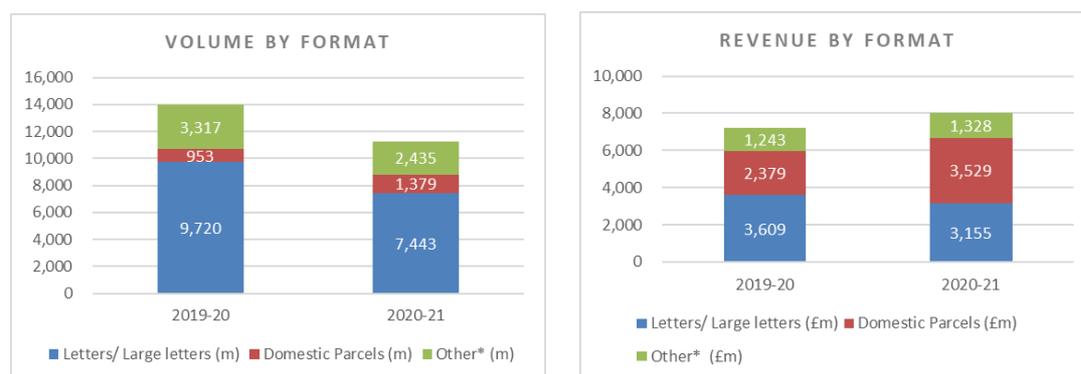
3.12 To understand the financial performance of the Reported Business, it is helpful to consider key drivers of revenues and costs. We consider these key drivers, as well as potential impact on financial sustainability of the USO, in more detail below. To assess the impact on the financial sustainability, we used the EBIT margin of the Reported Business as the main indicator of sustainability. We discuss the rationale for this later in this section.

Drivers of sustainability

3.13 Royal Mail faces revenue uncertainty, and outturn revenues depend on:

- **Growth in parcels revenues.** In 2020/21 Reported Business revenue grew mainly due to the growth in domestic parcel volumes, and for the first time, parcels revenue exceeded letters revenue (see Figure 3.1).⁵² The growth in overall parcel volumes represents an opportunity for revenue growth for Royal Mail, even where it faces competition from other parcel operators (see Section 6).
- **Decline in letters revenue.** The Reported Business addressed letter volumes continue to fall due to ongoing structural decline which has been exacerbated by the impact of the Covid-19 pandemic. The revenue effect of this volume decline was offset in part by price rises and a switch to more expensive products such as Tracked.⁵³ The successful management of letter pricing strategies that aim at slowing down e-substitution rather than achieving short-term gains, may help mitigate the risk of accelerating the market decline of letters (for letter pricing, see Sections 5 and 8).

Figure 3.1: Reported Business volumes (m) and revenues (£m) split by format



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis.

* Other products mainly consist of international letters and parcels and unaddressed mail

⁵¹ Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 33.

⁵² Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 42.

⁵³ Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 42.

- 3.14 This business is characterised by high fixed costs. Margins are significantly affected by Royal Mail's ability to deliver cost efficiencies and transform its cost base. Reported Business costs have continued to rise, although the 2020/21 increase is mainly driven by the strong increase in parcel volumes.⁵⁴ Royal Mail has set out its commitment to transforming its business to meet the evolving demands of the parcels market and capture parcel growth by:
- a) Rebalancing its operations and network from servicing letters to parcels, to reflect the changes in volume mix brought about by letters decline and parcels growth;
 - b) Maximising parcel capacity in the existing network and introducing automated parcel hubs; and
 - c) Improving overall efficiency of its operations, e.g. by enhancing frontline productivity and other initiatives relating to non-people costs.
- 3.15 We discuss cost transformation in more detail in the efficiency section and how it is key to driving improvements in financial sustainability.

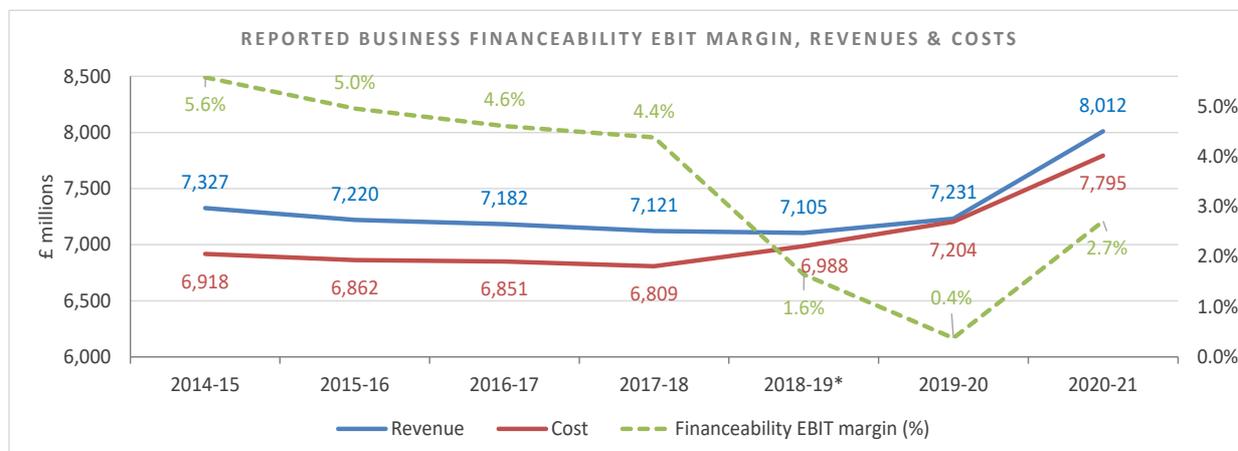
Sustainability outlook

- 3.16 In practice, the financeability EBIT margin achieved by the Reported Business has been below 5% over recent years. In 2020/21 the Reported Business' EBIT margin increased to 2.7%, a reversal of the downward trend for the first year since 2014/15. The growth was predominantly the result of increased parcel revenues, which significantly exceeded the net rise in operational costs and decline in letters revenue.⁵⁵ While recent returns remain below the 5 to 10% range, the significant changes in the parcels market present Royal Mail with an opportunity to transform into a sustainable parcel-led business over the longer-term, which in turn would support a sustainable USO.

⁵⁴ Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 42.

⁵⁵ Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 42-44.

Figure 3.2: Reported Business EBIT margin, revenue & costs



Source: Royal Mail Regulatory Financial Statements, unaudited submissions from Royal Mail and Ofcom analysis. *Adjusted to 52 weeks

- 3.17 We also recognise that the postal market is undergoing an unprecedented period of uncertainty and significant change as the market continues to transition towards parcels and away from letters, against the backdrop of the Covid-19 pandemic.
- 3.18 To assess the outlook for sustainability over the review period, we analysed Royal Mail’s latest business plan, which covers the financial years 2021/22 to 2023/24, and considered sensitivities around key assumptions and plausible longer-term trends.
- 3.19 Royal Mail’s plan, [X] over the next three years. [X.]
- 3.20 Royal Mail’s strategy centres on being able to grow its share of the growing parcels market and on [X] cost efficiencies being achieved. We considered a range of alternative revenue and cost scenarios over the next 3 years, as well as beyond.⁵⁶ [X.] Our analysis suggests that revenue growth alone appears unlikely to be enough to secure a sustainable level of profit unless Royal Mail can also improve on its recent efficiency performance.
- 3.21 We conclude that, Royal Mail’s latest business plan, [X]. However, this [X.]

⁵⁶ The analysis is based on Royal Mail’s confidential data.

3.22 We consider the implications of our assessment on our regulatory approach to supporting sustainability in the next section.

Our proposed regulatory approach

3.23 As outlined in the previous section, Royal Mail needs to modernise its operations to put itself in a better place to manage ongoing market risks, which would then help support the delivery of a sustainable USO.

3.24 Having considered the regulatory options that would best support Royal Mail to undertake the necessary transformation, while also fulfilling our duties and role in ensuring consumer protection, we propose to broadly maintain the present regulatory framework while strengthening our monitoring of the financial sustainability of the USO. The regulatory framework we are proposing to adopt is designed to underpin the USO as it is currently specified. We emphasise that, as per the conclusions of our Review of User Needs, any change to the minimum requirements of the universal service is a matter for Government. We recognise that any such changes could have a significant impact on the financial sustainability of the universal service.

3.25 We continue to believe that allowing Royal Mail sufficient commercial flexibility and control to respond to various market pressures remains appropriate. This is consistent with the view we took in our previous reviews. Royal Mail's flexibility has only been constrained by safeguard regulations to maintain Quality of Service, ensure affordability and support competition.

3.26 We considered the impact on sustainability of our current targeted regulation to protect consumers. We recognise that maintaining the regulatory safeguards imposes costs on Royal Mail, but consider that without them, the interests of consumers will be adversely impacted. As explained in Section 5, there are not sufficiently compelling financial sustainability reasons to re-open the safeguard cap on Second Class stamps early. Furthermore, the likely financial benefits of removing regulatory safeguards would appear to be less significant compared with those that Royal Mail could realise through successfully addressing the challenges such as network transformation and efficiency which we have explained earlier in this section.

3.27 While continuing to allow Royal Mail significant commercial freedom, we also recognise the importance of delivering a step change in cost performance and the significant market uncertainty more broadly in delivering a sustainable USO. Therefore, we propose to:

- a) strengthen our monitoring of the financial sustainability by requiring annually a five-year financial forecast from Royal Mail (we explain these changes in more detail in the following sub-section); and
- b) strengthen our oversight role in holding Royal Mail to account on efficiency performance which would also help us by providing an early warning sign of likely financial sustainability problems within the five-year review period (see Section 4).

- 3.28 While maintaining this flexible approach, we also recognise the importance of good regulatory practice and stability to support incentives to invest.
- 3.29 With this in mind, we consider that by ruling out mandating access to Royal Mail's parcels network in this review period (see Section 8), our proposed approach supports investment and competition in end-to-end parcel services, and allows Royal Mail to fully benefit from the upsides of any future success in the parcels market.
- 3.30 Further, we do not propose to hardwire specific regulatory actions to a given measure such as EBIT margin thresholds to maintain flexibility. EBIT margins, whether actual or forecast, which fall out of the 5 to 10% range do not necessarily mean that the financial sustainability of the universal service is threatened or that excessive profits are being earned. We will consider each case in its specific circumstances and in the wider context of Royal Mail's financial performance and position.
- 3.31 We will inform any future decision-making using evidence gathered through our monitoring regime. The reporting and forecasting of the different metrics helps us assess any risks to the sustainability of the universal postal service and inform our thinking on whether our regulatory framework needs to change and the potential impacts that any changes may have.

Our proposed monitoring regime for financial sustainability

Use of the EBIT margin as our measure of the commercial rate of return

- 3.32 When setting up the regulatory framework in 2012, we concluded on using an EBIT margin approach as our preferred measure of the commercial rate of return. In our 2017 Review, we reconsidered whether the EBIT margin approach remained the best measure of determining the commercial rate of return of the universal service.⁵⁷ We concluded that, despite the strong theoretical underpinning of a Return on Assets (ROA) approach (which includes the explicit determination of a level of return to remunerate the risk inherent in the capital invested), the EBIT margin approach remained the best methodology for assessing the returns of the universal postal service.
- 3.33 We identified several difficulties in implementing an ROA approach, such as determining a robust value for the regulatory asset base ('RAB') of the Reported Business. An appropriate value for the RAB is necessary for an accurate assessment of an ROA metric. On the other hand, the EBIT margin approach, introduced by us in March 2012 and implemented consistently since then, has proven to be simple and practicable in assessing the commercial rate of return of the Reported Business.
- 3.34 Royal Mail, in its response to our March CFI, considered that the EBIT margin approach should be retained. Royal Mail stated, "We agree with Ofcom that the EBIT financeability

⁵⁷ Ofcom, 2017. [Review of the Regulation of Royal Mail](#), page 22.

margin, at the Reported Business level, is a key metric providing insight on the financial sustainability of the Universal Service”.⁵⁸

- 3.35 We consider that our approach from the 2017 Statement remains appropriate. Therefore, we propose to retain the use of the EBIT margin approach to assess the commercial rate of return earned by the universal service.
- 3.36 We also propose that the Reported Business remains the entity that represents most accurately the activities of the provision of the universal service and therefore it is the appropriate level at which to measure the EBIT margin. Using the Royal Mail UK or the Royal Mail Group entities as the basis of our rate of return assessment would be less representative of the universal service than using the Reported Business.
- 3.37 As set out in Annex 8, we propose that a financeability EBIT margin in the range of 5 to 10% remains consistent with a commercial rate of return for the Reported Business. Given that our overall regulatory framework is based on commercial flexibility, our assessment of the profitability of the Reported Business is intended to be a first order indicator of sustainability and should not be interpreted as a ‘target’ return range.
- 3.38 We propose to continue evaluating the recent actual and the long-term forecast EBIT margins of the Reported Business and the underlying revenues and costs.
- 3.39 We recognise that forecast or actual EBIT margins of the Reported Business may over the coming periods fall outside the 5-10% range. This does not necessarily mean the universal postal service is not sustainable or it is making excessive profit. We will consider each case in its specific circumstances and in the wider context of Royal Mail’s financial performance and position. Any decision we take will be guided by the evidence available and the regulatory context of the decision. Therefore, we do not propose to adopt the formal ‘tramlines’ as suggested by Royal Mail.⁵⁹

Use of other information and metrics to assess financial sustainability

- 3.40 As set out above, our current approach involves monitoring the performance of the Relevant Group, including monitoring a number of specific financial health metrics that assist us in understanding the Relevant Group’s ability to meet its financial obligations.⁶⁰ The various sets of information received from Royal Mail allow us to form a holistic view of the business and to consider different future scenarios.
- 3.41 We continue to believe that monitoring the broader financial performance of the Relevant Group is important because this is the level at which the company manages its cash and makes investment decisions and it is the level at which its creditors, analysts, and investors consider Royal Mail’s returns and financial health.

⁵⁸ Royal Mail response to our March CFI, page 33.

⁵⁹ Royal Mail response to our March CFI, pages 34-35.

⁶⁰ These include, amongst other considerations, FFO/Net Debt, Net Debt/EBITDA, EBITDA/Interest and the Viability Statement Royal Mail publishes.

- 3.42 Furthermore, we note that it is conceivable that while the Reported Business makes a commercial rate of return, the rest of the Relevant Group might not perform well. This could potentially pose a threat to the financial sustainability of the provision of the universal service if such performance problems affect the liquidity and the funding resources of the Relevant Group as a whole.
- 3.43 Therefore, we propose to retain our current approach to monitoring the financial performance of the Relevant Group. In addition to the EBIT margin evaluation, we propose to continue monitoring a number of specific metrics:
- a) the actual and forecast cash flows of the Relevant Group;
 - b) the actual and forecast financial health metrics, including Funds From Operations (FFO)/Net Debt, Net Debt/EBITDA, EBITDA/Interest.⁶¹
- 3.44 However, as noted above, these metrics are considered in the round, with other financial information we receive from Royal Mail. We propose to continue with this overall holistic approach.
- 3.45 In its March CFI response, Royal Mail stated that “a financially sustainable Universal Service provider should be able to maintain a comfortable investment-grade credit rating and a progressive dividend policy.”⁶² Royal Mail suggested that we needed go further than our current approach by including equity metrics in our monitoring, and using tramlines around each of the debt and equity metrics. It also stated that it would be helpful to have Ofcom’s view on Royal Mail’s dividend and capital allocation policy.
- 3.46 We agree that a company needs to be an investable proposition for equity investors. Once the capital expenditure and liquidity needs of the business have been satisfied, it is reasonable for profits to be distributed to shareholders. However, any decisions on dividend policy are for Royal Mail Group to take and will reflect the performance and investment needs of the wider Group.
- 3.47 By continuing to monitor the financial performance of the Group, including its cash flow position, we will be able to assess the impact of the Group’s chosen capital allocation and dividend policy on the outlook for financial sustainability of the USO. However, there are different factors affecting a company’s capacity to pay dividends, and actual shareholder returns will depend on a range of market factors not related to the sustainability of the USO. Therefore, we do not propose to adopt formal targets for any specific equity metrics.
- 3.48 We also agree that maintaining an investment grade credit rating helps to support the long-term financial sustainability of the USO. As part of our current monitoring, we review the key financial health metrics used in Royal Mail’s debt covenants and in the context of

⁶¹ Net Debt is a measure of a company’s liabilities at a certain point in time which nets off the company’s cash and other liquid assets against its debts. FFO is a measure of the net cash flows generated by a company’s operations in a financial period, typically one year. EBITDA is Earnings Before Interest, Tax, Depreciation and Amortisation.

⁶² Royal Mail response to our March CFI, page 33.

how Standard and Poor's assesses Royal Mail's credit rating.⁶³ We consider this information, alongside the wider financial performance, to assess the Group's financial health, which is relevant for the long-term sustainability of the USO.

- 3.49 However, as outlined earlier, we do not propose to hardwire specific regulatory actions to any of these metrics falling outside a certain range. If the actual or forecast debt metrics appear concerning, we will consider the specific circumstances and the wider context of Royal Mail's financial performance and position to assess if this poses a long-term sustainability risk for the universal service.
- 3.50 As we do at present, we also propose to continue to closely review the Viability Statement and Statement of Principal Risks included within Royal Mail PLC's Annual Financial Report. The purpose of the statements is for the Board of Royal Mail to "to carry out a robust assessment of the company's emerging and principal risks" and that "the board should confirm in the annual report that it has completed this assessment, including a description of its principal risks" and these "should include, but are not necessarily limited to, those that could threaten the company's business model, future performance, solvency or liquidity and reputation" and describe those risks and explain how they are being managed or mitigated.⁶⁴ These statements are therefore highly relevant to our assessment of the ability of the Relevant Group to continue to provide the universal service.

Enhancing our monitoring with longer-term forecasts

- 3.51 Furthermore, we propose to strengthen our current approach by requiring Royal Mail to provide an annual five-year financial forecast. This would build on the existing three-year forecast often provided by Royal Mail in its Business Plans, with two further years of higher-level projections including EBIT margin. Currently our regulatory reporting requirements do not prescribe the length of the forecast period for Royal Mail.
- 3.52 While it is for Royal Mail to manage its business activities in a way that provides the best opportunity to secure the sustainability of the USO, we recognise the concerns stakeholders have raised in relation to its sustainability (particularly in relation to its performance to date on efficiency). Moreover, as discussed, USO sustainability could be significantly compromised if Royal Mail fails to modernise its business and deliver efficiencies, and we have also been concerned with Royal Mail's progress in these areas in recent years. Therefore, it is important that we best understand and are able to properly scrutinise the likely sustainability of the universal service in the longer term.
- 3.53 We think five years is the appropriate time period because it provides a longer period than the existing three-year plan that Royal Mail often uses in its business plans. This would provide a clearer trend and direction of travel particularly because some of the factors at work are long term e.g. decline in letters and the transformation of the network.

⁶³ Royal Mail is rated 'BBB' by Standard and Poor's. It does not have a rating with any of the other ratings agencies. FFO / Adjusted Net Debt (AND) 45% minimum; AND/EBITDA 2.0 maximum; are key thresholds used by S&P. Net Debt/EBITDA 3.5:1 maximum; EBITDA/Interest 3.5:1 minimum are the loan covenants.

⁶⁴ Financial Reporting Council, 2018. [UK Corporate Governance Code](#), Section 4 'Audit, risk and internal control'.

- 3.54 Longer term forecasts would also provide further incentives for Royal Mail to consider its longer-term planning in more detail. This in turn will help us gain a better understanding of Royal Mail’s long-term expectations, and the prospects for the financial sustainability of the universal service in the longer term. This is important for our ability to consider any required regulatory action in a timely manner.
- 3.55 We recognise that extending the length of any forecast involves challenges. Acknowledging this, the information we are proposing to require for the longer period builds on the three-year forecast Royal Mail is already providing in its Business Plans, with higher-level projections for two further years. We note that Royal Mail in its consultation response recognised that a “three-year time horizon will not be sufficient for assessing long-term financial sustainability, and a set of longer-term projections will be required”.⁶⁵
- 3.56 While a five year period is longer than the current forecast period provided, it is of a length that should still allow Royal Mail to generate meaningful forecasts, particularly if the forecasts are supplemented with adequate sensitivity and scenario analyses. The expectation that the final two years of the forecasts would be higher level also increases the likelihood that Royal Mail can provide a meaningful forecast, as we are not expecting the level of detail required in the current business plan across the full five years.
- 3.57 We also propose to require wider downside and sensitivity analyses because the uncertainty increases in the outer years, particularly due to the factors that are outside Royal Mail’s control and hard to predict. This would provide us with further information to assess the outlook for sustainability of the universal service over the forecast period and identify risks it faces. It would also allow us to assess the impact of Royal Mail’s delivery of further efficiencies and whether these efficiencies are sufficient for the future sustainability.
- 3.58 We also propose to prescribe the date on which the financial forecast is provided to us and are proposing that the first submission falls due on 31 May 2023. We think this date is proportionate as it aligns with Royal Mail’s business planning cycle, allowing Royal Mail to generate its business plan as at present, plus the additional two years that we are now requiring for certain metrics. It also allows Royal Mail sufficient time from our 2022 statement next year and the culmination of our subsequent regulatory reporting consultation to prepare its reporting systems and processes to produce and deliver the required reports. This timing aligns with our efficiency proposal in Section 4.

Summary of Proposals

- 3.59 Royal Mail’s 2021/22 to 2023/24 business plan, [36] However, significant risks remain – Royal Mail delivering its planned parcels strategy and cost efficiencies will be key in securing the sustainability of the universal service.

⁶⁵ Royal Mail suggested a longer term forecast should be “undertaken once per regulatory cycle (i.e. once every five to seven years) due to the additional resource it will take” (Royal Mail response to our March CFI, page 36).

- 3.60 It is our view that Royal Mail remains best placed to manage these risks. Therefore, we are proposing to broadly maintain the current regulatory framework which provides Royal Mail with significant commercial flexibility, recognising that the sustainability of the USO largely depends on macroeconomic factors and commercial levers within Royal Mail's control.
- 3.61 However, given the potential sustainability risk, we propose to increase accountability and our understanding of Royal Mail's outlook in the longer term. Therefore, in line with our statutory duties, we are proposing to strengthen our monitoring regime by requiring a five-year financial forecast from Royal Mail. Furthermore, given the relevance of efficiency to sustainability, we seek to strengthen our monitoring regime on efficiency also (see Section 4). To do this, we will be consulting in due course on the necessary changes to our financial regulatory requirement which are set out in the USP Accounting Condition and the Regulatory Accounting Guidelines. The consultation will describe these changes in detail and explain how they meet our regulatory needs and the relevant legal tests.

Consultation question

Question 3.1: Do you agree with our proposed approach to sustainability of the universal service? Please substantiate your response with reasons and evidence.

4. Efficiency

As explained in Section 3, Ofcom must have regard to the need for the provision of the universal postal service to be financially sustainable and efficient. Royal Mail's 2021/22 to 2023/24 business plan, if successfully executed, indicates that the provision of the universal service will be financially sustainable, for the duration of the plan and possibly beyond. However, significant risks remain. Royal Mail delivering its planned parcels strategy and cost efficiencies will be key in securing the sustainability of the universal service. In particular, Royal Mail must improve on its historical efficiency performance, [3].

However, Royal Mail's efficiency performance has continued to be of concern, and therefore a more transparent and simple way to track progress is required. We are therefore proposing steps that will increase our understanding of Royal Mail's longer-term sustainability outlook for the universal service and require it to report publicly on its longer-term efficiency plans.

Publication of Royal Mail's longer-term efficiency expectations will create a public benchmark against which its actual performance can be measured. It will also increase stakeholders' understanding of Royal Mail's progress on efficiency and provide a public reference point for future assessments of Royal Mail's efficiency.

Introduction

- 4.1 The PSA 2011 requires us to have regard to the need for the provision of a universal service to be financially sustainable, and for it to become efficient within a reasonable period and then remain efficient at all subsequent times.
- 4.2 Royal Mail's ability to plan and achieve efficiencies in this review period is an essential part of ensuring the long-term sustainability of the universal service as discussed in Section 3. While we do not think there is an immediate threat to the short-term sustainability of the universal service, we have had concerns around the pace of efficiency improvements in recent years.
- 4.3 As well as supporting a sustainable, commercially funded USO which meets consumers' needs, efficiency improvements can bring wider market benefits. For example, in end-to-end letters provision where Royal Mail does not face competition, efficiency gains can help reduce/offset the upward cost (and therefore pricing) pressure from declining volumes. Efficiency gains as Royal Mail transforms into a parcels-led business can also help support effective competition in the parcels market, to the ultimate benefit of consumers in the form of lower prices and greater innovation.
- 4.4 Therefore it is important our approach to efficiency is fit for purpose for this review period, to allow Royal Mail to identify and make the necessary changes to ensure the sustainability of the USO in the longer term and deliver wider benefits to consumers.

Current regulation

Our approach

- 4.5 Our current approach to fulfilling our duties for the provision of the USO to become efficient within a reasonable time and remain efficient is to provide Royal Mail with commercial and operational flexibility. This model gives Royal Mail strong incentives to make efficiency improvements because it will reap the benefits of these gains, rather than losing them to tight price caps. However, strong incentives do not guarantee gains will necessarily be delivered in practice, and we have had concerns in the past about Royal Mail's performance in this area. Accordingly, these strong commercial incentives are supported by monitoring Royal Mail's performance on efficiency over time.
- 4.6 In our last review of postal regulation in March 2017, we decided against the imposition of additional price controls or efficiency targets on parts of Royal Mail's business.⁶⁶ We outlined that commercial flexibility, subject to certain safeguards, along with achievement of a reasonable rate of efficiency improvement is the most likely means by which Royal Mail will be able to secure financial sustainability of the universal postal service despite the challenges it faces. We also noted that Royal Mail relying on service degradation or price rises without improving its efficiency performance could undermine financial sustainability in the longer term, and also undermine affordability and/or reasonable needs of users being met.⁶⁷ For example, excessive price rises could push customers towards e-substitution, which would accelerate letter decline, widening the gap between the costs and returns of letter delivery (all else being equal).
- 4.7 Furthermore, our decision not to impose further regulation was based on Royal Mail's future efficiency plans, which demonstrated greater ambition than its past performance and set targets within a reasonable range. We also believed that there was potential for Royal Mail to make greater efficiency gains than those forecasted.
- 4.8 We also set out the metrics and framework we would use to monitor Royal Mail's performance. Having an effective and ongoing monitoring regime is one of the key safeguards of our regulatory framework. To that end, Royal Mail provides us with data on financial metrics on various aspects of the business including EBIT margin of the Reported Business, Royal Mail Group-level cash flow, financial health metrics, transformation costs and several high-level indicators of efficiency. These indicators of efficiency include the following metrics:⁶⁸

⁶⁶ Ofcom, 2017. [Review of the Regulation of Royal Mail](#). [accessed on 28 September 2021]

⁶⁷ Ofcom, 2017. [Review of the Regulation of Royal Mail](#). [accessed on 28 September 2021]

⁶⁸ Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 56. In the Review of the Regulation of Royal Mail 2017 statement, we committed to monitoring the following short to medium term financial health metrics: Funds from operations/net debt, net debt/EBITDA and EBITDA/interest. While we cannot publish forward looking metrics as these rely on Royal Mail's confidential Business Plan, we can provide historic metrics as an indicator of financial health over the period considered.

- **the overall change in real costs**, which provides a high-level simplified view of efficiency;
- **Price, Volume, Efficiency and Other (PVEO) analysis**, which provides a measure of efficiency by disaggregating movements in costs in terms of price changes (i.e. cost inflation), volume effects, efficiencies achieved, and other one-off costs;⁶⁹
- **frontline gross hours in delivery and processing**, which captures year-on-year changes in paid hours.⁷⁰ These will change as a result of volume changes as well as efficiency; and
- **productivity** (Weighted Items per Gross Hours, or WIPGH), represents the ratio of workload (weighted volumes) to paid hours of the frontline workforce (gross hours).⁷¹

4.9 In addition to these metrics, we periodically review Royal Mail’s annual business plans and carry out international benchmarking to help understand opportunities for future efficiency gains as well as progress in comparison with Royal Mail’s peers.

Review of the current approach

Overall progress since 2016-17 has been concerning

4.10 Since 2016-17, we have seen some progress in terms of efficiency. In 2016-17, Royal Mail indicated in its Annual Report and Financial Statements that it achieved its cost reduction targets for three consecutive years and its cost avoidance programme was on track. We saw a minor improvement in cost reduction compared to the previous year, and a 2.2% efficiency improvement (via our PVEO analysis).⁷²

4.11 This trend continued in 2017-18, with a further 3% reduction in real total costs, and 2.8% efficiency improvements. Furthermore, Royal Mail reported in its 2017-18 Annual Report and Financial Statements that the cost avoidance programme in UKPIL was ahead of its expectations.⁷³ Royal Mail also said that it avoided annualised operating costs of £642 million over the past three financial years, ahead of its £600 million target.⁷⁴

4.12 However, this progress appeared to stall the following year, with a small increase in real costs (0.1%) and saw Royal Mail move to an inefficiency of 0.6% in 2018-19.⁷⁵ This

⁶⁹ PVEO analysis provides a measure of efficiency by disaggregating movements in costs in terms of price changes (i.e. cost inflation), volume effects, efficiencies achieved and other one-off costs.

⁷⁰ Gross hours are the hours paid for by Royal Mail for its frontline delivery and processing activities, which account for the majority of people costs and include both worked hours and paid absences such as sickness and leave. The gross hours metric captures year-on-year changes in hours worked as a result of volume changes as well as efficiency.

⁷¹ Royal Mail has recently adopted a new measure of productivity, calculated as the ratio of workload to worked (instead of gross) hours. These hours exclude those associated with paid absences e.g. paid sick leave.

⁷² Ofcom, 2017. [Annual Monitoring Update on Postal Services: Financial Year 2016-2017](#), page 72. [accessed on 19 November 2021].

⁷³ Ofcom, 2018. [Annual Monitoring Update on Postal Services: Financial Year 2017-18](#), page 70. [accessed on 02 December 2021].

⁷⁴ Ofcom, 2018. [Annual Monitoring Update on Postal Services: Financial Year 2017-18](#), page 70.

⁷⁵ Ofcom, 2019. [Annual Monitoring Update on Postal Services: Financial Year 2018-19](#), page 60. [accessed on 02 December 2021].

continued in 2019-20 - although Royal Mail reported that it met its overall cost avoidance target for the UK business in 2019-20, real costs for the Reported Business increased by 1.4%. Our analysis indicated that there were no underlying efficiency improvements (excluding transformation costs) and Royal Mail did not meet its 2%+ target of productivity improvement, achieving 1.0%.⁷⁶

- 4.13 We reported in our 2020 Annual Monitoring Update that Royal Mail's efficiency performance continued to be of concern, as efficiency, alongside modernising the network, was critical to the longer-term sustainability of the universal service.⁷⁷
- 4.14 We reported that while Royal Mail had made some improvements, notably an increase in parcel automation from 12% to 33%, that its efficiency achievements continued to be disappointing. The ambition set out at the start of 2019-20 to transform the business, including making significant productivity improvements, had yet to be realised.⁷⁸ We were concerned that many of the enablers of efficiency improvements identified by Royal Mail were behind schedule and had yet to be implemented. In its annual report of 2019-20 Royal Mail stated that, "There is a risk we will not be able to deliver our transformation programme and meet our required cost avoidance and productivity improvement targets during the life of the plan".⁷⁹

Covid-19 has had an impact on Royal Mail's efficiency progress

- 4.15 The Covid-19 pandemic had a significant impact on Royal Mail's operations and financial outlook. It led to short term changes in the way Royal Mail ran its network in the last eighteen months, which in some cases may not have improved efficiency, but allowed it to fulfil demand, compensate for increased absences and comply with social distancing regulations.
- 4.16 Whilst we are limited in the observations we can make on efficiency performance in 2020-21, we observe that the increase in real costs could exacerbate the existing challenges to Royal Mail's longer term financial sustainability.⁸⁰ Our PVEO analysis in our Annual Monitoring Update published today suggests that in addition to the one off Covid-19 costs, much of the change in costs was due to volume changes resulting from the pandemic.
- 4.17 We expect that Royal Mail will return to a focus on making efficiency improvements, ensuring that additional costs which have arisen due to the impact of the Covid-19 pandemic are removed and resource is efficiently matched to workload in 2021-22 and beyond.

⁷⁶ Ofcom, 2020. [Annual Monitoring Update on Postal Services: Financial Year 2019-20](#), page 62; For graphs of these trends over time see: Ofcom, 2021. [Annual Monitoring Update on Postal Service: Financial Year 2020-21](#).

⁷⁷ Ofcom, 2020. [Annual Monitoring Update on Postal Services: Financial Year 2019-20](#), page 53. [accessed 02 December 2021]

⁷⁸ In May 2019, Royal Mail announced a strategy to transform its business. The plan was to drive forward UK revenue growth from parcels, while improving productivity and containing costs. The strategy outlined a focus on efficiency in its UK operation enabled by a network and digital transformation.

⁷⁹ Royal Mail plc, 2020. [Annual Report and Financial Statements 2019-20](#), page 64. [accessed 02 December 2021]

⁸⁰ Ofcom, 2021. [Annual Monitoring Update on Postal Service: Financial Year 2020-21](#).

Royal Mail acknowledges that it needs to improve its efficiency

- 4.18 In its Annual Report of 2020-21 Royal Mail stated that “Royal Mail must become more efficient and flexible to compete effectively in the parcel and letter markets. The success of our strategy relies on the effective control of costs and delivery of efficiency and productivity benefits across all areas of the business. Failure to effectively control costs while at the same time delivering high-quality services could result in a loss of customers, market share and revenue.”⁸¹ It also recognised that it was “developing a plan as part of our UK transformation to underpin the sustainability of the Universal Service Obligation. This will help us become even more efficient and better placed to respond to changing customer demands”.⁸²
- 4.19 Through ongoing dialogue, regular regulatory reporting and formal information requests we remain updated on Royal Mail’s evolving efficiency plans and progress. Royal Mail has identified several key enablers of efficiency improvements. Under different plans, the overall ambitions or approach has been adjusted given updated circumstances, but the key enablers broadly remain relevant.
- 4.20 Below we set out a brief overview of Royal Mail’s current ambitions in relation to these key enablers and the progress made in recent years. Continued progress with the operational efficiency changes remain key to driving sustainable cost savings, but progress against these objectives has been limited as there have been delays and changes to the original plan.

Pathway to Change agreement

- 4.21 In December 2020, Royal Mail and the Communication Workers Union (CWU) agreed a deal to improve Royal Mail’s parcel operation, through new dedicated parcel duties, parcel hubs, and increased delivery times.⁸³ This agreement was ratified by the union members on 3 February 2021.⁸⁴ Since then, Royal Mail have been undertaking a revision programme to realign resources to the change in volumes from letters to parcels and to improve efficiency.⁸⁵
- 4.22 Royal Mail stated that “The agreement with the CWU gives us a platform for future growth, and the means to achieve productivity benefits of 3% plus this year. In 2021-22, more than £100 million in benefits are linked to effective execution and delivery of benefits associated with the agreement.”⁸⁶ We understand that Royal Mail is working with

⁸¹ Royal Mail plc., Annual Report and Financial Statements 2020-21, page 48.

⁸² Royal Mail plc., Annual Report and Financial Statements 2020-21, page 51.

⁸³ The Communication Workers Union (‘CWU’) is the biggest union for the communications industry in the UK with almost 200,000 members. It represents members in postal, telecom, mobile, administrative and financial companies including Royal Mail Group, UK Mail and BT, Telefonica O2, Virgin Media, EE and Santander, as well as outsourcing company Capita. Its members’ expertise includes engineering, computing, clerical, mechanical, driving, retail, financial, call centre and manual skills. (CWU, [What the union does](#) [accessed 02 December 2021]); CWU and Royal Mail, 2020. [Key Principles Framework Agreement \(The Pathway to Change\)](#) [accessed 01 December 2021].

⁸⁴ Royal Mail, 2021. [Royal Mail welcomes CWU ballot result](#) [accessed 01 December 2021].

⁸⁵ Royal Mail plc, 2021. [Results for the half year ended 26 September 2021, 18 November 2021](#), page 1. [accessed 01 December 2021].

⁸⁶ Royal Mail plc., [Annual Report and Financial Statements 2020-21](#), page 9.

the CWU to undertake more detailed modelling and planning for certain initiatives.⁸⁷ However, Royal Mail stated in its half year results that it is expected to deliver somewhat less than the £100m expected – it now expects at least £80 million full year benefit.⁸⁸

Table 4.1: Elements of the pathway to change agreement indicating progress

Initiative	Description	Ambition
Parcel Hubs	<p>North West Hub: the first of three automated hubs to be completed as part of the Parcels Automation strategy.</p> <p>Midlands Hub: the second of three automated hubs to be completed, it will replace the current National Distribution Centre (NDC).</p>	<p>North West Hub: It is currently in the commission phase and is on track to launch in Spring 2022.</p> <p>Midlands Hub: It is expected to open in Summer 2023, with the capability to sort over one million parcels a day.⁸⁹</p>
Scan in, scan out	An automated solution for employees to log in and out when an individual starts/finishes work and capture collective hours of attendance.	It will replace handwritten sign-in / sign-out systems at Royal Mail’s 43 processing sites, including all Mail Centres and Regional Distribution Centres.
Resource Scheduler	A software solution that draws together data from across Royal Mail’s operation to optimise alignment of duty sets and rosters to demand.	The trials of this technology identified a number of areas that Royal Mail wants to improve.
Delivery Revisions	<p>Delivery revisions are changes to the delivery routes carried out by postmen and women. There are two types of revisions:</p> <ul style="list-style-type: none"> • A Table-top revision is a change delivered and led by the Delivery Offices. The DOM (delivery office manager) and local CWU reps work out what changes are needed to achieve the relevant goals (e.g. productivity target). • A Full structural revision is a 32-step process, which rewrites the routes from scratch providing a new process to drive efficiency into the each DO. 	As at the end of October, most delivery offices - c1,200 - had been through a revision.

Source: Royal Mail correspondence to Ofcom dated 1 December 2021, which includes confirmation of updates given in Royal Mail Half Year 2021-22 Results published on 18 November 2021.

Other initiatives

4.23 Royal Mail had 20 automatic parcel sortation machines as at March 2021, with an expectation of increasing the number of parcel sorting machines to “around 30 by the end of 2021-22 with each machine able to process around 180,000 parcels per day and up to 10,000 parcels per hour”.⁹⁰ Royal Mail reported that 33% of parcels were automatically sorted at least once during the financial year – the same as the year before.⁹¹ Royal Mail

⁸⁷ Royal Mail plc., [Annual Report and Financial Statements 2020-21](#), page 9.

⁸⁸ Royal Mail plc., 2021. [Results for the half year ended 26 September 2021, 18 November 2021](#), page 1. [accessed 01 December 2021].

⁸⁹ Royal Mail plc., 2021. [Annual Report and Financial Statements for the full year ended 28 March 2021](#), page 27 [accessed 2 December 2021]

⁹⁰ Royal Mail plc., [Annual Report and Financial Statements 2020-21](#), page 17.

⁹¹ Royal Mail plc., [Annual Report and Financial Statements 2020-21](#), page 9; we note that the absolute number of parcels automatically sorted increased, but the percentage proportion has remained constant because of the significant increase in volumes due to the pandemic.

has said that it has “plans to increase parcel automation levels to at least 50% by the end of 2021-22”.⁹² It has an ambition to “achieve the benchmark of 90% in 2023-24”.⁹³

We remain concerned for the sustainability of the universal service if Royal Mail does not improve on its historic performance

- 4.24 Although slow, Royal Mail has made some progress in becoming more efficient under the current framework. Royal Mail also recognises that there remains significant scope for further improvements, and it has identified specific initiatives and changes that are needed to help address its challenges as set out above. Assessing the financial year 2019/20, we thought that Royal Mail’s efficiency performance continued to be of concern.⁹⁴ While we recognise that Covid-19 has had an impact on Royal Mail’s ability to deliver efficiency improvements in 2020/21, it has meant that additional costs from Covid-19 have been added to the business, potentially exacerbating the efficiency challenge.⁹⁵
- 4.25 As explained in Section 3, Royal Mail’s plan, if successfully executed, [§], [§] over the next three years. [§.]
- 4.26 However, the plan assumes that Royal Mail will be able to achieve [§] cost efficiencies. To test the plan, we considered a range of alternative revenue scenarios over the next 3 years, and [§].
- 4.27 Our analysis suggests that revenue growth alone appears unlikely to be enough to secure a sustainable level of profit in the longer term unless Royal Mail can also improve on its recent efficiency performance. Increasing the rate of efficiency improvement is therefore critical to the longer-term sustainability of the universal service.
- 4.28 Therefore, given Royal Mail’s track record on delivering efficiency improvements, and the importance of efficiency to ensuring longer-term sustainability, we consider it is appropriate to modify our approach.

Our proposals

Stakeholder responses to our March CFI

- 4.29 In our March CFI we set out our view that the existing regulatory approach to sustainability and efficiency, and the range of measures we use, was likely to remain appropriate for the next review period. This acknowledged the incentives within any private company to drive financial sustainability and efficiency, and supports it by providing operational flexibility for Royal Mail to work out the best way forward whilst also avoiding the risk of regulatory

⁹² Royal Mail plc., [Annual Report and Financial Statements 2020-21](#), page 15.

⁹³ Royal Mail plc., [Annual Report and Financial Statements 2020-21](#), page 20.

⁹⁴ Ofcom, 2020. [Annual Monitoring Update on Postal Services](#), page 53.

⁹⁵ Ofcom, 2021. [Annual Monitoring Update on Postal Services](#), page 60.

micromanagement or failure. It also ensures that there are some important safeguards in place, such as the monitoring regime which allows us and industry to assess Royal Mail's progress.

- 4.30 However, we also acknowledged that we, and stakeholders, have had concerns in relation to sustainability and efficiency during the last review period. We therefore invited stakeholder views on what the future framework should look like.

Stakeholder Responses

- 4.31 The majority of respondents supported Ofcom taking more action on ensuring that the provision of the universal service is efficient before the end of a reasonable period and continues to be efficient at all subsequent times. Some respondents argued that Ofcom may need to consider further regulatory action such as imposing efficiency targets, if current stakeholder incentives are not effective.⁹⁶ Several respondents went further, arguing for further regulatory intervention, such as imposing efficiency targets.⁹⁷ Three respondents reasoning for this was that Royal Mail did not have adequate incentives to make efficiency improvements due to its monopoly in mail and lightweight parcels delivery.⁹⁸ Three respondents thought Ofcom could introduce price controls as a solution.⁹⁹
- 4.32 Royal Mail recognised that, although it expects the Pathway to Change agreement will be a key enabler for productivity savings, previous agreements with CWU have not delivered on the efficiency targets set.¹⁰⁰ In this context, Royal Mail called for Ofcom to update its approach to monitoring by including metrics that align with Royal Mail's new transformation key metrics, such as parcel hubs and automation, and by removing those that it believes are no longer relevant. Royal Mail also called for Ofcom to review its draft 2021 Business Plan and confirm whether it views Royal Mail's efficiency ambition set out in the plan is "within reasonable range" as it believes this clarity from Ofcom would enable Royal Mail senior management to focus on the job of delivering on behalf of customers.¹⁰¹
- 4.33 The majority of other stakeholders thought that Royal Mail relying on service degradation or price rises without improving its efficiency performance could undermine financial sustainability in the longer term and also affordability and/or the reasonable needs of

⁹⁶ Citizens Advice Scotland response to our March CFI, 4.1; [redacted]

⁹⁷ Mail Competition Forum, Response to our March CFI, page 7; Mail Users Association response to our March CFI, page 4; Professional Publishers Association (PPA) response to our March CFI, page 2; UKMail response to our March CFI, page 3; [redacted].

⁹⁸ Mail Competition Forum, Response to our March CFI, page 7; Mail Users Association response to our March CFI, page 4; [redacted].

⁹⁹ Whistl response to our March CFI, page 8; Mail Users Association response to our March CFI, page 4; [redacted]

¹⁰⁰ Royal Mail response to our March CFI, page 26.

¹⁰¹ Royal Mail response to our March CFI, page 28.

users.¹⁰² The CWU however disagreed, taking the view that affordability and access price controls should not constrain pricing.¹⁰³ Royal Mail and [redacted] supported this, calling for the removal or raising of the Second Class safeguard cap.¹⁰⁴

- 4.34 Several respondents were in favour of maintaining the existing arrangements – believing they provide regulatory certainty, sufficient incentives and/or that alternatives could produce unintended consequences. Some respondents also highlighted that Royal Mail faces sufficient challenges in the current market and any significant regulatory shifts by Ofcom could prove disruptive.¹⁰⁵
- 4.35 CWU disagreed with Ofcom’s position on Royal Mail’s recent efficiency achievements being disappointing and cited examples of efficiency improvements that have been achieved since 2008.¹⁰⁶

Our proposals

- 4.36 We remain of the view that Royal Mail is best placed to manage its activities in a way that provides the best opportunity to secure the sustainability of the USO. We also consider that shareholder pressure and market forces will incentivise Royal Mail to become more efficient in the provision of the universal service. We therefore consider that our current approach, which has been to provide Royal Mail with commercial and operational flexibility, on the basis that it has incentives to make efficiency improvements to maximise shareholder returns, remains broadly appropriate. Furthermore, we consider it appropriate to maintain our overall existing safeguard monitoring regime with some adaptations as set out below.
- 4.37 In light of our concerns regarding the historical levels of efficiency improvements achieved by Royal Mail, we have considered whether any additional regulatory steps may be appropriate.
- 4.38 In this section, we explain why we are proposing to introduce an additional component to the way we monitor Royal Mail’s performance against its own expectations and additional publication requirements to give stakeholders greater visibility of Royal Mail’s performance on efficiency. We also explain why we rejected imposing price controls or setting efficiency targets.

¹⁰² ACS response to our March CFI, page 3; Consumer Council NI response to our March CFI, pages 5-6; CWU response to our March CFI, page 6; Whistl, response to our March CFI, Section 4; UKMail, response to our March CFI, page 1; Mail Users’ Association response to our March CFI, page 4; Professional Publishers Association response to our March CFI, pages 1-2; [redacted]

¹⁰³ CWU response to our March CFI, pages 13 and 24.

¹⁰⁴ Royal Mail response to our March CFI, page 6; [redacted].

¹⁰⁵ Royal Mail response to our March CFI, page 8; CWU response to our March CFI, page 8; [redacted].

¹⁰⁶ CWU response to our March CFI, page 5.

We do not think reintroducing price controls or attempting to set binding targets would support delivery of efficiencies

- 4.39 Whilst acknowledging Royal Mail's challenges in the previous review period, we continue to believe that shareholder pressure and market forces already create significant incentives for Royal Mail to become more efficient in the provision of the universal service.¹⁰⁷
- 4.40 Some stakeholders argued that price controls would create further incentives on Royal Mail to become more efficient.¹⁰⁸
- 4.41 However, introducing price controls could constrain Royal Mail's commercial flexibility and therefore its ability to respond to market changes effectively. Providing commercial flexibility can also create a stronger incentive to generate efficiency gains than price controls because Royal Mail can reap the full benefits of any improvement. Furthermore, price controls could result in unintended consequences. This is because of the difficulty in forecasting letter and parcel volumes due to the ongoing structural changes in the market. Therefore, we are of the provisional view that maintaining Royal Mail's current commercial and operational flexibility remains the most appropriate approach to supporting an efficient and financially sustainable universal service.
- 4.42 We also considered the possibility of imposing efficiency targets for Royal Mail. However, attempts to increase incentives by setting targets could be difficult to establish, implement, monitor and enforce, and may have little additional effect for an organisation that is already under pressure to cut costs. Further, they could distract Royal Mail from its own objectives if they are not set appropriately. We therefore do not consider that such targets would be beneficial at this stage.
- 4.43 Nonetheless, given its importance for future sustainability of the USO and our concerns with Royal Mail's progress in recent years, we think additional measures are necessary. Therefore, while it is for Royal Mail to manage its business activities in a way that provides the best opportunity to secure the sustainability of the USO, we think there is value in increasing the level of public understanding and scrutiny of Royal Mail's efficiency expectations and its progress against them.

Publication of new metrics will support greater scrutiny

- 4.44 We consider that publication of appropriate measures of the efficiency gains Royal Mail expects to make over the next five years and its progress towards achieving them is appropriate, given the increased focus on the efficiency improvements that Royal Mail must make to ensure the sustainability of the USO. Publication of its assumptions will create a public benchmark against which its actual performance can be measured. It will

¹⁰⁷ This is in line with our duty to have regard to "the need for the provision of a universal postal service to be efficient before the end of a reasonable period and for its provision to continue to be efficient at all subsequent times".

¹⁰⁸ Mail Users Association response to our March CFI, page 4; Whistl response to our March CFI, page 8; [3<].

also increase stakeholders' understanding of Royal Mail's progress on efficiency and provide a public reference point for future assessments of Royal Mail's efficiency.

- 4.45 We explained in the Section 3 that we will require Royal Mail to annually submit a five-year plan from 2023. We propose that the efficiency assumptions included in the first five-year plan for the period to 2028/29 should be used as the benchmark against which actual performance over that period will be assessed. We propose to require Royal Mail to publish selected efficiency metrics consistent with those expectations at the start of the five year period. We consider the appropriate metrics later in this section.
- 4.46 The first submission would be due on 31 May 2023. We think this date is appropriate as it aligns with Royal Mail's business planning cycle, allowing Royal Mail to establish its expectations alongside its other regulatory reporting requirements and its business plan. It also allows Royal Mail sufficient time from our 2022 policy statement to prepare its systems and processes to report on the selected metrics. It also aligns with our sustainability proposal to require a longer-term business plan from 2023.
- 4.47 It is important that we, and all stakeholders, understand Royal Mail's efficiency expectations over time. We propose that in the five years that follow, Royal Mail would also be required to report annually its actual performance against its five-year plan publicly. We also propose to require Royal Mail to explain the reasons for any divergence from the assumptions in the five-year plan.
- 4.48 We propose that Royal Mail set its five-year efficiency expectation upfront and that the metrics and the expectations are not amended in the intervening years, unless there are exceptional circumstances that make it a necessity. Although we propose to require Royal Mail to submit annually updated five-year business plans to inform our assessment of the sustainability of the USO, we do not propose to require Royal Mail to update its efficiency assumptions which we will be monitoring against, which will continue to be by reference to those at the start of the five-year period, other than in exceptional circumstances. We think that where Royal Mail consider exceptional circumstances have arisen, it would seek approval from us that the circumstances warrant a change in expectations within the five-year period.
- 4.49 Furthermore, we recognise that there may be reasons why forecasts may change from year to year and therefore the five-year period allows Royal Mail and stakeholders to take a longer-term view. We also recognise that some factors might be outside of Royal Mail's control over this period, making forecasting challenging, but we aim to reduce the impact of this uncertainty by choosing appropriate metrics and encouraging Royal Mail to be clear about the potential factors outside its control upfront (and the implicit assumptions it has made).

We welcome views on the possible metrics of the efficiency expectations against which we will monitor progress

4.50 We propose to specify the efficiency metrics that Royal Mail will be required to set and report against. Our intention is to then publish both the expectations and actual performance in future Annual Monitoring Updates.

Selecting the appropriate metrics

4.51 We already publish the following metrics when assessing Royal Mail's progress on efficiency in our Annual Monitoring Update, although we do not formally compare them to Royal Mail's own expectations:

- a) **the overall change in real costs**, which provides a high-level simplified view of efficiency;
- b) **Price, Volume, Efficiency and Other (PVEO)** analysis, which provides a measure of efficiency by disaggregating movements in costs in terms of price changes (i.e. cost inflation), volume effects, efficiencies achieved, and other one-off costs;¹⁰⁹
- c) **frontline gross hours** in delivery and processing, which captures year-on-year changes in paid hours.¹¹⁰ These will change as a result of volume changes as well as efficiency; and
- d) **Royal Mail's productivity metric** (Weighted Items per Gross Hours, or WIPGH), represents the ratio of workload (weighted volumes) to paid hours of the frontline workforce (gross hours).¹¹¹

4.52 When assessing the suitability of efficiency metrics for our proposed policy, we consider that the following properties are important:

- a) **Output based** – the monitoring of forecast efficiency outcomes (rather than operational inputs) over time is likely to provide a more meaningful benchmark. Although input/operational-based metrics (such as level of automation, number of revisions) can be informative about the drivers of efficiency outcomes, they do not necessarily show efficiency gains in and of themselves. Targeting and monitoring outcomes also gives Royal Mail flexibility to decide how to deliver efficiencies over time, while still demonstrating overall achievements.
- b) **Simple** – the metrics also need to be simple and easy to understand. Simple metrics will be understandable to all stakeholders. This in turn would help improve the transparency of our monitoring regime and Royal Mail's accountability. It could also reduce the administrative burden for all parties involved.

¹⁰⁹ PVEO analysis provides a measure of efficiency by disaggregating movements in costs in terms of price changes (i.e. cost inflation), volume effects, efficiencies achieved and other one-off costs.

¹¹⁰ Gross hours are the hours paid for by Royal Mail for its frontline delivery and processing activities, which account for the majority of people costs and include both worked hours and paid absences such as sickness and leave. The gross hours metric captures year-on-year changes in hours worked as a result of volume changes as well as efficiency.

¹¹¹ Royal Mail has recently adopted a new measure of productivity, calculated as the ratio of workload to worked (instead of gross) hours. These hours exclude those associated with paid absences e.g. paid sick leave.

- c) **Reliable** – ideally, metrics should accurately show Royal Mail’s efficiency progress, accounting for the fact that the forecast is over a five year period. Given that costs can be driven by changes in volumes and input prices and one-offs (e.g. Covid-19 restrictions), in addition to changes in efficiency, accuracy of a metric could be impacted by the extent to which it can separate out these changes, so as to identify the genuine efficiency impact on costs. Furthermore, the level of some metrics can be influenced in ways which are not linked to genuine efficiency performance, thus making the metric less robust/meaningful.
- d) **Transparent** – some metrics may contain commercially sensitive information. In selecting our metrics to use, we will consider the impact that disclosing commercially sensitive information would have on Royal Mail and other stakeholders.
- e) **Practicable** – in determining which metrics to adopt, we will also consider the associated administrative costs. In other words, we will seek to adopt the minimum number of metrics needed to achieve our policy objectives.

4.53 We note that some metrics may only capture efficiency outcomes for a subset of pipeline activities and/or costs, and so to ensure our overall approach is meaningful, our aim would be to select a combination of metrics which provides as complete a picture of Royal Mail’s forecast for efficiency (and progress against) as practical. We also note that metrics which do not account for changes in volumes and input prices, could be combined with other metrics to provide a more reliable picture of performance. We have adopted this approach in the past given the difficulties in accounting reliably for the impact of these changes. Therefore, no single metric appears to provide a clear enough picture of Royal Mail’s efficiency performance and a combination of several metrics is likely to be appropriate.

We have identified a shortlist of metrics that we consider would be most appropriate

4.54 We have conducted a detailed analysis of a range of potential metrics, in a similar fashion to that described above. We have conducted a full analysis in Annex 9, but we set out a summary here. We consider that some or all of the following metrics could provide a useful and proportionate suite of metrics:

- a) **PVE analysis** takes account of both changes in pay and changes in volumes to identify the effects of efficiency improvements but may be harder for some stakeholders to understand;
- b) **Change in total real costs of the Reported Business** is easy to understand and clearly covers a broad range of costs. However, changes in real costs might not be very instructive at times of volatile volumes which would cause the underlying costs to change. It also offers little insight into the factors driving the changes in costs;
- c) **Total gross hours** would provide greater coverage than front line hours alone, but, if this was the only metric, we would lose visibility of non-people cost efficiency improvements. In addition, similar to change in total real costs, this metric might not be as instructive at times of volatile volumes;

- d) **Non-people costs of the Reported Business, excluding capital and transformation costs.** This metric is simple and easy to understand and can account for input price inflation if adjusted by CPI inflation. However, given that most of Royal Mail's costs are people costs, this metric will not capture a significant portion of Royal Mail's scope for efficiency improvements on its own; and
- e) **Weighted Items per Gross Hours (WIPGH)** accounts for the rate of work throughput – and therefore provides a useful measure of productivity – but does not capture the effect of changes to pay.

4.55 We have also considered some other metrics which could be appropriate, but we are minded to not use as part of the regime. These include:

- a) **Pay rate change relative to productivity gain** – this is the forecast average pay increase relative to the forecast productivity gain in relation to Royal Mail's staff. Forecast productivity gain is measured as WIPGH (see above). While this metric captures both pay rate and labour productivity changes, this could be commercially sensitive to Royal Mail and therefore may not be suitable for publication.
- b) **Weighted Items per Worked Hour** – this is the productivity measure used by Royal Mail and CWU to set productivity targets across delivery offices as part of the new Pathway to Change agreement. While the advantage of this metric is that it will be used by Royal Mail and CWU to track progress of new Pathway to Change agreement, it is more limited in scope than the existing productivity measure so over time it may not capture the full scope of the efficiency progress.

4.56 We welcome views from stakeholders on which of these metrics (or indeed others) would be most appropriate.

Summary of proposals

4.57 We are proposing to require Royal Mail to publish the efficiency change it expects to have achieved across a five-year period starting in 2023, and updated every five years thereafter. We also propose to require Royal Mail to explain in future years how it has performed against the plan, and where it has deviated.

4.58 We are also proposing to broadly maintain our existing monitoring regime which will provide the data to us to monitor Royal Mail's progress against its own target.

4.59 We intend to finalise our view on the expectations policy, including the most appropriate metrics in our policy statement next year. We will then consult on the specific legal instrument which will implement this policy in our regulatory reporting consultation alongside the policy statement in 2022.

Consultation questions

Question 4.1: Do you agree with our proposal to maintain the historic approach but with the additional requirement on Royal Mail to set and report against a five-year expectation? Please substantiate your response with reasons and evidence.

Question 4.2: Do you agree with our proposals in relation to the monitoring and publication of the efficiency expectations prepared by Royal Mail? Please substantiate your response with reasons and evidence. Please substantiate your response with reasons and evidence.

5. USO letters regulation

Having access to simple, affordable and reliable postal services remains crucially important for customers throughout the UK.

Despite the enormous growth in online communication, almost 8 billion letters are still sent each year and 40% of residential postal users in the UK say they would feel cut off from society if they could not send or receive a letter almost every day.

The universal service has a key role in achieving this objective, and consumers continue to greatly value its core characteristics: affordability of the service, uniform tariffs across the UK, and frequent and reliable deliveries.

In the context of our overall approach to regulation to ensure postal users continue to have access to simple, affordable and reliable postal services that meet their needs, we have considered USO services and propose to:

- **Retain the existing scope of USO services**, which we consider continue to meet the reasonable needs of users of postal services in the United Kingdom.
- **Retain the existing price caps on second class mail** to ensure affordable prices for USO services. We have provisionally concluded that the current caps should remain in place until the end of March 2024.
- **Not impose a new requirement on Royal Mail to provide a discounted residential redirection service to financially vulnerable customers.** Although we have identified affordability concerns in respect of redirection services, we consider that Royal Mail's recently refreshed Concession Redirection, which came into effect on 29 November, largely addresses our main concerns.
- **Maintain the current quality of service standards.** Quality of service targets help to ensure users receive the service promised, and that their mail will arrive on time. Our research shows the current quality of service standards remain important for users, and we consider it necessary and appropriate to retain them at their current levels.
- **Retain the current specifications for Special Delivery Guaranteed by 1pm and proof of delivery services.** Although we have not proposed any changes in this consultation, we welcome input from stakeholders. We will consider revisiting our position if sufficient evidence is provided to demonstrate that changes would meet reasonable user needs and support efficiency.

Structure of this section

5.1 This section of our consultation document considers the universal service, and postal products offered by Royal Mail as part of the universal service obligation (USO) – in particular USO letters. Issues relating to USO parcels regulation are covered in Section 7.¹¹² The structure of this section is as follows:

- Market Context

¹¹² However, where relevant we may refer to issues relating to USO parcels in this section.

- The current universal service rules
- Overall approach to the USO
- Safeguard caps
- Redirection services
- Quality of service targets
- Ensuring everyone can access USO services
- Special Delivery, Signed For and additional services
- Meter mail (franking)
- Other issues

Market context

5.2 The UK postal market has changed significantly in recent years¹¹³, and letter volumes and revenues have continued to decline since 2011, as customers increasingly move towards online communications. Despite this, the letters market is still significant, with almost 8 billion addressed letters¹¹⁴ being sent in 2020-21.

Overview of the letters market

5.3 The UK letters market can be split into two parts:

- a) Single piece end-to-end services (mainly USO services) – single letters that individuals or SMEs send via post boxes and post offices (e.g. birthday cards/invoices), which are collected and delivered by Royal Mail; and,
- b) Bulk mail – Access mail and Royal Mail End-to-End mail (both non-USO) (see Section 8 – Access for bulk mail – for further details).

5.4 The focus of this section is on single piece end-to-end letters services, which are mainly USO services. Royal Mail provides a range of USO letter services (e.g. First Class, Second Class, Redirection and SDG). There is no significant competition in single piece letter services, either from other end-to-end or access operators. Therefore, users of single piece letter services rely almost exclusively on Royal Mail’s universal service.

5.5 As set out in the Market Context section, the total volume of addressed letters sent (which includes single piece letters) has declined over time¹¹⁵ and is likely to continue to do so.

5.6 For completeness, we note that USO products also include single piece parcels. Our detailed discussion of USO parcels is set out in Section 7 but some of the issues we cover here (including safeguard caps and Quality of Service) also apply to some USO parcels too.

¹¹³ See the Market Context section of this document.

¹¹⁴ These 8 billion letters include both Access and Royal Mail End-to-End addressed letters. For more details see the Market Context section of this document.

¹¹⁵ We use single piece-letter volumes as a proxy for USO volumes.

The current universal service rules

- 5.7 The USO requires the designated universal service provider, Royal Mail, to deliver a range of postal services to homes and businesses. As explained in Annex 6 (Overview of the relevant legal framework), there are three ‘building blocks’ which make up the universal service. We discuss these briefly in turn below.

Minimum requirements

- 5.8 Section 31 of the PSA 2011 sets these out and they include the requirement that Royal Mail deliver letters six days a week, at an affordable and geographically uniform price to every address in the UK. These minimum requirements can only be altered by Government and Parliament.¹¹⁶

Universal Postal Service Order

- 5.9 Ofcom is required by Section 30 of the PSA 2011 to set out a description of the services that it considers should be provided in the UK as a universal postal service, and the standards those services are to comply with. Ofcom did this in 2012, when it made the Postal Services (Universal Postal Service) Order 2012 (“the Universal Service Order”).¹¹⁷
- 5.10 While the PSA 2011 sets out various minimum requirements, the Universal Service Order can go beyond this following an assessment of the extent to which the market for the provision of postal services in the UK is meeting the reasonable needs of the users of those services. The current Universal Service Order includes features going beyond the minimum requirements of the PSA 2011, such as the requirement to provide First and Second Class services.

DUSP Conditions

- 5.11 Ofcom can impose designated universal service provider conditions (“DUSP Conditions”)¹¹⁸ on a universal service provider pursuant to Section 36 of the PSA 2011. These can include, amongst other things, a requirement for a universal service provider to provide a universal postal service (or part of such a service) throughout or in a specified part of the UK. Ofcom can also make provision as to the tariffs to be used for determining the prices of universal service products, as well as performance targets.
- 5.12 To date, Ofcom has imposed three DUSP conditions on Royal Mail.
- a) DUSP Condition 1 requires Royal Mail to provide those services set out in the Universal Service Order throughout the UK. It also includes performance targets that Royal Mail

¹¹⁶ In 2020, Ofcom published research into whether the minimum requirements reflect the reasonable needs of the users of postal services in the United Kingdom. Ofcom, 2020. [Review of postal users’ needs](#).

¹¹⁷ [The Postal Services \(Universal Postal Service\) Order 2012](#).

¹¹⁸ Ofcom, 2021. [Designated universal service provider \(DUSP\) conditions](#).

must meet in respect of some universal services, as well as obligations to notify and publish certain information;

- b) DUSP Condition 2 imposes a safeguard cap on stamps for Second Class letters; and,
- c) DUSP Condition 3 imposes a safeguard cap on stamps for Second Class large letters and parcels up to and including 2kg.

Overall approach to the USO

5.13 In our March call for inputs (March CFI)¹¹⁹ we invited stakeholders' views on whether our approach to regulating USO services would remain appropriate for a further five years.

Stakeholder responses to our March CFI

5.14 Responses to the March CFI showed strong stakeholder support for a universal service¹²⁰ and most stakeholders did not have significant comments regarding the high-level scope of the universal service. Royal Mail did ask for some specific changes to detailed requirements of the USO (in particular, for Ofcom to allow it to provide tracking on universal service parcels and to allow for delivery of Special Delivery services after 1pm).¹²¹ Royal Mail did not however comment more generally on the universal service specifications.

5.15 Some stakeholders¹²² commented on delivery days for letters. However, as explained in the March CFI, the scope of this Review does not include the number of delivery days, which was considered in detail in our Review of User Needs (RUN) (and on which any next steps would be for Government and Parliament).

Our proposed approach to the USO

5.16 Our research¹²³ indicates that the USO services remain vitally important for postal users. Our RUN research found strong support from users for core features of the USO.¹²⁴ Users supported a service that was affordable and offered value for money, was certain and reliable, and had delivery to the door. The vast majority (around nine in ten) of both

¹¹⁹ Ofcom, 2020. [Review of postal regulation; Call for inputs](#).

¹²⁰ [Advisory Committee for Scotland](#) response to our March CFI, page 1; [Citizens Advice response to our March CFI](#), page 7, paragraph 1.12; [Citizens Advice Scotland](#) response to our March CFI, page 4; [Consumer Communications Panel and ACOD](#) response to our March CFI, page 1; [Consumer Council for Northern Ireland](#) response to our March CFI, page 2; [Communication Workers Union](#) response to our March CFI, page 1; [Royal Mail](#) response to our March CFI, page 1; [techUK](#) response to our March CFI, page 2; [Whistl](#) response to our March CFI, paragraph 5.1.5.

¹²¹ Royal Mail response to our March CFI, page 3, paragraph 4 and page 7, paragraph 2.

¹²² [CFH](#) response to our March CFI, page 4; [Communication Workers Union](#), page 14; [Federation of Sub-Postmasters](#) response to our March CFI, page 3; [Post Office](#) response to our March CFI, page 2; [Mail Users Association](#) response to our March CFI, page 5; [Professional Publishers Association](#) response to our March CFI, page 2.

¹²³ To inform our provisional conclusions in this section, we have considered responses to the March CFI as well as our own research. The latter includes research recently conducted to support our Review of postal users' needs, our annual Postal Tracker survey, specific consumer research gathered for this review, as well as evidence gathered from statutory information gathering.

¹²⁴ Ofcom, 2020. [Review of user needs](#), page 23.

residential and SME users considered affordability and high certainty/reliability to be important aspects of the postal service.¹²⁵

- 5.17 Further, whilst we recognise that users' needs are changing (see our RUN and Section 2 of this consultation), our research suggests that users value the broad range of postal services provided under the USO. Indeed, in the RUN, we found that users' needs extend beyond the standard services of First Class and Second Class letter services and include additional services such as SDG, Signed For, Certificate of Posting and Redirections. Specifically, whilst our qualitative research suggested that postal users' needs could often be met by a narrow range of postal services, there were cases where the standard (First and Second Class) services did not meet user needs.¹²⁶ Users regarded SDG, Signed For and Certificate of Posting as essential.¹²⁷ Other services including metering (using franking machines), Redirection, insured services and return to sender remain important for users that need to use these services.¹²⁸
- 5.18 Royal Mail continues to have a near monopoly on the delivery of single-piece letters and large letters (and a large share of the market for parcels up to 2kg), with no other operator offering nationwide single-piece letter services.
- 5.19 Taking account of the above, and the fact that stakeholders raised no specific concerns with the high-level scope of the USO, we have not reviewed each of the precise service specifications in the USO and are of the provisional view that the overall shape of the USO will remain appropriate in the next review period.
- 5.20 Where specific comments have however been raised on particular USO requirements (for example, Royal Mail's request to add tracking to first and second class USO parcels), we have considered these elsewhere in the consultation.¹²⁹

¹²⁵ Ofcom, 2020. Review of user needs, page 34, paragraph 4.41.

¹²⁶ Ofcom 2020. Review of user needs, page 39, see from paragraph 4.61.

¹²⁷ Ofcom, 2020. Review of user needs, page 74, paragraph 6.36

¹²⁸ Ofcom, 2020. Review of user needs, pages 77 – 78.

¹²⁹ We discuss some specific issues on the USO specification for parcels raised in the March CFI in Section 7 – USO parcels regulation.

Safeguard caps

Safeguard price caps on second class letters and small parcels are an important part of the framework for regulating Royal Mail and help to ensure that basic postal services are affordable for postal users.

A decision was made on the scope and level of the safeguard caps in 2019 for the period to the end of March 2024, and we do not propose to revisit that decision earlier than currently planned.

We therefore intend to conduct a separate review of the appropriate scope and level of the safeguard caps that will apply from April 2024. We intend to begin work on this review towards the end of 2022.

Introduction and background

5.21 Our safeguard cap regime was designed to ensure that a basic, affordable, universal postal service is available to consumers and small businesses, and that users of postal services, especially vulnerable consumers, are protected from ongoing price increases.

5.22 We currently apply two price caps on Royal Mail's Second Class services to achieve this aim, which are the basis of our safeguard cap regime:

- a price cap on Second Class letter stamps; and
- a basket cap on Second Class large letters and parcels up to and including 2kg.

5.23 In the 2019 Review of safeguard caps¹³⁰, we undertook a full assessment of the affordability of Second Class letters, large letters and parcels up to 2kg. We concluded that there was some scope for price increases, while keeping prices affordable for a significant majority of vulnerable consumers. We said that raising the level of the standard letter cap would help to minimise the effect of the safeguard caps on Royal Mail's pricing freedom to avoid a material effect on wider financeability. We decided to:

- increase the level of the standard letter cap by 5% in real terms, to 65p in 2019;
- maintain the basket cap at its current level; and
- allow both caps to rise with CPI until March 2024, but not by more than that.¹³¹

5.24 We were concerned that giving Royal Mail more than 5% flexibility to increase prices on Second Class standard letters risked increasing affordability problems for vulnerable consumers.

5.25 In January 2021, Royal Mail raised prices on Second Class standard letters to the level of the cap and can now only raise prices in line with CPI for the remainder of the current review period, ending March 2024. As at April 2021, Royal Mail still has 22% headroom on

¹³⁰ Ofcom, 2019. [Review of Second Class safeguard caps](#), statement.

¹³¹ Ofcom, 2019. Review of Second Class safeguard caps pages 2-3.

the basket cap (which covers Second Class parcels and large letters),¹³² so continues to have commercial flexibility to raise its prices in respect of those services if required.

Stakeholder responses to our March CFI

- 5.26 In our March CFI, we asked whether stakeholders considered that our approach to the safeguard cap and ensuring affordability would remain appropriate going forward. If not, we asked them to explain what changes they think should be made, with supporting evidence.
- 5.27 There were mixed views from stakeholders about the appropriateness of safeguard caps for the future. Some consumer and industry organisations¹³³ agreed that safeguard caps would remain an appropriate safeguarding measure for the future. Others, Citizens Advice¹³⁴ and Citizens Advice Scotland (CAS)¹³⁵, advocated specific changes. In particular, Citizens Advice and CAS were concerned that some respondents to their research said that letters and parcels were becoming unaffordable.¹³⁶ Their view was reflected by Consumer Council for Northern Ireland (CCNI)¹³⁷ and the Advisory Committee for Scotland (ACS)¹³⁸, which highlighted the importance of affordability of safeguarded products, particularly for vulnerable and rural consumers.
- 5.28 Conversely, Royal Mail argued there are no affordability concerns around safeguarded products even without a cap, citing the low spend on post products and e-substitution as a constraint on pricing.¹³⁹ Furthermore, Royal Mail suggested that additional commercial flexibility may be needed in the future and advocated removing the caps or, at the minimum, a significant increase of the caps.
- 5.29 In Royal Mail's view, the removal of the basket cap would not result in its safeguarded products becoming unaffordable as there is sufficient competition in the parcel market to keep prices down.¹⁴⁰ Mail Competition Forum (MCF)¹⁴¹ agreed that if the basket cap were to be lifted, this would not necessarily result in a rise in parcel prices, and [redacted] recommend the removal of the Second Class safeguard cap to allow the competitive market to control pricing.¹⁴²

¹³² Royal Mail's Second Class Safeguard Cap Compliance Statement for 2021-22.

¹³³ [Pitney Bowes](#) response to our March CFI, page 2; Post Office response to our March CFI, page 11, paragraph 5.1.1; techUK response to our March CFI, page 1; [UKMail](#) response to our March CFI, page 4; Whistl response to our March CFI, page 9.

¹³⁴ Citizens Advice response to our March CFI, page 13, paragraph 2.4.

¹³⁵ Citizens Advice Scotland response to our March CFI, page 4.

¹³⁶ Citizens Advice research findings indicated that 4 in 10 (42%) consumers think the cost of sending letters or parcels is unaffordable. Page 13, https://www.ofcom.org.uk/_data/assets/pdf_file/0020/221645/citizens-advice.pdf [accessed 6 December 2021]

¹³⁷ Consumer Council of Northern Ireland response to our March CFI, page 6, paragraph 5.1.

¹³⁸ Advisory Committee for Scotland response to our March CFI, page 4.

¹³⁹ Royal Mail response to our March CFI, pages 41-43.

¹⁴⁰ Royal Mail response to our March CFI, page 44.

¹⁴¹ [Mail Competition Forum](#) response to our March CFI, page 8.

¹⁴² [redacted] confidential response to our March CFI, page 8.

Our provisional assessment

- 5.30 Given that our review of the safeguard caps is recent, we would need compelling reasons (supported by robust evidence) to justify re-opening the cap early. The purpose of the cap is to provide a safeguard against unduly large increases in prices, so the fact that Royal Mail is now setting prices at the safeguard limit is not in itself a reason to re-open it.
- 5.31 Our provisional view is that neither affordability nor sustainability considerations provide compelling reasons to re-open the safeguard cap:
- a) We do not expect affordability conditions, especially for the most financially vulnerable, to have improved materially since our 2019 review, in particular factoring in the economic impacts of the Covid-19 pandemic.¹⁴³ We recognised in our Review of Safeguard Caps statement that, unfortunately, postal services may be unaffordable for some even under the cap.¹⁴⁴ Overall, we are not persuaded that there are sufficiently compelling affordability reasons to re-open the cap early.
 - b) Royal Mail's request that we remove or uplift the safeguard caps was premised on it potentially needing additional commercial flexibility in the future, rather than because of an immediate or specific financial sustainability concern. Further, Royal Mail's financial position has strengthened since 2019 when we last set the level of the safeguard caps, following a detailed review. As set out in Section 3, Royal Mail's 2021/22 to 2023/24 business plan, if successfully executed, indicates that the provision of the universal service will be financially sustainable, for the duration of the plan and possibly beyond (although significant risks remain). Consequently, our provisional view is that there are also not sufficiently compelling financial sustainability reasons to re-open the cap early.
- 5.32 For the reasons set out above, we are not persuaded that it would be appropriate to review the caps at this stage of the current pricing framework period, ahead of our planned separate review. We are therefore proposing to conduct a separate review of the appropriate scope and level of the safeguard caps that will apply from April 2024. We intend to begin work on this review towards the end of 2022.

¹⁴³ See page 23-25 of [our March CFI](#).

¹⁴⁴ Ofcom, 2019. Review of Second Class safeguard caps. Page 47, paragraph 4.22.

Redirection services

Our research suggests that the majority of postal users find Royal Mail's Redirection service to be affordable but that financially vulnerable consumers have encountered significant affordability issues, notwithstanding the introduction by Royal Mail of a discounted service in 2019.

We had therefore intended to propose a new targeted price cap on redirection services for financially vulnerable consumers. However, on 8 November 2021, Royal Mail announced that from 29 November it would make several significant changes to the scope and scale of its discounted service, which is known as Concession Redirections. Our provisional view is that Royal Mail's refreshed Concession Redirection largely addresses our affordability concerns. On that basis, we do not propose to impose new regulatory requirements on Royal Mail at this time.

Introduction and background

- 5.33 Customers (both individuals and businesses) can purchase a Redirection from Royal Mail to divert mail addressed to a particular recipient from one address to another address, for a specified period.
- 5.34 Consumers tend to take out redirections when moving home, as a temporary measure to ensure no mail is missed while they update their contacts of their new address, and therefore it is generally an occasional purchase. Redirection can also help protect consumers from the potential risk and consequences of identity fraud.
- 5.35 Royal Mail currently offers consumers a choice of three Redirection durations: 3, 6 and 12 months.¹⁴⁵ Similarly, businesses can take out a Redirection of these durations when moving between premises.¹⁴⁶
- 5.36 Royal Mail is the only provider of a universally available redirection service, and providing this service is required under the USO. While redirections are not currently subject to a price cap, Royal Mail is required to provide redirections at an affordable price which is uniform throughout the United Kingdom.
- 5.37 As of 2020-21, Royal Mail made revenues of £[§<] on residential Redirections and dealt with around 1.4m residential Redirections. In comparison, Royal Mail's revenues and volumes for its business Redirection service were £[§<] and around 50k, respectively.¹⁴⁷
- 5.38 Currently, payment for Redirection is made upfront as a single lump sum at the point of purchase, regardless of the length of package taken out. Standard prices range from £33.99

¹⁴⁵ A consumer Redirection can be instigated up to 6 months either side of a moving date and can then be renewed until four years has elapsed. See <https://www.royalmail.com/personal/receiving-mail/Redirection> [accessed 18 November 2021].

¹⁴⁶ Both residential and business Redirection services are part of the USO.

¹⁴⁷ Ofcom analysis based on Royal Mail's response to our formal information request dated 1 September 2021. The revenue and volume figures capture Royal Mail's domestic redirections across all contract length packages (the 3-month, 6-month and 12-month package), and including any contract renewals.

for one person ('lead applicant') for 3 months to £68.99 for one person for a 12-month package (see Table 5.1 below).

Table 5.1: Prices of residential and business Redirection services 2021/22

Time period	Standard residential Redirection	Standard business Redirection ¹⁴⁸
3 months	£33.99 + £8.00 per extra person	£216
6 months	£47.99 + £9.00 per extra person	£321
12 months	£68.99 + £10.00 per extra person	£519

Source: <https://www.royalmail.com/personal/receiving-mail/Redirection>, <https://www.royalmail.com/business/manage-mail/Redirection-diversion>

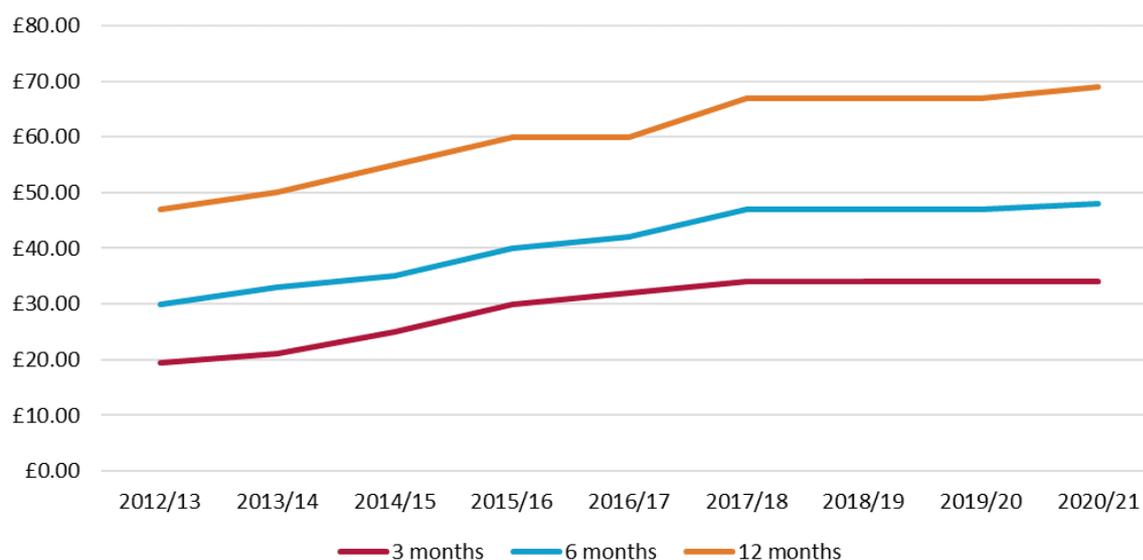
5.39 Royal Mail's prices for its residential Redirection services have risen significantly over time. Between 2012/13 and 2020/21, we estimate that the price of a 3-month package increased by around 74% in nominal terms (55% in real terms). We also estimate that prices for the 6-month and 12-month package rose by 60% and 47% in nominal terms (42% and 30% in real terms), respectively.¹⁴⁹ While, over a similar time period, we estimate that real disposable incomes across all households in the UK increased by around 15%.¹⁵⁰

¹⁴⁸ A business redirection service can be used when businesses move between premises. Royal Mail also offers a business diversion product for businesses that are located in multi-occupancy buildings or only moving part of their business. As of September 2020, Royal Mail also introduced a business diversion product for small businesses, with fewer than 50 employees. Business diversion products are priced separately. See <https://www.royalmail.com/business/manage-mail/Redirection-diversion> [accessed 29 November 2021]

¹⁴⁹ Ofcom analysis based on Royal Mail's Redirection prices, provided in response to our formal information request dated 8 June 2021. Royal Mail changed the pricing structure of Redirections in 2019, from charging on a per surname basis prior to 2019 to charging on a per person basis post 2019.

¹⁵⁰ Ofcom analysis based on ONS data. ONS, 2021. [Average household incomes, taxes and benefits](#), Table 14. [accessed 30 November 2021]

Figure 5.2: Residential Redirection nominal prices (lead applicant fee) by contract length¹⁵¹



Source: Ofcom analysis based on Royal Mail's response to our s.55 request dated May 2021.

5.40 In recent years, Royal Mail has also launched several initiatives for redirection services in response to concerns raised by consumer bodies.¹⁵² These include:

- implementing a four-year price freeze on the 3-month package since 2017/18 (as can be observed in Figure 5.2 above);
- providing a free Redirection service for those under the age of 16, those that are victims of scams and those that are affected by exceptional events (e.g. flooding);
- changing the pricing structure, thereby charging on a per-person basis rather than per-surname;
- implementing a secure and confidential Redirection process for victims of domestic abuse; and
- introducing a Concession Redirection scheme for renters in receipt of either Job Seekers Allowance (JSA) or Pension Credits, in the form of a 20% discount against full-price 3-month and 6-month packages in the UK.¹⁵³ However, it is worth noting that since the scheme was introduced in 2019, Royal Mail have received a very low number of applications for it, as at March 2021.¹⁵⁴

¹⁵¹ For every extra applicant, there is also an additional fee.

¹⁵² Royal Mail response to our March CFI response, page 47.

¹⁵³ This concessionary Redirection rate applied until 29 November 2021, when Royal Mail introduced a refreshed Concession Redirection rate, discussed later in this section. See 'Applying for our concessionary discount', <https://www.royalmail.com/personal/receiving-mail/Redirection>.

¹⁵⁴ Royal Mail's response to our formal information request dated 8 June 2021 and 1 September 2021.

Royal Mail Concession Redirection refresh (announced on 8 November 2021)

5.41 Shortly before the publication of this consultation, Royal Mail announced some significant changes to the scope and scale of its Concession Redirection¹⁵⁵ scheme. These changes were then implemented from 29 November. These are summarised in Table 5.3 below.

Table 5.3: Summary of changes to Royal Mail Redirection concession scheme

	Concession Redirection (prior to 29 November 2021)	Refreshed Concession Redirection (from 29 November 2021)
Eligibility criteria	Applicant must be in receipt of either Pension Credits or JSA plus be in rented accommodation .	Applicant must be in receipt of Pension Credit or Universal Credit . There is no rental requirement .
Discount	20% discount against standard 3 and 6-month Redirection prices. Applies also to second named applicant, and renewals.	New fee structure (see Table 5.4, below) Applies to renewals.
Applicable packages	3- and 6-month Redirection packages.	3-, 6- and 12-month Redirection packages.

Source: Royal Mail website and press-release.

Table 5.4: Fee list and pricing structure for Royal Mail's refreshed Concession Redirection

Household members	Standard Price	Concessionary price	Discount
One adult			
Up to 3 months	£33.99	£22.50	34%
Up to 6 months	£47.99	£30.00	37%
Up to 12 months	£68.99	£60.00	13%
Two adults			
Up to 3 months	£41.99	£30.00	29%
Up to 6 months	£56.99	£30.00	47%
Up to 12 months	£78.99	£60.00	24%
Household of two adults and two children (both under 16)			

¹⁵⁵ Royal Mail, 8 November 2021. [Royal Mail to cut the cost of its redirection service for millions of lower-income households](#) – press release. [accessed 18 November 2021].

Up to 3 months	£41.99	£30.00	29%
Up to 6 months	£56.99	£30.00	47%
Up to 12 months	£78.99	£60.00	24%
Household of two adults and three children (two under 16)			
Up to 3 months	£49.99	£30.00	40%
Up to 6 months	£65.99	£30.00	55%
Up to 12 months	£88.99	£60.00	33%

Source: Royal Mail press release

- 5.42 We note that Royal Mail has also improved the prominence of information about its Concession Redirection on its Redirection landing page, including a link to a dedicated webpage. Royal Mail also highlighted that it has made payment easier by introducing the option to pay by phone.¹⁵⁶

Stakeholder responses to our March CFI

- 5.43 In our March CFI, we noted that the price of Redirection services had risen significantly since 2012 and that we were concerned about the affordability of this service.¹⁵⁷ We invited stakeholders' views on whether our approach to the regulation of residential and business redirection services would remain appropriate going forwards, and to comment on what changes they thought should be made.
- 5.44 Stakeholders highlighted the importance of redirection services for consumers. In particular, Citizen's Advice highlighted the importance of redirection in preventing post identity fraud and missed important mail.¹⁵⁸
- 5.45 Citizens Advice also said that, as redirection is a monopoly product, we should explore putting in place price controls to protect consumers.¹⁵⁹ As a response to our March CFI, Citizens Advice presented evidence that 10% of people surveyed as part of their research who did not take out a redirection did so because they found the service to be unaffordable¹⁶⁰, and 22% did not take out a redirection for 'cost related reasons'.¹⁶¹ Citizens Advice said that their research indicated that uptake of redirections could be increased by enhanced affordability for certain groups from a combination of reduced price and the introduction of monthly payment options.¹⁶²
- 5.46 Citizens Advice said that we should step in to protect consumers at higher risk of disadvantage, detriment or harm and improve the existing discount scheme to ensure that

¹⁵⁶ Previously, applications had to be made by post and paid for by cheque.

¹⁵⁷ Ofcom, 2020. [Call for inputs](#), page 30, paragraph 5.44.

¹⁵⁸ Citizens Advice response to our March CFI, page 21, paragraph 3.4 – 3.6.

¹⁵⁹ Citizens Advice response to our March CFI, page 20.

¹⁶⁰ Citizen Advice's finding differs from our own finding on affordability because the test/definition of affordability used is different.

¹⁶¹ Citizens Advice response to our March CFI, page 25, paragraph 3.18.

¹⁶² Citizens Advice response to our March CFI, pages 31-32.

mail redirection is truly affordable.¹⁶³ Citizens Advice also highlighted the poor visibility of information about the existing voluntary discount.

- 5.47 Royal Mail said that Redirection services are affordable for most people and that most consumers think that Redirections are good value for money.¹⁶⁴ Royal Mail also referred to the voluntary initiatives summarised at paragraph 5.40 above, and noted that it would be reviewing this as part of a planned product refresh¹⁶⁵ (which, as explained at paragraph 5.41 above, they concluded in November). They also said that they are looking at the visibility of the existing Concession Redirection on their webpages.¹⁶⁶

Our provisional assessment

- 5.48 We recognise that responses to our March CFI have been mixed; with Royal Mail suggesting that the service is affordable and that no further regulatory action is needed (given its own product refresh programme), but with others concerned about affordability and the impact that this has on some, particularly vulnerable, consumers.
- 5.49 With this in mind, we decided to conduct some research in order to better understand the importance of residential redirection services (and therefore the potential for consumer harm where services are not affordable), and the affordability of Redirection services offered by Royal Mail (“Redirections affordability research”). Our research covered 3,571 adults aged 18+ in the UK across region, gender, age, and working status. Fieldwork took place between 9 August to 31 August 2021.¹⁶⁷ The research was undertaken in relation to standard prices at the time, and prior to Royal Mail’s announcement of its refreshed Concession Redirection rate on 8 November 2021.
- 5.50 We have focused our assessment on residential Redirection services, in line with stakeholder responses to the March CFI. As outlined above, business Redirection prices have grown less steeply over time in comparison with residential Redirection.¹⁶⁸
- 5.51 The remainder of this section is structured as follows:
- a) Our provisional assessment of affordability;
 - b) The impact of Royal Mail’s new Concession Redirection on our affordability concerns; and,

¹⁶³ Citizens Advice response to our March CFI, page 36.

¹⁶⁴ Royal Mail response to our March CFI, page 48, paragraph 5.24.

¹⁶⁵ Royal Mail response to our March CFI, page 46.

¹⁶⁶ Citizens Advice response to our March CFI, page 34, para 3.41

¹⁶⁷ This involved a combination of online and Computer Assisted Telephone Interviewing (CATI) interviews. We also applied ‘boosts’ among some potentially vulnerable groups, and for those with no internet at home (and within this group an additional boost of those who have moved to a new house in the last 5 years). We were particularly interested in ‘recent movers’ i.e. those who have moved homes in the last 12 months. For further details of the methodology, please see the [Ofcom Redirection affordability research](#).

¹⁶⁸ While some concerns were raised in 2019/20 about the price of business Redirections during the Covid-19 pandemic, as we set out in our 2019/20 Annual Monitoring Update, the problem pertained to the cost of Business Diversion services for SMEs in shared buildings. Royal Mail introduced a Small Business Diversion product to address this concern. See Ofcom, 2020. [Annual monitoring update](#), paragraphs 8.31 – 8.33.

- c) Our provisional view.

Assessment of existing constraints on pricing

- 5.52 We first consider the extent to which Royal Mail faces any constraints on the demand and supply side for its residential Redirection service, and whether these constraints are sufficient to prevent Royal Mail from raising its prices significantly:
- a) On the supply side, Royal Mail is the only provider of a universally available redirection service and is likely to continue being the only provider over this review period. In its CFI response, Royal Mail pointed towards website-based services such as “iammoving” and “movemy”, as alternative market options to taking out a residential redirection service. These website-based services (the first of which is free with the latter being fee-based) can be used to notify certain mail senders such as the DVLA, utility providers and local councils of an address change. While notifying contacts is viewed by some consumers as an alternative to taking out a redirections service, it is not a like-for-like substitute.
 - b) On the demand side, our market research suggests there are some alternatives a consumer could consider when thinking about redirecting their mail. For example, 15% of those who didn’t use the service reported they had someone forward their mail over, and 28% reported collecting their mail directly from the old address.¹⁶⁹ However, we note that these may be imperfect in many circumstances, as it may still be possible to miss important mail or be at risk of identification fraud with these alternative methods.
- 5.53 We therefore provisionally find that Royal Mail is likely to face limited constraints, on the demand and supply side, to prevent it from raising prices significantly. This is consistent with the observation that prices have risen significantly over time, despite Royal Mail freezing the price of the 3-month Redirection package in recent years (as mentioned above).

Why consumers buy redirections, and the potential consequences of not

- 5.54 Our research suggests that amongst those who had moved in the last 12 months, 47% had used a Royal Mail Redirection.¹⁷⁰
- 5.55 The main reasons for purchasing a redirection identified in the research were: in case consumers forgot to notify a contact (54%); consumers considering their mail as important (51%); and consumers needing more time to notify contacts (48%).¹⁷¹ Concerns about becoming a victim of fraud without it were also reported by 18%.¹⁷² Indeed, 49% of consumers who had used a redirection agreed that it “is an essential service to prevent

¹⁶⁹ Slide 13, Redirections affordability research.

¹⁷⁰ Slide 10, Redirections affordability research.

¹⁷¹ Slide 20, Redirections affordability research.

¹⁷² Slide 10, Redirections affordability research.

people from becoming a victim of fraud”.¹⁷³ We are aware that the Metropolitan Police¹⁷⁴, Cifas (UK’s fraud prevention service)¹⁷⁵ and individual companies such as Barclays Bank UK plc¹⁷⁶ all recommend that households redirect their mail when moving home to protect against identity fraud.

5.56 Consumers who decided not to take out a redirection did so for a range of reasons, as set out in Figure 5.6, later in this section This includes those who did not think they needed it, as well as those who were not aware of the service. However, some (11%) reported not taking up a Redirection due to being unable to afford the service at current prices (and without cutting back on other essentials), despite having a need for the service.¹⁷⁷

The potential consequences of not being able to redirect mail could be greater for some more than others

5.57 Our research suggests that most consumers that had moved in the past year and not used a redirection found an alternative solution for retrieving their mail, such as collecting the mail themselves or getting someone to forward their mail over. The majority were satisfied with the alternative solution.

5.58 However, about 13% cited “doing nothing” to retrieve their mail.¹⁷⁸ We also found that, amongst those that had moved in the past year and not used a redirection, some went on to experience a range of adverse consequences¹⁷⁹:

- 24% worried about lost mail, missing personal information and/or about potential fraud;
- 13% missed out on bill payments, appointments and/or other important information; and
- 10% lost mail and 6% lost personal/ sensitive information.

5.59 Therefore, although the research suggests that most respondents were satisfied with the alternative solution used to retrieve their mail, we note that about a quarter still had worries about losing their mail or missing important information. We are also aware that some of these consequences may potentially be even more prevalent and severe for those in receipt of benefits, on low incomes and/or in financially vulnerable circumstances. As Citizens Advice note in their CFI response, this could lead to consumers missing out on benefits, housing and/or employment opportunities.¹⁸⁰

¹⁷³ Q28, Redirections affordability research.

¹⁷⁴ <https://www.met.police.uk/advice/advice-and-information/fa/fraud/personal-fraud/identity-fraud/> [accessed 30 November 2021].

¹⁷⁵ <https://www.cifas.org.uk/newsroom/home-movers-at-risk-of-identify-theft> [accessed 30 November 2021].

¹⁷⁶ <https://www.barclaycard.co.uk/personal/money-matters/fraud-protection/what-is-identity-theft> [accessed 30 November 2021].

¹⁷⁷ Slide 12, Redirections affordability research.

¹⁷⁸ Slide 13, Redirections affordability research.

¹⁷⁹ Slide 13, Redirections affordability research.

¹⁸⁰ Citizens Advice response to our March CFI, page 21, paragraph 3.3.

Our provisional assessment of affordability

5.60 As mentioned above, we are concerned that in light of the limited constraints on Royal Mail's pricing, Redirection may be priced at a level which some consumers are unable to afford, despite having a need for the service. In this section, we assess the affordability of Royal Mail's standard Redirection service.

Our approach to assessing affordability of Redirection

5.61 We have adopted a similar approach to assessing the affordability of redirections as we did in 2013 when we considered the affordability of all universal postal services.¹⁸¹ It is also similar to the approach we adopted in our Review of Safeguard Caps, and is consistent with our definition and approach in other sectors (such as telecoms).

5.62 Specifically, we consider that postal services might be unaffordable for consumers where:

- i) consumers reduce their purchases of postal services due to the price; and/or
- ii) consumers continue to buy postal services but must cut back on other 'essential' expenditure.¹⁸²

5.63 We have considered the following evidence, in addition to responses to our March CFI, in assessing the affordability of Royal Mail's standard Redirection service¹⁸³:

- a) **market research on the affordability of Redirection services**, particularly amongst vulnerable consumers (Redirection Affordability research);
- b) **spend on Redirection services relative to comparator items**, to obtain insights into the potential trade-offs households may need to make with their spending (ONS Living Costs and Food Survey); and
- c) **spend on Redirection services as a proportion of real disposable incomes**, to obtain insights into the likely risk of affordability issues (ONS Living Costs and Food Survey).

While most consumers find Redirection services to be affordable, a significant minority do not

5.64 As set out above, our market research explored the affordability of Royal Mail's Redirection service (the standard 3 months package priced at £33.99). Our research suggests that the majority of consumers were able to afford Royal Mail's Redirection service, without cutting back on essential spending. However, we found that a significant minority indicated experiencing affordability issues or the potential to experience affordability issues at the prices set by Royal Mail.

¹⁸¹ Ofcom, 2013. [The affordability of universal postal services](#).

¹⁸² By essential expenditure we mean utility bills, housing costs, groceries, school supplies and medicines.

¹⁸³ Our provisional assessment of affordability is based on Royal Mail's standard Redirection prices. We then consider the extent to which Royal Mail's concessionary discount scheme addresses any affordability concerns associated with the standard price.

- 5.65 Amongst all respondents, when asked the price point at which they would have to cut back on essential spending, three-in-ten adults provided a price that was below the standard cost of a 3-month package (£33.99).¹⁸⁴
- 5.66 Our research also suggested that some groups, particularly those on low incomes or who are otherwise financially vulnerable¹⁸⁵ and/or more likely to be reliant on post, were disproportionately likely to respond that current standard prices were unaffordable without cutting back on essentials¹⁸⁶:
- those with no internet access at all (48%);
 - those in social grade E (42%);
 - those receiving benefits (39%);
 - those financially vulnerable (39%);
 - those with restricted mobility (38%); and
 - those on a household income of less than £11,500 per year (38%).
- 5.67 Amongst those that actually moved in the past year and used the service, around 15% of all respondents agreed that they had to cut back on other essential spending to pay for redirection services.¹⁸⁷ This rises to 24% for those in receipt of benefits and 32% for those with restricted mobility, as Figure 5.5 below illustrates.

¹⁸⁴ Slide 16, Redirections affordability research.

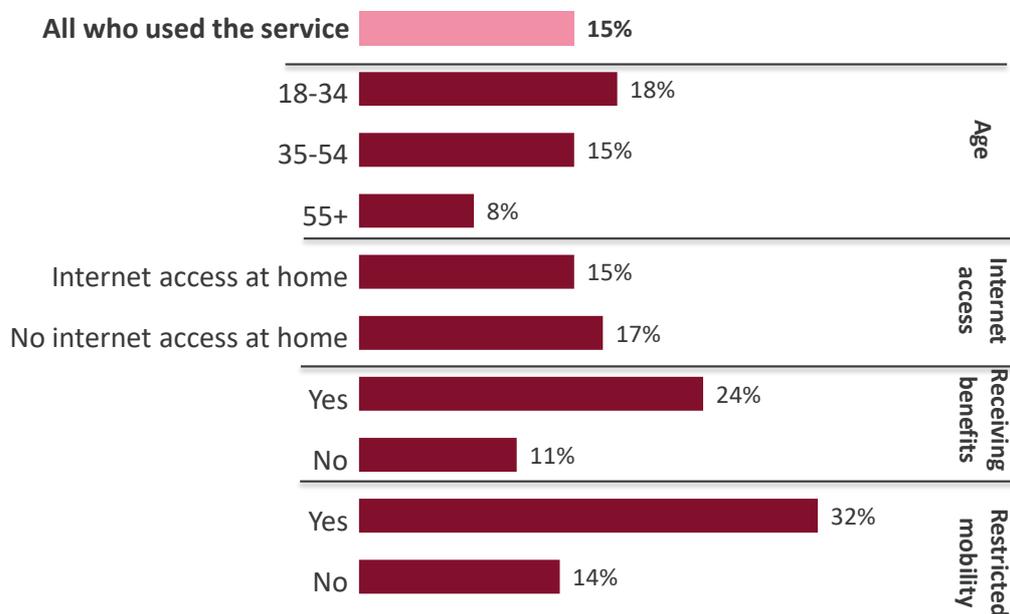
¹⁸⁵ In our research, this definition of financial vulnerability included any survey respondent who indicated that their household had to take some financial action to be able to afford to pay for essential spending in the last month. Actions included cutting back spend on other essential items, spending savings, using an overdraft facility, borrowing from friends or family, selling or pawning assets, taking out a short-term 'payday' loan, taking out a new credit card, or borrowing more than usual on an existing one, using a payment holiday or payment plan to spread costs over a longer period, or other similar financial actions.

¹⁸⁶ Slide 16, Redirections affordability research.

¹⁸⁷ On a scale of 0 (strongly disagree) to 10 (strongly agree), 15% cited an agreement of between 8 to 10 that they had to cut back on other essential spending to pay for Redirections. Slide 11, Redirections affordability research.

Figure 5.5: Affordability of Redirection services amongst those who used them in the past year

Net: 8-10 agreement that they needed to cutback on essential spending to be able to afford the service (in last 12 months)



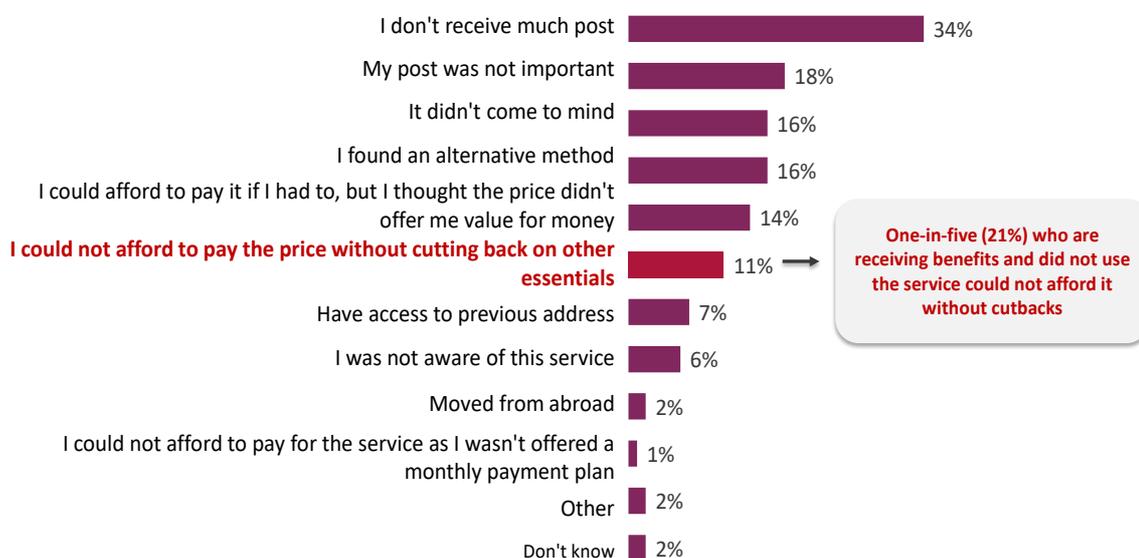
Source: Ofcom Redirection affordability research

5.68 Similarly, amongst those that had moved in the past year and did not use a Redirection service, around 11% cited this was because they were unable to afford the price without cutting back on other essentials. This rose to 21% for those in receipt of benefits¹⁸⁸ (see Figure 5.6 below).

¹⁸⁸ Slide 12, Redirections affordability research.

Figure 5.6: Reasons for consumers who moved in the past 12 months not using Redirection

Reasons for not using the Post Redirection Service amongst all who moved in the last 12 months and did not use Redirections



Source: Ofcom Redirection affordability research

5.69 Therefore, our research suggests that affordability barriers to the use of Redirection services were greater among certain groups than others, particularly (although not exclusively) those consumers with lower incomes.

For some consumers, redirection services can be a significant part of their spending

5.70 Below, we set out our analysis of spend on Royal Mail's standard Redirection service as a proportion of total expenditure and income, to obtain insights into the potential trade-offs households may need to make with their spending and the likely risk of affordability issues.

Spend on Redirection relative to comparator items

5.71 Using ONS data, we have examined spend on Redirection as a proportion of total expenditure and relative to comparator items, to obtain insights into the potential trade-offs households may need to make with their spending.

5.72 For households in the lowest income decile, we estimate that a standard 3- and 6-month Redirection package accounts for roughly 3% and 4% of total average monthly spend,¹⁸⁹ respectively. We estimate this is close to the average monthly spend on electricity services for households in the lowest income decile of roughly 4%.¹⁹⁰ Also, as Citizens Advice note in their CFI response, we estimate that a standard 12-month Redirection service represents

¹⁸⁹ Based on a household of two adults.

¹⁹⁰ Ofcom analysis based on data from the ONS, 2021. [Living Costs and Food Survey - Detailed Expenditure and Trends, 2019-20](#), Table 3.1E: Detailed household expenditure by equivalised disposable income decile group (OECD-modified scale).

roughly about 1.5 weeks' worth of food for a couple in the lowest income decile¹⁹¹, and similarly that a standard 6-month service represents about one week worth of food.¹⁹²

5.73 Therefore, the above suggests that spend on standard Redirection services is material, and for those on low incomes comparable to other essential household services, especially due to the upfront and lump sum nature of costs for Redirections. We consider this is consistent with our research findings that some households may be unable to afford Royal Mail's standard Redirection service without cutting back on essential services.

Spend on Redirection as a proportion of real disposable incomes

5.74 We have also examined spend on Redirection as a proportion of disposable incomes, to understand the likely risk of affordability issues. The higher the proportion of income spent on redirection, the greater the risk that households may experience affordability issues. Again, we have examined data from the ONS, which provides the distribution of household income in the UK, broken down into ten equal decile groups.¹⁹³

5.75 We consider two different income measures as part of our assessment:

- Spend on Redirection as a proportion of monthly disposable income; and
- Spend on Redirection as a proportion of monthly disposable income, net of other essential spending.

5.76 As Table 5.7 below illustrates, the differences in incomes between the deciles means that there are also material differences in the proportion of income spent on Redirection, and therefore the risk of affordability concerns. For example, a 3-month Redirection accounts for around 3.7% of monthly disposable income for households in the lowest income decile, but only around 0.3% for households in the highest income decile.

Table 5.7: Spend on Redirection¹⁹⁴ as a proportion of monthly disposable income¹⁹⁵

	Lowest	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Highest
Monthly	£907	£1,737	£2,114	£2,538	£2,970	£3,409	£3,951	£4,686	£5,557	£10,565
Spend as a % of disposable income	3.7%	2.0%	1.6%	1.3%	1.1%	1.0%	0.9%	0.7%	0.6%	0.3%

Source: Ofcom estimates based on data from the ONS on household disposable income, 2019-20.

¹⁹¹ Citizens Advice estimated that a 12-month Redirection package represents about 2.5 weeks' worth of food for a couple on low income (based on gross income). Citizens Advice response to our March CFI, page 28, paragraph 3.24.

¹⁹² Ofcom analysis based on data from the ONS, 2021. [Living Costs and Food Survey - Detailed Expenditure and Trends, 2019-20](#), Table 3.1E: Detailed household expenditure by equivalised disposable income decile group (OECD-modified scale).

¹⁹³ ONS, 2021. [Effects of taxes and benefits on household income, 2019-20](#), Table 14: Average household incomes, taxes and benefits of all individuals by decile group.

¹⁹⁴ Spend on a 3-month Redirection package, for a household consisting of one adult.

¹⁹⁵ This consists of all income, plus direct benefits, minus direct taxation. All income figures presented here are non-equivalised and therefore real income levels, however in the process of ranking individuals into deciles, equivalised income is used by the ONS. Equivalisation is a method of adjusting income to account for differences in household composition. ONS data uses the OECD-modified scale which is outlined [here](#).

5.77 This effect is amplified when we examine spend on Redirection after deducting for certain essential household expenditures such as housing, energy, water and food and drink. On average, we estimate that a household in the lowest income decile would spend around 11% of their remaining income on Redirection.¹⁹⁶ This is almost three times higher than spend as a proportion of remaining income for the second decile (3.3%). Therefore, once we deduct for essential expenditures, we observe substantial differences in the average proportion of income spent on Redirections, between households in the lowest income decile and all other deciles.

Table 5.8: Spend on Redirections¹⁹⁷ as a proportion of monthly disposable income¹⁹⁸, net of essential spending

	Lowest	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Highest
Disposable income	£907	£1,737	£2,114	£2,538	£2,970	£3,409	£3,951	£4,686	£5,557	£10,565
Housing ¹⁹⁹	-£266	-£338	-£390	-£440	-£490	-£595	-£612	-£637	-£861	-£1,132
Energy ²⁰⁰	-£98	-£97	-£101	-£106	-£101	-£103	-£106	-£107	-£114	-£126
Water ²⁰¹	-£37	-£43	-£37	-£39	-£39	-£43	-£51	-£47	-£49	-£65
Food and Drink ²⁰²	-£195	-£224	-£239	-£262	-£271	-£283	-£314	-£306	-£322	-£345
Total remaining income	£311	£1,036	£1,347	£1,691	£2,068	£2,384	£2,869	£3,588	£4,211	£8,897
Spend as a % of remaining income	10.9%	3.3%	2.5%	2.0%	1.6%	1.4%	1.2%	0.9%	0.8%	0.4%

Source: Ofcom estimates based on data from the ONS on household disposable income and household expenditures, 2019-20.

¹⁹⁶ The analysis is based on average incomes within each decile, therefore we note that redirections could account for a higher proportion of income for some within the lowest income decile.

¹⁹⁷ Spend on a 3-month Redirection package, for a household consisting of one adult.

¹⁹⁸ Again, we have used non-equivalised income, therefore income un-adjusted for household composition. This is necessary when deducting for expenditure based on data from the ONS, as expenditure figures are given in non-equivalised terms.

¹⁹⁹ We have derived estimates for housing expenditure based on data from the ONS. We have accounted for rent and mortgage payments, and spend associated with the purchase, maintenance, and repair of dwellings. We have excluded housing benefit and council tax, as they are accounted for already as a deduction from income to generate disposable income figures.

²⁰⁰ Inclusive of spend on gas, electricity and other fuels.

²⁰¹ Inclusive of spend on water services to the premise and miscellaneous services relating to the dwelling.

²⁰² Inclusive of spend on food and drink, except for spend on alcoholic drinks.

5.78 This income measure particularly affects low income households as essential expenditures, such as utilities and food and drink, represents a much higher proportion of their total income. This suggests that – in line with our research – low income households may potentially be at greater risk of being unable to afford a Redirection service with their remaining income, once deducting for essential expenditures.

Summary of provisional assessment

5.79 Our provisional assessment, based on 2021/22 standard Royal Mail Redirection prices, is that a Redirection is affordable for most consumers. Therefore, based on the evidence seen to date, we do not consider that it would be appropriate to propose a general cap on Royal Mail’s standard Redirection pricing, which would apply to all consumers. However, we are mindful of the potential impact that future price rises could have on the general affordability of Redirection. Therefore, going forward, we propose to monitor Redirection prices so that we can re-assess the case for broader intervention if necessary (e.g. if we observe evidence of wider affordability concerns).

5.80 Notwithstanding the above, our research suggests that there are some postal users that find prices for Royal Mail’s standard Redirection service unaffordable.

- a) Our research suggests lower-income households, such as those in receipt of benefits, were more likely to find standard Redirection prices unaffordable, without cutting back on essential spending.
- b) Despite Royal Mail’s Redirection service being an infrequent purchase, we found that spend on Redirection was comparable to the monthly spend on essential services such as electricity for those in the lowest income decile, due to Redirections being paid as an upfront cost. For households in the lowest income decile, after deducting for essential household expenditures, we found that Redirection represented a high proportion of their remaining income, therefore increasing the risk of any potential affordability issues.

5.81 We recognise that Royal Mail has, since 2019, had in place a voluntary discount of 20% for certain eligible consumers, and that it has implemented a range of other positive voluntary interventions (see paragraph 5.40 above) aimed at addressing affordability concerns identified by Ofcom or consumer bodies. While we welcome the steps made by Royal Mail to increase the affordability of its Redirection service for financially vulnerable consumers in 2019, we do not consider that the pricing and terms of the original Concession Redirections scheme offered by Royal Mail prior to 29 November 2021 were sufficient to address our affordability concerns. Without improved prices for financially vulnerable consumers, we would have proposed formal intervention, as discussed from paragraph 5.84 below.

5.82 However, as set out at paragraph 5.41, Royal Mail made significant changes to the scope and scale of its Concession Redirection scheme shortly before the publication of this consultation. We set out below our consideration of Royal Mail’s new Concession

Redirection scheme, and our provisional view regarding the impact of this on our affordability concerns.

Impact of Royal Mail's new Concession Redirection scheme on our affordability concerns

- 5.83 Prior to Royal Mail's announcement of the refreshed Concession Redirection scheme on 8 November 2021, we had considered what changes we thought would need to be made to Royal Mail's Redirections pricing (in particular, to the scope and scale of its original Concession Redirection scheme) in order to ensure that its Redirection services are affordable for a significant majority of financially vulnerable postal users.
- 5.84 As a minimum, we considered that the following changes would need to be made to Royal Mail's discounted Redirection service in order to address our affordability concerns:
- the discount should apply to a significantly wider eligibility group, better reflecting the range of consumers who might be least able to afford a Redirection, and regardless of housing tenure;
 - the level of the discount against the standard price should be significantly increased to ensure a Redirection is affordable for the majority of eligible consumers;
 - consumers should have a choice of discounted packages of different durations; and,
 - information about the discount and eligibility should be made significantly more prominent.
- 5.85 We recognise that Royal Mail made significant changes to the scope and scale of its Concession Redirection scheme on 29 November 2021, including by increasing eligibility and lowering the prices (and modifying the fee structures) for eligible consumers. For the reasons set out below, our provisional view is that the terms of Royal Mail's revised Concession Redirection scheme largely address our affordability concerns.

Eligibility

- 5.86 We considered that Royal Mail's eligibility criteria for its previous concessionary rate (up to 29 November 2021) were too restrictive, and unlikely to be suitable in light of changes to the UK's benefit system.²⁰³ We considered that a substantial expansion in eligibility would be required to protect the significant majority of consumers least able to afford a Redirection.
- 5.87 Royal Mail's Concession Redirection refresh has extended eligibility to include recipients of Universal Credit, as well as retaining the prior Pension Credit eligibility criteria. We also understand that they have removed the requirement for applicants to be in rented

²⁰³ Universal Credit is gradually replacing the following benefits: Child Tax Credit; Housing Benefit; Income Support; income-based Jobseeker's Allowance (JSA); income-related Employment and Support Allowance (ESA); and, Working Tax Credit. Legacy benefits are gradually being phased out.

accommodation. This represents a significant expansion in eligibility, potentially from around 1.7 million to around 7.2 million people.²⁰⁴

Discount

5.88 Our analysis indicated that for certain groups of financially vulnerable consumers, a significant discount on the standard 3- and 6-month Redirection packages would be required to make a redirection affordable. Royal Mail's refreshed Concession pricing and fee structure means that the new concessionary price for a 3-month Redirection is equivalent to a 34% discount on the standard price, and the price of a 6-month Concession package is 37% below the standard price. Additionally, Royal Mail's new concessionary fee structure sets a flat-rate for 6- and 12-month Redirection packages, regardless of household size, and the rate also applies to renewals.

Packages

5.89 We considered evidence from stakeholder responses to our March CFI, as well as the implications of upfront payment for Redirection, and the potential level of discounting required to make 3-, 6- and 12-month Redirection packages affordable for most consumers. We considered that consumers should have a choice of discounted packages of different durations. Royal Mail's new fee structure means that many eligible consumers will now be able to access a 3- or 6-month Redirections for the same price, regardless of household size, and a 12-month package is now discounted by between 13% and 33% against the price of a standard 12-month Redirection, depending on household size.

Visibility

5.90 Before we published our March CFI, we were concerned that information about the discount and eligibility lacked prominence on Royal Mail's Redirection website landing page, contributing to poor up-take. This was an issue which was also picked up by stakeholders in CFI responses. Following the publication of the CFI, Royal Mail increased the prominence of information about the availability of a discount for eligible consumers. Following Royal Mail's announcement on 8 November that it would refresh its Concession Redirection, Royal Mail has created a dedicated page for the concessionary scheme, with direction from the standard Redirection page. We welcome this increased prominence and expect this to continue.

Our provisional conclusion

5.91 We welcome the significant changes made by Royal Mail recently to its Redirections pricing, and think Royal Mail's refreshed Redirection Concession sufficiently addresses our main affordability concerns (and is well aligned with the regulatory proposals upon which we would otherwise have consulted). On that basis, we are not proposing to impose additional obligations in relation to Royal Mail's Redirection pricing. We consider this to be

²⁰⁴ 1.7 million people represents the total recipients of Pension Credits and Job Seekers Allowance cited in [DWP statistics at August 2021](#) [accessed 17 November 2021]. 7.2 Million represents the 5.8m Universal Credit claimants as at 9 September 2021 cited [by Royal Mail](#), plus the [latest available statistics](#) at the time of writing in relation to receipt of Pension Credits, c. 1.5m as at February 2021.

consistent with our Regulatory Principles, which state clearly that we have a bias against intervention²⁰⁵.

- 5.92 We recognise that Royal Mail may wish to increase the price of concessionary Redirections in future as certain input costs rise. We would, however, be potentially concerned if these prices were to rise above CPI such that they became unaffordable to a greater proportion of customers over time within the review period to 2027.
- 5.93 We will continue to monitor standard and Concession Redirection pricing and reserve the right to re-open this issue during the review period if we believe it is appropriate to do so to protect consumers.

Quality of service targets

The quality of service regime helps to ensure that users benefit from certainty that an item will arrive on the date promised, and high reliability. We know that users value these qualities of the universal service above speed of delivery. Taking into account responses to our CFI, we believe that overall, the existing regime is working well, and so we are not proposing any changes.

Introduction and background

- 5.94 Royal Mail is required by Ofcom to achieve certain performance targets in the delivery of USO services. These targets aim to ensure that users of key USO services benefit from a reliable service, and that mail will arrive when promised. Royal Mail is required to monitor its performance against these targets, and to publish for each quarter and financial year, its performance against the targets. If it fails to meet the targets Ofcom can open an investigation and consider taking enforcement action.²⁰⁶
- 5.95 DUSP condition 1.9.1 sets out the specific performance targets applicable for USO services. Table 5.9 below sets out the main performance targets.

Table 5.9: Royal Mail's performance targets

Target	Specification
Deliveries	Royal Mail to complete at least 99.9% of all delivery routes, each day on which a delivery is required.
Collections	Royal Mail to serve at least 99.9% of public access points, each day on which a collection is required.
First Class (i)	Royal Mail to deliver at least 93% of First Class items within one working day of collection on a national (UK) basis.

²⁰⁵ [Policies and guidelines - Ofcom](#)

²⁰⁶ For example, Ofcom fined Royal Mail £1.5m for failing to meet its First Class national delivery target in 2018/19. See: Ofcom, 2020. [Royal Mail fined £1.5m for missing 2018/19 delivery target](#)

First Class (ii)	Royal Mail is also subject to a separate postcode area target which requires it to deliver 91.5% of First Class mail within one working day of collection in each postcode area in the UK apart from HS, KW and ZE (118 of 121 postcode areas in the UK). This is to make sure that local areas receive an adequate level of service over time.
Second Class	Royal Mail to deliver at least 98.5% of Second Class items within three working days of collection on a national basis.
Special Delivery Guaranteed by 1pm	Royal Mail to deliver at least 99% of Special Delivery items the next working day by 1pm on a national basis.

Source: Ofcom analysis of DUSP conditions.

- 5.96 Royal Mail has been subject to comparable regulatory obligations since 2001, including the First Class national performance targets and postcode area (PCA) performance targets. The levels of the standards were originally based on Royal Mail’s then internal quality of service targets. Royal Mail subsequently agreed to an increase in the standards and, by 2005-06 the present levels were in place.
- 5.97 Our RUN found that a high degree of certainty that an item will arrive by the promised date, and reliability, were important for users over and above speed of delivery. This is consistent with high quality of service standards, which give users a corresponding high degree of certainty as to when an item of mail will arrive. Our analysis also found that relatively limited cost savings would be achieved by Royal Mail from reducing quality of service levels.²⁰⁷

Stakeholder responses to our March CFI

General comments

- 5.98 There was broad support for both the need for quality of service targets, and their current levels. Post Office stated that the fact that Royal Mail either meets the targets or comes very close suggests that the targets’ levels are “challenging but realistic”.²⁰⁸ The Communications Consumer Panel argued that the targets were important to protect consumers, and ensure that they receive a high level of service.²⁰⁹
- 5.99 Citizens Advice said that all the current targets remain important, and requirements for Royal Mail to report publicly on its performance provided transparency, and enabled the consumer advocacy bodies to monitor performance.²¹⁰ The Advisory Committee for

²⁰⁷ Ofcom, 2020. [Review of postal users’ needs](#), pages 69-73. In particular, we found that whilst there may be some cost savings from a reduction in quality of service standards, these may be offset by associated revenue reductions, such that Royal Mail’s profitability may in practice reduce.

²⁰⁸ Post Office response to our March CFI, page 14.

²⁰⁹ [Communications Consumer Panel and ACOD](#) response to our March CFI, page 8.

²¹⁰ Citizens Advice response to our March CFI, page 38.

Scotland asserted that there were quality of service issues affecting remote parts of Scotland, and called for greater visibility at regional/nation level.²¹¹

- 5.100 Some respondents asked for changes to specific targets. Royal Mail requested the following changes.
- a) To change the First Class PCA target from 91.5% to 90% so that it statistically aligns with the First Class national target (which is set at 93%); and
 - b) To change the deliveries target from measuring complete delivery routes to the proportion of delivery points reached.
 - c) To change the SDG target (which is set at 99%) in line with other changes it has requested to the specification (i.e. potentially changing the 1pm deadline), or in the absence of change, it noted that the current target is “very challenging and not consistently achievable”.
- 5.101 Two stakeholders argued for changes to exemptions to quality of service targets:
- a) One stakeholder submitted that the mainland part of the Kirkwall (KW) postcode area should not be exempted from the First Class PCA target. Linked to this, it recommended that we examine the application of the Islands (Scotland) Act 2018.
 - b) UK Mail suggested that there should not be an exemption which allows for reduced service performance in peak times e.g. Christmas.²¹²

Covid-19-related comments

- 5.102 Many stakeholders expressed concern about the poor quality of service experienced by users as a result of the impact of the Covid-19 pandemic. In particular, the consumer advocacy bodies and others highlighted that Royal Mail did not publish updates on its quality of service performance as required during the emergency period, and that this had meant that they could not scrutinise it accordingly.²¹³ Some respondents suggested that we should review the procedures in place for future emergency periods. This included considering setting out criteria on how long such a period could go on for, and deciding when the normal regulatory regime would be restored.²¹⁴ Citizens Advice asked for consumer bodies to be consulted before significant changes are made to the USO during an emergency period.²¹⁵

²¹¹ Advisory Committee for Scotland response to our March CFI, page 6.

²¹² [UK Mail](#) response to our March CFI, page 5.

²¹³ Citizens Advice response to our March CFI, page 39.

²¹⁴ Citizens Advice response to our March CFI, page 39; Mail Competition Forum response to our March CFI, pages 8-9; [The Delivery Group](#) response to our March CFI, page 3.

²¹⁵ Citizens Advice response to our March CFI, page 40.

Our provisional assessment

Overall view on quality of service targets

5.103 The quality of service regime helps to ensure that users benefit from certainty that an item will arrive on the date promised, and high reliability. We know from our RUN that users value these qualities of the universal service above speed of delivery. Taking into account responses to our CFI and our RUN research, we believe that stretching quality of service targets remain appropriate. We consider comments on specific standards below.

First Class Postcode Area target

- 5.104 As explained above, Royal Mail must deliver at least 91.5% of First Class mail within one working day of collection in 118 of the 121 postcode areas in the UK (known as the PCA target).²¹⁶ Separately, Royal Mail must deliver at least 93% of First Class items within one working day of collection on a national basis (known as the national target).
- 5.105 Royal Mail submitted that the PCA target should be changed from 91.5% to 90% in order to align statistically with the First Class national target (set at 93%). It argued that it would not achieve the PCA target even when it met the national target, and that based on the variation in performance between PCAs in previous years, to be statistically confident of meeting the 91.5% PCA target in each of the 118 PCAs, it would need to achieve a national performance of 94.5%. It argued that by aiming for this 1.5% over-achievement, significant additional costs were added into its operation.
- 5.106 For the reasons set out below, we are not proposing to change the First Class PCA target.
- 5.107 The First Class national and PCA targets are two separate targets, with different objectives. In particular:
- a) the national target is a clear overarching target to ensure an adequate level of service across the UK as a whole; whereas
 - b) the PCA target exists to ensure an adequate level of service in each local area, and to limit the variations in service between different PCAs. This target helps to ensure that users in rural, or other harder to reach areas, are protected.
- 5.108 Taking this into account, we are concerned that a reduction in the level of the PCA target could disincentivise Royal Mail's efforts to ensure high quality of service levels are provided in rural or other hard to reach areas. This could result in a wider variation in USO quality of service across the UK, and would likely lead to postal users in some local areas experiencing poorer levels of service.
- 5.109 We are concerned that this would be inconsistent with our duty to further the interests of citizens and consumers, including by having regard to (amongst other things) the opinions of consumers in relevant markets and of members of the public generally; and the different interests of persons in the different parts of the United Kingdom and of persons

²¹⁶ This is for 118 of 121 PCAs across the UK (HS, KW and ZE are excepted for reasons of remoteness).

living in rural and in urban areas. We note in this regard that our RUN research demonstrated the value that users place on reliability and certainty, and – as explained at paragraph 5.103 above - our general view is that Royal Mail should continue to be subject to stretching quality of service targets in respect of its key USO services.

- 5.110 We are also mindful of the fact that Royal Mail’s quality of service performance is measured using a sample of items delivered (rather than all mail items), with the application of a confidence interval.²¹⁷ When we consider Royal Mail’s compliance with its target, we would not intervene or investigate further as long as Royal Mail’s performance adjusted to the upper bound of the 95% confidence interval meets the relevant standard (in this case, 91.5%). If the middle of the sample performance is below the 91.5% target we could not be satisfied that Royal Mail had missed the target or not.²¹⁸ We are concerned that, in light of the continued need for us to apply a confidence interval in line with standard statistical practice, a 90% PCA target would not be sufficiently stretching.
- 5.111 Our experience is that the current PCA target (91.5%) has proved a useful tool to help us identify areas of concern and encourage Royal Mail to improve local performance. We tend to focus our activity on PCAs which have demonstrated poor performance over several years. For example, we asked Royal Mail to consider the reasons behind poor performance in the Inverness PCA over the period 2015-19. We consider that our investigation encouraged Royal Mail to take steps to improve its performance and contributed to its decision to relocate to a new, larger mail centre and delivery office in Inverness to serve the PCA in 2019.
- 5.112 In this context, we have considered the impact that lowering the PCA target to 90% (from 91.5%) would have had over recent years, given that our enforcement approach takes into account the confidence interval. Our analysis has found that, if it had been lowered to 90%, it would have meant that only a small number of PCAs would have failed the target over the last 10 years²¹⁹, after accounting for the confidence interval.

Deliveries target

- 5.113 Currently, Royal Mail must complete at least 99.9% of all delivery routes each day on which a delivery is required.
- 5.114 Royal Mail submitted that we should consider changing this to a target based on the proportion of delivery points (addresses) reached each day on which a delivery is required.

²¹⁷ Royal Mail’s quality of service performance is assessed taking into account its performance in delivering a certain number of test items (rather than all mail items). The application of a confidence interval allows us to extrapolate overall performance from the performance of the sample with confidence. It results in a range within which there is a 95% probability that Royal Mail’s true performance falls (although it is not possible to determine precisely where in that range Royal Mail’s actual performance lies). The range or degree of the confidence interval is determined by (i) the measured quality of service achieved for the sample; and (ii) the sample size.

²¹⁸ Ofcom, 2015. [Annual monitoring update on the postal market – Financial year 2014-15](#), paragraph 3.35. Also see Ofcom, 2014. [Annual monitoring update on the postal market – Financial year 2013-14](#), paragraph 5.40; Ofcom, 2016. [Decision to conclude investigation of Royal Mail Group Limited in relation to a contravention of Designated Universal Service Provider Condition 1.9.1, CW/01183/05/16](#), paragraph 3.6; Ofcom, 2019. [Decision to conclude investigation into Royal Mail’s compliance with its quality of service performance standards in 2017/18](#), page 11, paragraph 3.17.

²¹⁹ This excludes performance during 2020/21.

This is because changes to its network, and the shift from letters to parcels, mean that in future there will be fewer delivery routes, but each will be longer, making the target increasingly challenging. Royal Mail also stated that the current target, which is strictly pass or fail, does not take account of part-route failures (i.e. a route where one address is missed would count as a fail). Instead, Royal Mail proposed that we should change the methodology to an approach based on estimating how many delivery points on a route had been missed each day.

- 5.115 We have carefully considered the case for changing this target. On one hand, the current delivery route approach is simple to assess and measure. It incentivises Royal Mail to reach every address on a delivery route, no matter how far it is from the start of the route. This is in line with the principle of universality that is at the core of the universal service. It is also simple to determine compliance, as either the delivery route has been completed, or it has not. On the other hand, Royal Mail’s proposed delivery point approach has some benefits: it better takes account of part-route failures, and is an approach already used for the collection target. However, we are concerned with two aspects of the proposal. Firstly, it would rely on Royal Mail’s delivery staff accurately estimating the number of delivery points missed each day by looking at the relevant sorting frame.²²⁰ We are not persuaded that this is sufficiently robust. Further, under the proposed approach, there is less of an incentive to reach each and every address on a delivery route, meaning that there is a risk that harder to reach addresses could be missed more frequently.
- 5.116 In light of the above, we are not proposing to change the deliveries target.

Special Delivery Guaranteed by 1pm target

- 5.117 In its response, Royal Mail asked for various changes to the SDG specification, including the removal of the 1pm delivery deadline. We consider the case for these changes in the section on Special Delivery, Signed For and additional services below.
- 5.118 If the specification were to remain unchanged, Royal Mail suggested that the target should be lowered. It commented that the current level (99%) is “very challenging” and “not consistently achievable”.²²¹ However, it did not provide any specific evidence to support this position. It also highlighted that factors outside its control affect its performance, such as mis-sorting of SDG items in post offices.²²²
- 5.119 Our approach since 2012 has been to set stretching performance targets for USO services, as we know that users value high reliability generally. And, as explained above, we continue to believe that stretching quality of service targets are appropriate. Although we did not cover SDG quality of service levels specifically in our 2020 RUN consumer research,

²²⁰ A sorting frame exists at the delivery office for each delivery route. It is used to put letters and parcels in order of delivery. There is usually a slot for each delivery point (address), and the frame typically contains several hundred delivery points.

²²¹ Royal Mail response to our March CFI, page 56, paragraph 5.65.

²²² Royal Mail response to our March CFI, page 56, paragraph 5.65.

we would expect that user expectations of reliability would be higher for a premium service like SDG than for everyday First and Second Class services.

- 5.120 We appreciate that the 99% target is challenging to meet, and that Royal Mail has not met it for some time. This does not, however, automatically mean that the target is no longer appropriate and Royal Mail has provided little evidence to make the case for the change it has requested. Further, we note that we have discretion in enforcement and would expect to take account of factors outside Royal Mail’s control (such as mis-sorting in post offices) as part of that process.
- 5.121 We are also concerned that a reduction in this target would be inconsistent with our duty to further the interests of citizens and consumers, including by having regard to (amongst other things) the opinions of consumers in relevant markets and of members of the public generally. The SDG service is a premium next day service which tends to be used for the mailing of important, valuable and/or urgent items. It is more expensive than standard next day (First Class) services, and our RUN found that most postal users felt that it was an “essential” service, typically using it for the guarantee of next day delivery.²²³
- 5.122 Taking account of the above, and of our general view that Royal Mail should be subject to stretching quality of service targets in respect of its key USO services, we are not proposing to reduce the 99% SDG target.
- 5.123 Royal Mail has separately asked for changes to the requirement that SDG services arrive by 1pm the next day, which are discussed in more detail in the section below on Special Delivery, Signed For and additional services. While we are not proposing any changes in this consultation to the 1pm deadline or other aspects of the product, we note that we would expect to re-consider the quality of service target for SDG services if any changes were made in future to the 1pm deadline.

Exemptions from targets

- 5.124 The Kirkwall (KW) PCA includes part of the mainland of Scotland (Caithness and east Sutherland), and the Orkney Islands. The whole PCA is exempt from the First Class PCA target because of its remoteness.²²⁴ We have carefully considered the argument put forward that the exemption should apply to the Orkney Islands, but not to the mainland part of the PCA, but we do not see the case for reopening this exemption.²²⁵
- 5.125 Firstly, we think it is important for reasons of simplicity that the targets should be set at PCA-level, and not at sub-PCA level. Further, in terms of remoteness, although the mainland part of the PCA is arguably less remote than the Orkney Islands, we believe that the mainland part is still sufficiently remote to justify its continued exemption. This is because the nearest mail centre and delivery office, in Inverness, is a considerable distance

²²³ Ofcom, 2020. [Review of postal users’ needs](#), page 75, para. 6.39.

²²⁴ There are three PCAs exempt from the First Class PCA target. The other two exempted PCAs are HS (Outer Hebrides) and ZE (Shetland Islands).

²²⁵ We are sensitive to the needs of island communities and have examined the Islands (Scotland) Act 2018 as suggested by one respondent. While we understand the aims of the Act, we note that it does not place any duties on us, or Royal Mail.

from large areas of the mainland part of the Kirkwall PCA, and there are limited road connections, making it a challenging area to serve.

- 5.126 In addition, it is important to note that, while not subject to the First Class PCA target, we require Royal Mail to publish performance for the exempted PCAs as part of its regular public reporting.²²⁶ Performance in the Kirkwall PCA is also taken into account when assessing Royal Mail's performance against the First Class national target.
- 5.127 However, to further increase transparency, Royal Mail has confirmed that it will explore the feasibility of publishing information about its performance in the Kirkwall PCA split into its two constituent parts: the Orkney Islands and the mainland area.
- 5.128 Separately, we are not proposing to remove the exemption from meeting the performance targets which applies during the Christmas period.²²⁷ The reason this period is exempt is because of significantly increased volumes of mail over this period, which mean that meeting performance targets designed for the rest of the year would not be achievable without disproportionate levels of investment. Instead, we consider that the current approach, which is to require Royal Mail to publish its Christmas performance separately for monitoring purposes, remains appropriate.²²⁸

The impact of Covid-19

- 5.129 While the focus of this review is about the regulation that applies during normal times, we have carefully considered comments from stakeholders about the impact of Covid-19 on quality of service. The Covid-19 pandemic seriously affected Royal Mail's performance and we appreciate that many people and businesses have experienced delays to their postal service over the last 18 months.
- 5.130 As provided in the PSA 2011, the regulatory conditions relating to the universal service state that Royal Mail is not required to sustain these services without interruption, suspension or restriction in the event of an emergency.²²⁹ In April 2020, we acknowledged that the pandemic constituted an emergency period. From that date, until the period was treated as coming to an end on 31 August 2021, Royal Mail was able to take steps to temporarily reduce service levels or change product specifications where necessary, without the need for formal Ofcom authorisation.
- 5.131 During this period, we closely monitored the steps Royal Mail took to respond to and minimise the impact of the pandemic on its provision of the USO. We challenged it to justify key decisions, sought appropriate evidence (e.g. on staff absence levels), and set out

²²⁶ See DUSP 1.10.4 (a). The universal service provider shall notify Ofcom and the consumer advocacy bodies and publish, no later than two months from the end of each quarter, its performance for that quarter in relation to all the standards in Table 1.

²²⁷ DUSP 1.9.1 provides that the universal service provider is not required to meet the performance targets during the Christmas period. DUSP 1.1.2 (g) defines "Christmas period" as the period commencing on the first Monday in December in any year and ending at the start of the first working day after the New Year public holiday in the following year, or in Scotland, at the start of the first working day after the Scottish New Year public holiday in the following year.

²²⁸ DUSP 1.10.5 requires the universal service provider to notify Ofcom and the consumer advocacy bodies and publish, no later than two months from the end of each Christmas period, its performance during that Christmas period.

²²⁹ See [Postal Services Act 2011](#), section 33(3), Exceptions to minimum requirements

our expectation that the emergency period should be brought to an end as quickly as possible. Section 5 of the 2021 Annual Monitoring Update explains our interactions with Royal Mail on this matter in more detail.²³⁰

- 5.132 In their responses, some stakeholders raised concerns that Royal Mail did not publish certain of its quarterly performance updates during 2020/21. Royal Mail delayed publication of the Q1, Q2 and Q3 data until Spring 2021, when it was published along the Q4 and cumulative year data. While Royal Mail has a regulatory obligation to publish this data, we decided that, in light of the extraordinary circumstances prevailing, it was not appropriate to take enforcement action. However, we had access to the data we required to scrutinise Royal Mail's performance at all times and we required Royal Mail to continue to make it available to the relevant consumer advocacy bodies.
- 5.133 In terms of the procedures in place for future emergency periods, we do not agree that we should set out criteria on how the length of any future period should be decided. This is because this is a statutory exemption set by Parliament in the legislation, and we do not think it is appropriate for us to seek to prejudge how future emergency periods should be treated. We think that it is important to note that this was the first time that this emergency exemption has applied, and the circumstances were genuinely extraordinary. Further, in practice the exemption provided Royal Mail with an essential level of flexibility so that it could respond to unpredictable, rapidly changing circumstances.

Ensuring everyone can access USO services

Requirements on the geographic distribution of USO access points (e.g. post boxes) help to ensure that users can post letters and parcels near where they live and work. Additional requirements are designed to support the inclusion of specific vulnerable groups. These include the articles for the blind service and the requirement for Royal Mail to set out its arrangements for disabled users. Taking into account responses on both these issues, we are not proposing any changes to regulation in these areas.

Introduction and background

- 5.134 It is important that people and businesses across the UK can access USO postal services, and send and receive USO letters and parcels regularly.

General access, including in remote areas

- 5.135 To support widespread access, we require Royal Mail to have an extensive network of access points (e.g. post boxes) for the universal service.²³¹ Overall, there are around

²³⁰ Ofcom, 2021. [Annual monitoring update for postal services – Financial year 2020-2021](#).

²³¹ DUSP 1.8.2 (a) requires Royal Mail to ensure that in the UK as a whole, there is a letter box within half a mile of the premises of not less than 98% of users of postal services. DUSP 1.8.2 (c) (i) requires Royal Mail to ensure that in the UK as a whole the premises of not less than 95% of users of postal services are within 5 kilometres of an access point capable of

115,000 post boxes across the UK, and users can also access USO services at approximately 11,600 post offices.²³² We also require Royal Mail to have a statement of arrangements to ensure that those in remote areas, whose premises are not within 10km of an access point, are provided with reasonable access to such facilities. This means that, in practice, the vast majority of users have a range of access points available to them.

Vulnerable users

- 5.136 To ensure that the needs of vulnerable people and those who may be more reliant on postal services are met, Royal Mail is required to:
- a) offer the articles for the blind service. This is a free First Class service for qualifying items when sent to blind and partially sighted people (and which is a minimum requirement of the universal service set in the PSA 2011).²³³
 - b) have, and review annually, a statement of arrangements with the aim of ensuring that users who are blind, partially sighted, infirm through age, chronically sick or disabled are able to post letters and parcels using the universal service regularly, and as far as possible without significant cost to those users which are attributable to their situation.²³⁴ In its August 2021 statement, Royal Mail explained the steps it takes in relation to access points and collections.²³⁵
- 5.137 Further, to benefit from USO services, we know that people must also have safe access to an address where they can receive mail. We are aware of ongoing work by stakeholders to ensure that particular groups, for example those who are homeless or have unsafe living situations (e.g. victims of domestic abuse), are not prevented from receiving mail. Following a report from Citizens Advice in 2018, Royal Mail trialled allowing homeless people to collect their mail free of charge from its delivery offices. This trial recognised that, to access postal services, people also need an address where they can receive mail. Citizens Advice explored this issue further, considering the needs of those who are homeless and those in unsafe living situations.²³⁶ In its most recent reports, Citizens Advice

receiving the largest postal packets and registered items. DUSP 1.8.2 (c) (ii) requires Royal Mail to ensure that in all postcode areas the premises of not less than 95% of users of postal services are within 10 kilometres of an access point capable of receiving the largest postal packets and registered items.

²³² Ofcom does not regulate Post Office, but we note that it is required to meet six access criteria set by Government on the distribution of post offices across the UK. It must also report annually to the Government, and to Parliament, on the accessibility of the post office network.

²³³ A free articles for the blind service is a minimum requirement of the universal postal service set by the PSA 2011. Ofcom's Universal Service Order requires this service to be First Class and specifies the items eligible to use the service.

²³⁴ See DUSP Condition 1.8.4.

²³⁵ Royal Mail, 2021. [Statement on the arrangements for arrangements for users of postal services who are blind, partially sighted, infirm through age, chronically sick, or disabled](#). Royal Mail explains that, in relation to access points (e.g. post boxes), it takes great care when installing or relocating a post box to ensure that a location is reasonably accessible for all users subject to cost and other legal constraints. In relation to collection, it states that its operational managers will endeavour to respond sympathetically to users who have special needs and deal flexibly with their requirements wherever possible. It also notes that all customers in rural areas can give stamped, letterbox-sized mail to delivery staff when their delivery is being made (without leaving home). It also highlights its new Parcel Collect service where, for a fee, Royal Mail will collect barcoded parcels from a user's address.

²³⁶ Citizens Advice, 2020. [Millions without mail](#); Citizens Advice, 2020. [On the receiving end: how post can enable domestic abuse](#); Citizens Advice, 2018. [The postal paradox: how having no address keeps people homeless](#).

called for the Government to fund a service where specific groups could collect their mail free of charge from post offices.²³⁷

Stakeholder responses to our March CFI

General access, including in remote areas

- 5.138 In relation to requirements on the distribution of access points (e.g. post boxes), Royal Mail stated that it rarely removes a post box, and that the overall number of post boxes in both rural and urban areas had remained stable for the past decade.²³⁸ Post Office stated that the number of post offices had remained stable over the past decade, as had the split across rural, urban and deprived areas.²³⁹ As a result, Post Office believed that current requirements on the distribution of access points remained sufficient.
- 5.139 One stakeholder raised concerns about the impact of the next phase of Royal Mail's Postbox Strategy on remote rural users in Scotland. This strategy, which began in 2014, involves bringing forward final collection times from most post boxes (e.g. so that post is collected in the morning when mail is being delivered), while retaining a core network of post boxes with later collections. The reason given by Royal Mail for the changes is to deliver efficiency improvements.²⁴⁰

Vulnerable users

- 5.140 Royal Mail said that it continually considers how it can improve access for vulnerable users, and it would continue to work with consumer bodies to improve access. Royal Mail pointed to its Parcel Collect service as a new service which could be of value to those who have difficulty leaving their homes.²⁴¹ CCNI encouraged us to consider whether requiring a register of vulnerable users could help to safeguard their access to USO services.²⁴²
- 5.141 Citizens Advice and CCNI expressed concern about users who do not have safe access to an address where they can receive mail. This includes specific groups e.g. homeless people; gypsies, travellers, and Roma communities; refugees; and people living in unsafe situations.²⁴³ Citizens Advice highlighted that these groups are more likely to need access to post for support services (e.g. housing). Post Office highlighted its work with others looking for solutions to this issue. It also highlighted the sensitivity, complexity and costs associated with possible solutions, and felt it was unlikely to be best addressed through regulation.²⁴⁴

²³⁷ See Citizens Advice reports [Millions without mail](#) and [On the receiving end: how post can enable domestic abuse](#).

²³⁸ Royal Mail response to our March CFI, page 63.

²³⁹ Post Office is required by Government to meet six access criteria on the distribution of post offices across the UK. It must also report annually to the Government, and to Parliament, on the accessibility of the post office network.

²⁴⁰ Royal Mail, May 2018. [Annual Report and Financial Statements 2017-18](#), page 9.

²⁴¹ Royal Mail response to our March CFI, page 63. Parcel Collect is a new commercial service offered by Royal Mail where, for a fee, users can have barcoded parcels collected from their address.

²⁴² Consumer Council for Northern Ireland response to our March CFI, page 9.

²⁴³ See responses to our March CFI from Citizens Advice, pages 43-50; and [CCNI](#) page 9.

²⁴⁴ Post Office response to our March CFI, page 18.

5.142 Elmburgh, Runnymede and Spelthorne Talking Newspaper, one of around 400 talking newspapers in the UK, delivers audio recordings of local newspapers to its members. It suggested that eligibility for the articles for the blind service should be expanded to include a wider range of medical conditions which affect whether people can read. It said that evidence shows that these include dementia, stroke, cerebral palsy and autism.²⁴⁵

Our provisional assessment

General access, including remote areas

5.143 Respondents did not identify any concerns about the geographic distribution of access points for the universal service. Therefore, our initial position is that existing regulation we place on Royal Mail remains appropriate to ensure widespread access. We note that our regulation is, in turn, supported by access to USO services provided by the Post Office network, which has its own separate access requirements set by the Government.

5.144 In relation to concerns about the impact of the next phase of Royal Mail's Postbox Strategy on rural users, we note that we do not specify collection times from post boxes. However, to ensure that users are informed, we require Royal Mail to publish clear and up-to-date information on key features of its service, including collection times.²⁴⁶ Royal Mail includes this information on each postbox, together with details of the nearest post box with a later collection. When changes are proposed to move specific postboxes to earlier collection times, we require Royal Mail to publish its plans in such a way as to ensure reasonable publicity for them, and to notify us and the consumer advocacy bodies at least a month in advance of the change.²⁴⁷ As the Postbox Strategy programme continues, which Royal Mail maintains is important to realise efficiency improvements, we expect it to communicate clearly with stakeholders and users on changes, and take account of local feedback. We will continue to monitor developments.

Vulnerable users

5.145 We recognise that to benefit from USO services, people need an address where they can receive mail reliably and without risk. For specific groups this can be challenging, and they may need an alternative, convenient way to receive their mail without incurring charges associated with a long-term Redirection or PO Box service. Building on research highlighted above, and a Citizens Advice-led workshop in May 2021, we note that a small trial is planned to help identify and test potential solutions. Our regulatory powers are limited to postal operators (i.e. in this case to Royal Mail). We note that any scheme is likely to require cooperation between Royal Mail, Post Office, Government and charities. Therefore, we do not currently see any role for regulatory intervention, but we welcome the work being undertaken in this area and believe that this is an important issue, which if addressed, would help to support the inclusion of vulnerable groups.

²⁴⁵ [Elmburgh, Runnymede and Spelthorne Talking Newspaper](#) response to our March CFI, page 1.

²⁴⁶ See DUSP 1.10.1 (c).

²⁴⁷ See DUSP 1.10.2 (c), (d).

- 5.146 We have considered whether requiring Royal Mail to maintain a register of users in vulnerable circumstances would support access to USO services. Our initial view is that broad obligations on Royal Mail to identify users in vulnerable circumstances, such as customers who have suffered significant life events like a bereavement, is unlikely to be workable in practice. While in sectors such as telecommunications there are clear steps providers can take to help with an individual's circumstances, it is less clear how many vulnerabilities would affect access to USO postal services. Further, we are unclear what the additional benefits of being named on such a list would be, beyond existing arrangements for housebound users (e.g. collection of stamped letters by your postperson when your mail is being delivered in rural areas, or the new ParcelCollect service). In addition, we have concerns that it would be extremely challenging for Royal Mail to identify who should be on the list and keep it up to date. There may also be significant data protection and privacy concerns in requiring Royal Mail to establish and maintain a list of all disabled and vulnerable users across the UK.
- 5.147 However, we welcome Royal Mail's continuing consideration of how it can improve access for vulnerable users. Having considered existing arrangements, we would support the extension to urban areas of the service whereby, if vulnerable, your postperson will collect stamped letters from you when they deliver your post (i.e. without leaving your home). Currently it is a service offered to all users in rural areas only.
- 5.148 We have considered the suggestion that the articles for the blind service is out of date, and that it should be expanded to include other medical conditions which affect whether people can read. A free articles for the blind service is a minimum requirement of the universal postal service set by the PSA 2011.²⁴⁸ The legislation sets out that the service should be provided "to such descriptions of blind or partially sighted persons as are so specified." In line with this, the Universal Service Order sets the specification of services that should be provided without charge to "blind" or "partially sighted" persons, and defines them.²⁴⁹
- 5.149 We recognise that individuals affected by medical conditions such as dementia, stroke, cerebral palsy and autism may struggle, as a result, to read. However, to the extent that those individuals fall within the relatively wide definition of blind or partially sighted in the existing Universal Service Order, we note that they would benefit from the existing articles for the blind service. Further, while we did not explicitly consider this service in our RUN consumer research, as part of our engagement the Royal National Institute of Blind People confirmed that the service is valued by them, local support agencies and blind and partially sighted people, and that it is important that the scope of the service is not diminished.²⁵⁰

²⁴⁸ See PSA 2011, section 31, requirement 6.

²⁴⁹ The Postal Services (Universal Postal Service) Order 2012, paragraph 2. "Blind" means registered blind under the provisions of the National Assistance Act 1948 c.29; "partially sighted means certified by an ophthalmologist, doctor or ophthalmic optician as having vision which cannot be improved using optical aids (including magnifiers) or additional illumination to allow 12 point sized print to be read at a comfortable reading distance."

²⁵⁰ Ofcom, 2020. Review of user needs, page 76.

No suggestion that the definition of blind or partially sighted in the existing Universal Service Order is too narrow was raised as part of our work on RUN.

- 5.150 To the extent that the concern is that individuals with reasonable eye-sight may still struggle to read as a result of certain medical conditions, then we are not currently minded to expand the scope of the USO to require the provision of a free service for the posting of audio recordings, as has been requested. At this stage we do not have sufficient evidence to impose this new service requirement on Royal Mail, and to do so we would be required to carry out an assessment under section 30(3) of the PSA 2011 to understand whether such a service is a reasonable need (and, if so, the extent to which the wider market is meeting this need). We also note that, given the availability of local radio services (which include news) and the fact that audio recordings of local newspapers can be distributed using the internet, it may be challenging to demonstrate the need for an additional universal service in these circumstances. However, our RUN did not consider this specific issue and we remain open to further evidence from stakeholders on this matter as part of this review.
- 5.151 Separately, in relation to parcel services, we have set out in Section 6 of this consultation how we are proposing new rules requiring parcel operators (including Royal Mail) to have policies and procedures in place that will help ensure services better meet the needs of disabled consumers. For Royal Mail we would expect these policies to include how USO parcel services will address the specific needs of disabled consumers using these services.

Special Delivery, Signed For and additional services

We note that Royal Mail is currently undertaking a significant review of its services building on customer research, which is yet to be completed. In its response to our March CFI, Royal Mail said it intends to simplify and improve its product offerings under a “good”, “better”, “best” approach.²⁵¹ With this in mind, we remain open to considering additional evidence on SDG and Signed For requirements during this review period – specifically whether any changes would meet reasonable user needs and support efficiency.

Introduction and background

- 5.152 SDG and Signed For services offered by Royal Mail are universal postal service products. The universal postal service ensures that citizens across the UK can access important postal services at the same price.²⁵²
- 5.153 The minimum requirements of the universal postal service include a requirement for the provision of a registered items service and an insured items service.²⁵³ The Universal Service Order and DUSP Condition 1 require Royal Mail to offer one or more registered and

²⁵¹ Royal Mail’s response to our March CFI, page 58.

²⁵² Specific areas of the UK are unable to receive deliveries by 1pm the next day under the SDG by 1pm service. [See Royal Mail’s website for more information](#) [accessed 1 December 2021].

²⁵³ See PSA 2011, section 31, requirements 4 and 5.

insured service(s). These services must also have a target delivery time of next day by 1pm (except where this is not reasonably possible) and should include tracking and offer proof of delivery.²⁵⁴ Royal Mail is meeting this requirement by offering the SDG service.²⁵⁵

- 5.154 The DUSP Condition also requires Royal Mail to offer an optional ‘add-on’ to its First Class and Second Class services which includes provision of proof of delivery by the recipient on application by the sender.²⁵⁶ Royal Mail is meeting this requirement by offering the Signed For service.
- 5.155 Our RUN research found there was substantial usage of both SDG and Signed For services among residential and business users in 2019/20,²⁵⁷ signalling that there is an appetite for these services. Although they are used less often than First Class and Second Class services, they are seen as “essential” when they are used.²⁵⁸

Stakeholder responses to our March CFI

- 5.156 Stakeholders broadly agreed that both the SDG and Signed For services remain an important part of the universal service, with no calls for their removal. However, there were some specific issues regarding their specifications that were flagged in the responses to our March CFI.
- 5.157 Royal Mail made three proposals for SDG and Signed For services in their response:
- i) The removal of the 1pm deadline from the SDG service. Its reasoning for this proposal included research suggesting that the 1pm deadline is not a primary driving factor for consumers when selecting the product, the need to offer flexibility to consumers to better suit their needs with regards to delivery times and the inefficiencies that it causes its operations.²⁵⁹
 - ii) The separation of registered and insured features within the DUSP Condition (which are currently fulfilled by the SDG service), so that they can be offered as separate products. Royal Mail said evidence from its qualitative research suggests that the SDG service is over-specified and goes beyond what some of its customers require. For example, some may need the speed of the SDG service, but not the insurance element (and vice versa). Therefore, Royal Mail proposed that it would be appropriate to disaggregate the offering to allow users to pick-and-choose the features they need at the time to promote further consumer choice.
 - iii) A call for greater flexibility on the way that it can confirm delivery of Signed For items, in addition to the historical procedure of taking the recipient’s signature on

²⁵⁴ See DUSP Condition 1.6.1(d).

²⁵⁵ Royal Mail also offers a Special Delivery Guaranteed by 9am service. It offers this on a commercial basis. It is outside the USO specification.

²⁵⁶ See DUSP Condition 1.6.1 (a)(d); and DUSP Condition 1.6.1(b)(d).

²⁵⁷ [Jigsaw Review of User Needs quantitative research](#), 2020. Approximately 40% of residential users used the Recorded/Signed For service and one in five used the SDG service in the last 12 months for both letters and parcels.

²⁵⁸ Ofcom, 2020. [Review of Postal Users’ Needs qualitative research](#), page 32. We asked participants whether they considered specific services to be “essential”, “nice to have” or “not required”.

²⁵⁹ Royal Mail’s response to our March CFI, page 61-62.

delivery. Royal Mail proposed the removal of the requirement for “evidence from the recipient” in the DUSP Conditions to accomplish this. Royal Mail noted that there are now a range of confirmation options – such as scans (with accompanying delivery confirmation), GPS coordinates and photos – that can also help fulfil the varying needs of consumers.

- 5.158 The CCNI²⁶⁰ and the Ofcom Advisory Committee for Scotland (ACS)²⁶¹ were concerned about the lack of clear, concise information regarding the features of the SDG and Signed For services. They explained that this causes confusion to consumers, particularly when assessing the various pricing and service levels, and that we may need to explore how to make it easier to understand the features of each service and the differences between them.

Our provisional assessment

Clarity of information regarding Special Delivery Guaranteed by 1pm and Signed For features

- 5.159 The points raised by the CCNI and the ACS have also been substantiated by findings from our own research which suggested that users were often unclear about the specific features of SDG and Signed For, as well as the differences between them. We suggest that Royal Mail should take note of these points made by the CCNI and the ACS regarding the need for clear, concise information as it progresses its product simplification initiative.

Special Delivery Guaranteed by 1pm – 1pm deadline

- 5.160 Our provisional assessment of the currently available evidence suggests that there remains a user need for an SDG service. We have not seen evidence that would justify the removal of the requirement for delivery by 1pm the following day. We therefore are not proposing a change to the requirement but would be interested in stakeholder views as to whether user needs have changed in this regard. Royal Mail is of course free to offer other SDG services with other delivery times outside of the USO, as it has done with its Special Delivery Guaranteed by 9am service, to address some of the issues identified in its March CFI response.

Registered and Insured elements

- 5.161 We have noted Royal Mail’s suggestion that the rules on SDG should explicitly allow registered and insured services to be offered as separate universal service products. There may be a potential user need case for Royal Mail offering a registered SDG service without insurance, as it would likely be cheaper than the current product²⁶², but we consider that greater clarity is needed from Royal Mail about its proposal and its reasoning before we would consider such a change.

²⁶⁰ Consumer Council for Northern Ireland’s response to our March CFI page 9, paragraph 5.18.

²⁶¹ Advisory Committee of Scotland’s response to our March CFI, page 7-8.

²⁶² SDG by 1pm currently includes a minimum insurance cover of £500 which drives up the price of the service.

- 5.162 We are also aware that our recent research on C2X parcel services suggested that consumers may not fully understand all of the features of SDG and they may therefore gravitate towards the most reassuring service when presented with a range of options to choose from.²⁶³ However, although we do have some research in support of Royal Mail's proposals regarding the over-prescription of SDG, we are of the view that we have not conducted sufficient research to justify a change to its features.
- 5.163 Therefore, we are not proposing a change to the SDG requirements at this stage, but we would welcome stakeholder views on the separation of registered and insured services. We may revisit this issue alongside any further consideration of SDG requirements, such as delivery by 1pm, if evidence is provided that suggests changes would better meet reasonable user needs.

Signed For and proof of delivery

- 5.164 We consider that the requirement on Royal Mail to offer a "proof of delivery" option fulfils specific user needs, and we have not seen evidence to suggest that this need would be met without requiring evidence from the recipient to demonstrate proof of delivery. For example, our C2X qualitative research suggests that marketplace sellers use the Signed For service as a means of acquiring formal evidence to show that an item has been delivered to their buyers and to protect against fraud.²⁶⁴ As noted in Section 7 on the parcels USO, our qualitative research found that 'proof of delivery' was around twice as important for consumers when choosing a parcel operator than 'Tracking information on stage and day of delivery'. In addition, participants in our RUN also felt that the Signed For option is needed because it could be recommended when sending legal or government documents so that there was a record of an item having been received, which is an important use case.²⁶⁵
- 5.165 We also note that the existing definition of "proof of delivery" in DUSP 1.1.2(z) allows for the recipient to confirm delivery by means other than a signature.²⁶⁶ This permits Royal Mail to develop procedures that use alternative methods for acquiring evidence from the recipient, so long as they adhere to the DUSP Conditions that we have laid out.
- 5.166 Therefore, we are of the initial view that it would not be appropriate to update the definition of "proof of delivery" and remove the requirement for evidence from the recipient as Royal Mail have proposed. However, we welcome the views of stakeholders on this issue.

²⁶³ Ofcom, 2020. Review of Postal Users' Needs qualitative research, page 19.

²⁶⁴ [C2X parcels qualitative research](#), slide 49.

²⁶⁵ Ofcom, 2020. Review of Postal Users' Needs qualitative research, page 32.

²⁶⁶ See DUSP Condition 1.1.2(z), "...or other evidence from the recipient in confirmation of receipt"

Meter mail (franking)

Meter mail is a payment option for letters (and parcels) within the universal service. Our provisional view is that meter mail, as a payment option for single piece services, is consistent with the principles of the universal service. We also provisionally conclude that meter mail should be retained within the USO, as it remains important to SMEs and the market does not offer comparable services.

- 5.167 Metered (franked) mail is an in-house postage and payment option that allows businesses and other organisations (such as charities or local authorities) to buy or lease franking machines that print the post mark directly onto envelopes (or label for parcels).²⁶⁷
- 5.168 Royal Mail offers meter mail (franking) at discounted prices relative to regular stamps. For example, a First Class letter as of 2021 costs 77p with standard (legacy) franking and 72p with Mailmark franking, compared to 85p for a regular first class stamp. As in the case of stamps, metered mail prices have risen for letters and large letters since 2013.²⁶⁸

Stakeholder responses to our March CFI

- 5.169 Some access operators argued that meter mail is inconsistent with the principles of the universal service and that its inclusion distorts competition, as it enables Royal Mail to sell discounted letter services.
- The MCF argued that Royal Mail's ability to price metered mail at discounted prices makes it inconsistent with the principles of the universal service.²⁶⁹ The MCF also argued that the usage requirements for metered mail (the need to buy or lease a franking machine) means that it is not an option available to all users. Therefore, they argued that meter mail as a payment channel should be excluded from the universal service.
 - UK Mail also pointed out that it is important that hybrid mail solutions, which may emerge as an effective alternative to meter mail, are not put at a VAT disadvantage, as a result of the inclusion of meter mail within the universal service.²⁷⁰
- 5.170 In contrast, other stakeholders such as Royal Mail, the Communications Workers Union (CWU), the Mail Users Association (MUA) and suppliers of franking machines considered that there is a continued need for meter mail amongst SMEs and/or that it should be retained as a payment channel for single piece services within the universal service:
- Royal Mail argued that there is no affordable UK-wide alternative available to meter mail customers, as access operators are unlikely to serve small and medium-sized

²⁶⁷ From January 2023, Royal Mail will only accept franked mail from customers using Mailmark Franking machines, which uses barcode technology. Therefore, businesses using Standard Franking machines will need to migrate to Mailmark to continue accessing metered mail services. <https://www.royalmail.com/business/shipping/franking> (accessed 1 December 2021).

²⁶⁸ See Figure 5.1 (Royal Mail USO letter and large letter prices in real terms) in our March [CFI](#).

²⁶⁹ [MCF](#) response to our March CFI, page 10.

²⁷⁰ [UK Mail](#) response to our March CFI, page 5.

meter mail customers.²⁷¹ They also argued that removing metered mail from the universal service could increase prices (for businesses that cannot reclaim VAT), accelerate the decline in letter volumes and threaten the financial sustainability of the universal service.

- The MUA, and Franking machine manufacturers such as Pitney Bowes and Quadiant UK Ltd highlighted that access operators have a threshold of collecting 250 letters, and were sceptical that the removal of metered mail from the universal service would lead to more competition.²⁷² Pitney Bowes noted that while there is some competition for sending tracked items via access operators, the collection arrangements from access operators are not as convenient as that of metered mail.²⁷³
- Others such as the CWU and CCNI agreed with our findings from the RUN that there is a need for meter mail as a payment channel within the universal service²⁷⁴, whereas the Post Office indicated having no strong views on its inclusion within the universal service.²⁷⁵

Our provisional assessment

Metered mail for single piece services is not inconsistent with the universal service

- 5.171 Our provisional view is that meter mail may be used as a payment method for universal services, and that this is not, as some stakeholders have suggested, inconsistent with the universal service.
- 5.172 While payment by meter is at a discounted rate to payment by stamp, we do not think this is by itself inconsistent with the universal service. The definition of single piece service in the Universal Service Order makes clear that volume and certain other discounts²⁷⁶ are not consistent with the provision of a single piece service, and therefore with the universal service. However, the discount provided by Royal Mail to those paying for single piece services via a meter is not a volume-related discount; nor do we consider it to be one of the other discounts which is specifically prohibited. We agree however that, when used as a payment method for bulk mail (for example, if the sender also benefits from a volume-related discount), meter mail is not included within the universal service.

²⁷¹ Royal Mail response to our March CFI, page 62.

²⁷² [Mail Users Association](#) response to our March CFI, page 6. [Pitney Bowes](#) response to our March CFI, page 4. [Quadiant](#) response to our March CFI, page 2.

²⁷³ Pitney Bowes response to our March CFI, pages 3 and 4.

²⁷⁴ [CWU](#) response to our March CFI, page 14. Consumer Council for Northern Ireland response to our March CFI, page 9.

²⁷⁵ Post Office response to our March CFI, page 22.

²⁷⁶ "Single piece service" is defined as a postal service for the conveyance of an individual postal packet to the addressee, for which the price per postal packet is not subject to any discounts related to—

- (a) the number of postal packets sent in connection with the person who paid for the service;
- (b) the positioning or formatting of text on the postal packet;
- (c) the use of markings which facilitate the use of machines to sort postal packets;
- (d) pre-sortation into geographical areas for delivery; or
- (e) the purchase of any other conveyance of the same or any other postal packet.

- 5.173 We also disagree that metered mail is not an option available to all postal users. While postal users will need to buy or lease a franking machine and have a license from Royal Mail, this is an option which is – in principle – available to all users under the same conditions.
- 5.174 Notwithstanding the above, we have considered whether it remains appropriate to continue to require, in the Universal Service Order and DUSP Condition 1, that meter be used as a payment channel for universal services.

Metered mail remains important to some SMEs

- 5.175 Our quantitative RUN research found that while most SMEs use stamps when sending letters, 14% of SMEs use metered/franked mail services. This compares to only 3% of SMEs that use the bulk mail letter services offered by Royal Mail, and 2% that use bulk mail letter services provided by other postal operators.²⁷⁷
- 5.176 Among SMEs that use metered/franked mail services, 85% considered this method of sending mail to be ‘important’ or ‘very important’ to their business.²⁷⁸
- 5.177 This view is echoed in our qualitative RUN research which found that although many SMEs do not use metered/franked mail services, those that use these services see it as essential or very important, citing costs and speed as the key benefits.²⁷⁹

The market does not offer comparable services

- 5.178 The wider postal market does offer some services that are sometimes positioned as a substitute for metered mail.
- 5.179 Access mail operators such as Citipost, DX, UK Mail (DHL) and Whistl provide users with two different bulk mail services: sorted and unsorted. However, eligibility for these services differ in terms of the volumes and level of processing required by businesses.
- i) Sorted mail services – a minimum volume threshold of 4,000 items per day may be required.²⁸⁰
 - ii) Unsorted mail services – a minimum volume threshold of around 250 items per day may be required.²⁸¹ This service is targeted at businesses that do not necessarily have the volumes to pre-sort their mail and invest in sortation technology.
- 5.180 In contrast, meter mail gives SMEs flexibility in applying postal markings to variable volumes of letters (and parcels) at discounted rates, as they do not need to commit to minimum volumes of mail.

²⁷⁷ Ofcom, 2020. [Review of User Needs Quant Report, Page 21-23.](#)

²⁷⁸ Ofcom, 2020. Review of User Needs Quant Report, Page 22.

²⁷⁹ Ofcom, 2020. Review of User Needs Qual Report, page 33.

²⁸⁰ Based on Whistl’s sorted mail delivery services. See: <https://www.whistl.co.uk/mail/sorted-mail> [accessed 1 December 2021].

²⁸¹ The Mail Users’ Association (MUA) noted in their response that access operators tend to have a threshold of 250 letters. This is consistent with Whistl’s threshold for some of its unsorted mail delivery services. See: <https://www.whistl.co.uk/mail/unsorted-mail/premiersort-flex> [accessed 1 December 2021].

- 5.181 We also understand that the costs of leasing a machine are low. We estimate that a business renting a low volume franking machine could break even by sending around three First Class letters per day at a minimum.²⁸² This is significantly below the minimum volume thresholds that we understand are set by bulk mail operators.
- 5.182 Therefore, the need for metered mail amongst businesses dealing with low volumes of mail is unlikely to be met through bulk mail services.
- 5.183 We are however aware of hybrid mail solutions (digital mail solutions) emerging that may be suited to businesses with lower postal volume needs, even if not completely comparable to metered mail services. This solution is currently offered by Royal Mail and some access operators and involves electronic copies of mailings being sent by the sender to the operator, to be printed, produced, enveloped and then posted.

Metered mail should be retained within the USO

- 5.184 In light of the importance of meter services to SMEs, and the fact that the wider postal market is unlikely to offer comparable services, our provisional view is that Royal Mail should be required to continue offering the option of payment via meter under the DUSP condition.
- 5.185 We are aware that Royal Mail benefits from a VAT exemption where it provides services pursuant to a regulatory obligation. However, we do not think this is likely to have any significant adverse effect on competition between metered mail and other market services.
- 5.186 This is because primary users of meter mail are SMEs sending low and variable volumes of mail, while access operators offering bulk mail services target businesses sending higher and stable volumes of mail.
- 5.187 Removing meter mail as a payment channel from the USO may instead encourage substitution to Royal Mail stamps and/or further e-substitution, rather than to alternative bulk mail providers.
- 5.188 However, we will continue to monitor meter mail within scope of the universal service and its likely impact on competition in the context of new services emerging.

Other issues raised by stakeholders

Delivery days

- 5.189 We received some comments about letters delivery days in response to the March CFI. Of the stakeholders that commented, all agreed that a six-day delivery schedule should be

²⁸² The monthly cost of a low volume franking machine is likely to be around £20-£40 (excluding expenses associated with printing ink, labels, etc). See: <https://www.frankingmachineexperts.co.uk/how-much-franking-machine-cost/> [accessed 1 December 2021]. For a machine with a monthly lease cost of £40, a business would at a minimum need to send 3 letters per day using First Class rates (mailmark price of £0.72) in order to cover this cost (assuming on average there are 20 working days in a given month).

retained, often citing negative consequences to consumer satisfaction if it were to be reduced (CWU²⁸³ and National Federation of Subpostmasters²⁸⁴). There was also support that, if the schedule were reduced to five days, Saturday delivery should be retained and a weekday should be dropped instead (MUA²⁸⁵ and Professional Publishers Association²⁸⁶).

5.190 However, as we explained in our March CFI, the requirement for the delivery of letters to homes and businesses six days a week falls under the minimum requirements of the universal service set by Government and Parliament. We cannot change these requirements, so it is not within the scope of this review.

Consultation questions

Question 5.1: Do you agree with our proposed approach of maintaining the current regulatory safeguards of the safeguard cap, high quality of services standards, and requirements on access to universal services? Please substantiate your response with reasons and evidence.

Question 5.2: Do you agree with our proposal to not impose further regulatory requirements on Royal Mail in relation to Redirection pricing, following implementation of its improved Concession Redirection scheme? Please substantiate your response with reasons and evidence.

Question 5.3: Do you have any further evidence on other issues raised in this section?

²⁸³ Communication Workers Union response to our March CFI. Page 14, paragraph 58.

²⁸⁴ [National Federation of Subpostmasters](#) response to our March CFI. Pages 2-3.

²⁸⁵ Mail Users Association response to our March CFI. Pages 5-6.

²⁸⁶ [Professional Publishers Association](#) response to our March CFI. Page 2.

6. Parcels market regulation

This section considers the broader parcels market and how well it is working for consumers. The aims of our regulation in the parcels market are to protect consumers, promote competition and support innovation.

Our assessment of the parcels market is that it works well overall, and that competition is driving benefits for consumers. But our evidence also suggests there are some problems for consumers that need to be addressed.

We found that:

- consumer complaints and contact handling processes were too often inaccessible or inadequate; and
- disabled consumers were more likely to experience detriment from services failing to meet their needs.

We therefore propose to take targeted and proportionate steps to address these problems by:

- **Issuing new guidance for all parcel operators (including Royal Mail) setting out the steps we expect operators to take when dealing with consumer complaints to ensure compliance with our complaints handling rules.** We expect parcel operators to make substantial improvements in customer service and complaints handling and may consider enforcement action (or further regulation), as appropriate, if progress is not made. Our new guidance applies to consumer complaints relating to B2C and C2X parcel services.
- **Introducing a new condition to require parcel operators (including Royal Mail) to publish policies and procedures for how disabled consumers' specific needs will be met, including how delivery staff on the ground will act on their delivery requests.**

With the increasing importance of parcel deliveries to customers over recent years it is crucial the market works well for all customers. We will monitor operators' performance in these areas and will keep under review the need for additional regulation to protect consumers.

Introduction

- 6.1 In this section we set out our analysis of the broader parcels market and how it is working for consumers. Specific issues on the specification of the universal service for parcels provided by Royal Mail are covered in Section 7.

Our research and market analysis

- 6.2 To develop our understanding of the parcels market, we have commissioned consumer research, issued information requests to some of the main operators and engaged with stakeholders.

Consumer research

- 6.3 In January 2021, we commissioned Yonder to undertake quantitative research to understand the customer experience of receiving deliveries from parcel operators (including Royal Mail) to fulfil online orders, which we refer to as the ‘B2C parcels consumer research’.²⁸⁷
- 6.4 In Summer 2021, we undertook a major programme of qualitative and quantitative research with a view to better understanding C2X parcel senders²⁸⁸ (referred to as the ‘C2X research’) when using Royal Mail and other parcel operators. In particular, we wanted insight into what drives consumer choice, what service features C2X senders value (with particular emphasis on tracking facilities), the nature and resolution of issues and complaints, and the overall consumer experience in the C2X segment. We commissioned Jigsaw Research to carry out the qualitative research²⁸⁹ and BVA-BDRC for the quantitative research.²⁹⁰
- 6.5 Our [research findings](#) and [data tables](#) have been published alongside this document.
- 6.6 We have also drawn on other research sources, such as our annual residential consumer and SME postal trackers and research published by stakeholders.

Market analysis

- 6.7 To conduct our market analysis, we rely on a number of sources including public and confidential information from industry stakeholders, our market research and broader engagement with stakeholders throughout the year. This includes market, consumer, and operator data (including analysis on volumes, market shares and pricing) recently gathered from formal information requests as well as information provided in response to our call for inputs published in March 2021 (“March CFI”).²⁹¹

²⁸⁷ We undertook 2,019 online interviews with adults across the UK. This research was conducted in January 2021 during a period of significant Covid-19 restrictions when operators experienced high demand and operational pressures, so we recognise this is likely to have had some impact on the research findings.

²⁸⁸ C2X senders were defined as having sent at least one parcel in the last 12 months. The sample was designed to be representative of parcels senders using the demographic profile from the Ofcom residential postal tracker. Northern Ireland, Scotland and Wales were ‘over sampled’ to ensure that there were sufficient numbers of interviews for analysis. There were also boosts for rural respondents. Weighting was then applied to correct to their correct proportions. A full unweighted and weighted sample profile can be found in the published research slides.

²⁸⁹ In Summer 2021, we carried out qualitative research comprising of eight online groups and 21 in-depth interviews with vulnerable users. Research participants were spread over the UK with different drivers for C2X sending (social senders, online marketplace sellers and SME sellers) and a range of demographic characteristics including digital exclusion.

²⁹⁰ The July 2021 quantitative research was also split by the four nations within the UK; different C2X sender types; younger and older senders; those living in urban, rural and deep rural areas; as well as disabled senders. We undertook 3,379 30-minute online panel interviews with UK adult C2X senders.

²⁹¹ Ofcom, 2021. [Call for inputs: Review of postal regulation](#).

Market context

Parcel market segments

- 6.8 Parcels have become increasingly important to the lives of UK citizens and consumers, and this is expected to continue. Volumes had already been growing steadily during the review period from 2017, but the impact of Covid-19 sharply accelerated parcel growth, driven by the increase in online shopping linked to the restrictions on physical retailers during 2020-21. The ONS reported that internet sales made up 28.1% of total UK retail sales in 2020, up from 19.2% in 2019 and 18.0% in 2018.²⁹² Total domestic parcel volumes increased by 54% year-on-year in 2020-21, reaching 3.6 billion items.
- 6.9 While the rate of future growth is uncertain, parcel volumes are expected to continue to increase going forward²⁹³, with residential users in our RUN research indicating they expect the number of parcels they receive to stay the same or increase.²⁹⁴
- 6.10 The UK parcels market is made up of the following segments:
- **Business-to-consumer (B2C):** deliveries of items to end consumers made as part of bulk contracts agreed between businesses and parcel operators (e.g. an online retailer sending multiple items bought online by consumers);
 - **Consumer-to-business/consumer (C2X):** these are largely single-piece items sent by individual consumers or SMEs to another person or business (e.g. a person sending a birthday present to a relative, a consumer returning an item purchased from an online retailer²⁹⁵, or an online marketplace seller fulfilling orders); and
 - **Business-to-business (B2B):** bulk deliveries of parcels between businesses (e.g. a clothes manufacturer receiving fabric from a supplier, or a publisher receiving paper and ink in bulk).²⁹⁶
- 6.11 B2C is by far the largest segment in the parcels market. In 2020-21, we estimate that B2C accounted for between 70-80% of total domestic parcels volumes across operators.²⁹⁷ The C2X segment accounts for approximately 10% of parcels volumes across operators and is growing (but at a slower rate than B2C).

²⁹² Office for National Statistics, [last accessed] 21 October 2021. [Internet sales as a percentage of total retail sales \(ratio\) \(%\)](#)

²⁹³ In the immediate term, however, growth is uncertain. It will be affected by a range of factors and risks such as ongoing consumer behaviour (and the extent to which changes accelerated by the Covid-19 pandemic are sustained longer term), and short term capacity within the parcels industry to meet demand.

²⁹⁴ Ofcom, 2020. [Review of postal users' needs](#), paragraph 4.28. Also see Jigsaw, 2020. [UK Postal User Research: Quantitative Research Report](#), Figure 45.

²⁹⁵ Where the postage charge is covered by the online retailer, the return of items might be regarded as B2C deliveries.

²⁹⁶ In this review we focus on the consumer facing segments (C2X and B2C), where issues may directly result in consumer detriment. The B2B segment faces limited regulation and appears to be working well, with several parcel operators offering competing B2B services.

²⁹⁷ Ofcom illustrative estimate using 2020-21 parcels market data published at aggregate level in our 2021 annual monitoring update. We use single-piece and bulk parcel volumes as a proxy for C2X and combined B2C/B2B volumes, respectively. To estimate the proportion of bulk parcels that are B2C, we have applied assumptions to the data based on our understanding of each parcel operator's operations. Our C2X estimates exclude returns pre-paid by the retailer, which we generally consider as B2C.

6.12 In contrast to letters, there is end-to-end competition in delivery of parcels in the UK, with multiple parcel operators competing for customers. In addition, some operators with a relatively limited geographic network, or without a last mile network of their own, also provide parcel services via access agreements (in which they collect, sort and inject parcels into the network of another operator, such as Royal Mail). Other operators specialise in last mile delivery in particular geographies, for example in urban centres or remote areas, on behalf of other operators. The degree and model of competition varies by segment, which we explore in more detail below.

Business to consumer (B2C) parcels segment

6.13 The business-to-consumer (B2C) segment is the largest and fastest growing segment of the parcels sector, linked closely to the growth in online shopping. This trend was amplified in 2020-21 as the Covid-19 pandemic changed behaviours and accelerated growth, with domestic bulk parcel volumes (the majority of which are B2C) increasing by around 60% compared to the previous year.²⁹⁸

Description of participants

6.14 The market dynamics in the B2C segment are more complex than in the C2X segment, due to the number of parties involved and how they interact with each other. There are at least three parties involved when a consumer purchases a retail good for delivery to their home address – the retailer, the parcel operator and the consumer.²⁹⁹

Retailer (sender)

6.15 Retailers tend to buy bulk contracts with parcel operators once they reach a certain volume.³⁰⁰ Some retailers also arrange pre-paid returns, whereby they cover the postage charge. The retailer can engage with a single or multiple parcel operators, depending on their specific needs and what they want to offer their customers. Some retailers also engage with multiple parcel operators to reduce the risk of service disruption if a carrier were to experience congestion or service failure. The retailer bears the risk of delivery up to the moment the parcel is physically given to the consumer and is liable in the case of missing or damaged delivery.

6.16 From the perspective of the parcel operator, there are advantages offered by serving retail customers, compared to C2X customers. These retailers are typically large with an online presence, and therefore tend to send large volumes of items per shipment, and on a more

²⁹⁸ Ofcom analysis based on data collected for Annual monitoring update on the postal market: 2019-20 and 2020-21. We calculate these figures by using bulk piece service shares, which are mostly B2C but also include B2B volumes. Some operators were unable to accurately distinguish between their bulk and single piece parcels. Therefore, these figures should be treated as an approximation only. We received data from Amazon, APC, DHL, DPD, DX, FedEx, Hermes, Royal Mail, Tuffnells, UPS and Yodel

²⁹⁹ Other important players in the B2C segment include online shopping platforms that bring consumers and retailers together (such as Amazon Marketplace, AliExpress and notonthehighstreet.com), and last mile carriers that provide last mile delivery services to parcel operators, mainly in the Scottish Highlands & Islands.

³⁰⁰ For Hermes, this appears to be around 150 parcels per week <https://www.myhermes.co.uk/faqs/account/i-send-a-lot-of-parcels-can-you-offer-me-a-business-or-credit-account>, last accessed 2 December 2021

frequent basis. In addition, some retailers, depending on their scale of traffic, inject their parcels directly into the carrier's network (either at the depot level or hub level) reducing costs for the parcel operator.

Parcel operator

- 6.17 Based on the delivery profile of the retailer, the parcel operator will offer different services (usually bulk) and agree a price for delivery. Therefore, pricing in the B2C segment is often bespoke and depends on a number of factors, such as, size, dimension and weight of the parcels, volume of parcels per collection, speed of delivery, sender and recipient distance from sorting centres³⁰¹, and inclusion of additional features such as proof of delivery and increased options for the recipient.
- 6.18 Retailers typically require flexibility and speed from parcel operators, and so operators have had to react by investing in automated parcel hubs, boosting their sortation capacity, and offering later acceptance times for next day delivery. In addition, despite there being no universal service obligation for 6 day a week delivery for parcels, all the main parcel operators offer Saturday delivery, with some also offering Sunday delivery.

Consumer (recipient)

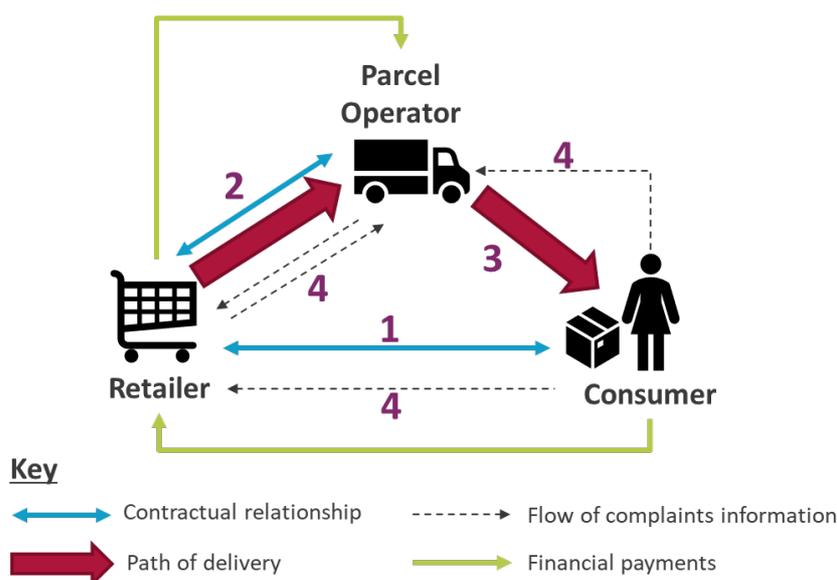
- 6.19 The consumer (of the retail good and the parcel service) will be given a price for delivery at the point of sale once the delivery destination and target delivery date are set. Depending on the item being purchased and the retailer, the consumer may have little choice about the delivery provider or service (which may impact the consumer's experience for specific deliveries).

Market dynamics

- 6.20 Figure 6.1 illustrates the interplay between retailer, parcel operator and consumer.

³⁰¹ In B2C there are geographic variations in terms of the delivery charges. Most operators have a UK-wide footprint but many have differentiated delivery charging on the basis of geographic location, as discussed below.

Figure 6.1: Market dynamics in the B2C segment



Source: Ofcom's analysis

6.21 With reference to the numbering in Figure 6.1, we summarise the market dynamics and the interplay of relationships between the three main parties:

1. Consumers purchase goods from retailers, usually with limited knowledge or influence over the parcel operator used by the retailer. The retailer and consumer enter into a contractual relationship whereby the purchased item(s) must be delivered to the consumer. It is also the retailer that determines the explicit delivery fee (if any) charged to their customer.
2. Retailers contract with parcel operators based on a number of factors, including price, speed of delivery and quality of service. These contracts will usually be large volume bulk contracts.
3. Parcel operators deliver parcels to consumers. There is no direct contractual relationship between the consumer recipient and the parcel operator.³⁰²
4. If consumers have a query or complaint with the delivery, they may seek to contact the retailer, the parcel operator or both.³⁰³

³⁰² Parcel operators must however comply with their regulatory obligations when delivering parcels to consumers, including, as set out in more detail below, their obligation under consumer protection condition 3.2.

³⁰³ Consumer protection legislation is relevant to the B2C market segment. Where the parcel company is delivering an online order, it is the retailer that enters into a direct contractual relationship with the consumer and it is the retailer's contractual responsibility to make sure the item is delivered to the consumer. Depending on the particular circumstances, consumers may therefore be able to rely on provisions of consumer protection legislation, for instance the Consumer Rights Act 2015, to seek redress directly from retailers (for example if items are lost or damaged). A Citizens Advice publication, *If something you ordered hasn't arrived*, contains guidance for consumers in these instances. Consumer protection legislation with regard to retail sales is determined by Parliament and is beyond Ofcom's remit.

Competition in the B2C segment

There are several large nationwide end-to-end parcel delivery networks

- 6.22 There are several end-to-end parcel delivery network operators competing for B2C customers in the UK. Most of these operators have nationwide network footprints. There are also some parcel operators who only serve specific areas within the UK (e.g. Menzies in the Scottish Highlands).³⁰⁴
- 6.23 In 2020-21, our estimates suggest the four largest operators accounted for more than 80% of bulk domestic parcel volumes, as set out in Table 6.2 below.³⁰⁵ [X].

Table 6.2: Estimated 2020-21 volume shares for domestic bulk parcel deliveries [X]

Differentiation in B2C delivery

- 6.24 Parcels differ in terms of size, dimensions, weight, value, fragility, and where they are being picked up from and delivered to. Different businesses also have different preferences in terms of the services they want to offer their customers (e.g. some may want basic, low cost delivery, while others may want to offer a faster, premium service). Operators have accordingly tailored their products to meet varying customers' sending needs, offering a range of services which provide different combinations of characteristics, including cost and speed of delivery, quality of delivery, and enhanced product features (such as proof of delivery, live tracking and inflight delivery options).
- 6.25 Parcel operators usually offer a broad range of services, within which some tailor their product offering to make it more attractive to particular types of B2C customers. For example:
- DPD offers products to customers that require value-add services, having introduced premium features such as by offering Sunday delivery, inflight options, and one-hour delivery windows.
 - Hermes has targeted more price sensitive customers, due to its low-cost delivery model which includes the use of self-employed couriers.
 - Royal Mail's postal network design has historically been tailored towards the delivery of small (particularly letter-boxable) items, due to its position as the universal postal service provider. This is reflected in its pricing strategy - while it sets higher prices for larger/heavier retail bulk parcels, it sets relatively lower prices for smaller/lightweight retail bulk parcels.³⁰⁶ Therefore for customers with a volume profile mainly consisting

³⁰⁴ Some of these parcel operators also deliver parcels on behalf of other operators, who collect and sort parcels from businesses which they then pass on to an end-to-end parcel operator (often Royal Mail) for delivery.

³⁰⁵ These estimates are based on the data collected as part of our annual monitoring regime. We use bulk piece service shares, which is an imperfect approximation for B2C shares as they contain B2B volumes (although most bulk volumes are B2C). In addition, some operators were unable to accurately distinguish between their bulk and single piece parcels. Therefore, these figures should be treated as an approximation only.

³⁰⁶ In its response to our statutory information request, [X].

of smaller/lightweight bulk parcels, Royal Mail has historically held a stronger position.³⁰⁷

- Yodel offers next day and two-day B2C delivery services across the UK mainland, specialising in sectors such as wine and flowers, and has recently relaunched its C2X proposition.³⁰⁸
- DX Freight, Tuffnells and Parcelforce’s delivery networks are more tailored towards serving customers sending larger and heavier items.³⁰⁹
- Amazon has developed a large scale parcel delivery operation through vertically integrating its delivery services with its position as a large online retailer (and therefore buyer of parcel services from a variety of operators). Amazon delivers both its own parcels and those of other retailers which sell items on the Amazon Marketplace platform. In addition, in June 2020, Amazon launched ‘Amazon Shipping’, which allows retailers outside of Amazon Marketplace to send parcels through the Amazon network.³¹⁰
- Some operators have tailored their networks to be able to offer (or prioritise) niche or high value services:
 - i) Safe shipping. Some specialise in the movement of delicate items (such as flowers and small electrical goods), or high value items (e.g. APC).³¹¹
 - ii) Speed. Some provide fast delivery of time sensitive, ‘mission critical’ items (e.g. DX Express).³¹²
 - iii) Locality. Some focus their operations solely on key business cities, despite most operators covering extensive parts of the UK (e.g. CitySprint).³¹³

6.26 This means that competition occurs across B2C, with some variation in market focus of parcel operators within B2C services.

There is competition across the B2C segment, including small bulk parcels

6.27 Although some parcel operators have a particular focus on some groups of B2C customers, information provided by stakeholders in response to our statutory information requests³¹⁴ indicates that several parcel operators compete for all types of parcel customers. Parcel operators confirmed that once a parcel network is set-up, they can generally carry items of any size/weight.³¹⁵ This, combined with parcel operators operating for much of the year

³⁰⁷ See Section 8 for a more detailed discussion on these types of customers. As we explain there, Royal Mail does face competitive pressure for this type of customer and there are indications of this pressure growing over time.

³⁰⁸ [Yodel website](#), last accessed 2 December 2021.

³⁰⁹ <https://www.parcelmonkey.co.uk/delivery-services/heavy-parcel-delivery>, last accessed 2 December 2021.

³¹⁰ <https://ship.amazon.co.uk/requestinfo>, last accessed 2 December 2021.

³¹¹ <https://apc-overnight.com/>, last accessed 2 December 2021.

³¹² <https://investors.dxdelivery.com/websites/dxgroup/English/1000/about-dx.html>, last accessed 2 December 2021.

³¹³ <https://www.citysprint.co.uk/about-us/national-coverage>, last accessed 2 December 2021.

³¹⁴ Responses received to our statutory information request from [redacted]

³¹⁵ Parcel operators however impose upper weight limits, which are generally determined by health and safety rules which consider the weight that can be handled by a single person or two persons.

with excess capacity levels of [redacted]³¹⁶, means that operators can typically deliver additional volumes under their existing suites of products at a relatively low cost.³¹⁷

- 6.28 Royal Mail has historically accounted for a large share of small B2C parcels. It had a competitive advantage in these parcels because they can be delivered using the same network that delivers universal service obligation (USO) parcels and letters. This position has eroded over time, and the evidence suggests that competition in this segment of the market is growing:
- a) First, alternative parcel operators have been expanding their offer of small B2C parcels. In 2019, Hermes launched a letter-boxable parcel product which seeks to compete against Royal Mail's small B2C parcels. Other parcel operators have also introduced products which cater for those customers with a small parcel profile.³¹⁸
 - b) Second, as mentioned above, Amazon has developed its own delivery capabilities (at a national scale), which has increased its ability to satisfy its own small parcel delivery needs as well as those of other retailers.
 - c) Third, analysis conducted for Royal Mail for this review suggests that alternative parcel operators have been successful at increasing their share of small B2C parcels.³¹⁹ The analysis indicates that Royal Mail's share of small B2C parcels has dropped in the period from 2016 to 2020 from [redacted]% to [redacted]% for small letterboxable items, and from [redacted] to [redacted] for small but non-letterboxable items.³²⁰

Overall, the B2C segment appears to be broadly competitive

- 6.29 The B2C segment has experienced substantial growth in recent years, and is of increasing importance to the lives of UK citizens and consumers. It has benefitted from growing investment and fast-paced product innovation. The upcoming years provide a good opportunity for growth for parcel operators, and will be important in determining how the market and competition develops. Our current view is that the B2C segment is broadly competitive, and that competition is growing for the smaller parcels where Royal Mail was historically stronger. Overall, the market is working well for consumers, as discussed further in the sub-sections below.

Consumer to business/consumer (C2X) parcels segment

- 6.30 The C2X segment is relatively small compared to B2C, but still accounted for approximately 350m parcels in 2020-21.³²¹ Our RUN research indicates that most residential users send

³¹⁶ Study conducted for Royal Mail to respond to our March CFI.

³¹⁷ Although recent unforeseen growth in parcels due to Covid-19 has reduced spare capacity in the industry, parcel operators are accelerating their network expansion plans to cope with demand growth.

³¹⁸ Yodel offers Xpress mini for parcels up to 3kg. DPD offers the Expresspak service for parcels up to 5kg.

³¹⁹ Royal Mail response to our March CFI.

³²⁰ [redacted].

³²¹ Ofcom analysis based on Annual monitoring update on the postal market: 2020-21 data. We calculate these figures by using single piece service volumes as a proxy for C2X service volumes. Some operators were unable to accurately distinguish between their bulk and single piece parcels. Therefore, these figures should be treated as an approximation only.

few parcels.³²² However, people are sending and receiving more parcels than previously as a result of the increase in online shopping, which drives sales through online marketplaces and returns of unwanted goods,³²³ both of which use C2X services.³²⁴ In 2020-21, the C2X segment grew by around 25%³²⁵, accelerated by the Covid-19 online shopping boom.

6.31 Royal Mail is the main provider of C2X services, and its product offering is heavily shaped by the USO. The USO ensures affordable and universally priced C2X parcel services are available across the UK, and as such remains an important and valued service for postal users (including for those that send parcel services to, or from, locations where the market provision of C2X services is otherwise more variable).³²⁶ Outside of Royal Mail, providers of C2X services include Hermes, DHL, Yodel and DPD - offering a range of services across weight steps with varying speeds and 'add on' features such as tracking facilities and proof of delivery.

³²² Jigsaw, 2020. [UK Postal User Research: Quantitative Research Report](#), paragraph 4.1.

³²³ We make a distinction between pre-paid returns, where the postage charge is covered by the online retailer, and non-pre-paid returns, where the postage charge is covered by the consumer. For the former, the consumer is usually restricted in terms of which parcel operator they can use. In contrast, for non-pre-paid returns the consumer is free to choose which parcel operator to use but they normally have to pay for the service. The focus of our analysis on the C2X segment, where relevant, is on non-pre-paid returns.

³²⁴ Ofcom, 2020. [Review of postal users' needs](#), paragraph 4.28.

³²⁵ Ofcom analysis based on Annual monitoring update on the postal market: 2019-20 and 2020-21 data. See footnote 323.

³²⁶ We discuss the variability in the market provision of C2X services available to different consumers in the Section 7. We explain that in some instances these can be less accessible and/or higher priced when users are sending parcels to, and/or from, Northern Ireland and the Scottish Highlands & Islands.

- 6.32 People can access C2X services in several ways. Our C2X quantitative research found that the most popular method used to purchase C2X services is via the Post Office (64%), followed by online (either directly from an operator’s website, a marketplace such as eBay, or a price comparison site such as Parcel2Go) (43%).³²⁷
- 6.33 Once purchased, there are also different ways for consumers to get their parcel into the delivery network, and their availability and convenience has been increasing over time. Some consumer pick up/ drop off (PUDO) networks provide C2X delivery services, allowing consumers to drop parcels off to return to retailers, or send parcels directly to other recipients. In recent years, operators have expanded the number of access points in their networks as set out in Table 6.3 (which shows the additional points since 2019).³²⁸ There are also now more operators offering C2X services.³²⁹

Table 6.3. Numbers of access points

	Parcel Operator	Number of access points	Access points location
Post Office	Royal Mail / Parcelforce	11,500	Post Office branches/outlets
CollectPlus	Yodel, DHL, DPD, FedEx	10,000 (+3,000)	Newsagents, convenience stores, supermarkets, petrol stations
myHermes ParcelShop	Hermes	5,400 (+900)	Convenience stores, lockers
DPD Pickup	DPD	4,500 (+2,000)	Convenience stores, pharmacies, retail shops
UPS Access Point	UPS	2,800	Convenience stores, supermarkets, petrol stations
InPost parcel lockers	InPost, DHL, Hermes	2,000 (+800)	Convenience stores, supermarkets, petrol stations
DHL Service Points	DHL	1,300 (+100)	High street/retail outlets

Source: Parcel operator websites (correct as at November 2021). In parentheses, additional access points since January 2019.³³⁰

- 6.34 In addition, some operators – including Royal Mail, DPD and Hermes – offer home parcel collection services whereby they will collect parcels from consumer properties for an additional charge to deliver elsewhere, or back to retailers in the case of returns. Consumers must pre-book their collection online and pay in advance.

³²⁷ C2X quantitative research data tables, Table 48.

³²⁸ Collect+ operate a network of 10,000 stores and since May 2020 has expanded to process parcels on behalf of a range of parcel operators including Yodel, DPD, FedEx and Amazon. Hermes operates a network of 5,000 ParcelShops including 900 lockers which are accessible 24/7. Collect+, May 2020. [About Collect+](#). Hermes, 2020. [ParcelShops: Your local Hermes parcel store](#).

³²⁹ <https://www.yodel.co.uk/news/2021/july-2021/yodel-launches-consumer-to-consumer-service-via-yodel-direct-expanding-its-offering-to-a-new-market>, last accessed 2 December 2021.

³³⁰ See Table 3.1. [Review of the Second Class Safeguard Caps](#) (2019).

6.35 As well as changes to the supply of C2X services, we also observe that people are increasingly using C2X services for different types of activity, for which consumer needs and behaviours appear to vary:

- **Social sending:** Mainly people sending parcels to family and friends.

Our C2X research found that 81% of all senders³³¹ do some form of social sending. 19% only do social sending – and of these, people are sending less frequently than for other types of sending (a median of two parcels sent for this purpose in the last year).³³² People that only do social sending (‘solus social senders’) are more likely to only use Royal Mail, with 67% using Royal Mail only (compared to the average of 37%). Moreover, in terms of reasons why they use Royal Mail, solus social senders are significantly more likely to cite reasons related to the Post Office such as accessibility, convenience or friendly staff (74% vs 68% average) and familiarity and trust with Royal Mail (81% vs 72% average).

- **Online selling:** This segment includes selling online by residential consumers or some SMEs – from occasional sellers to people that sell items online for a source of income. The most frequent type of online selling is through online marketplaces³³³, which often act as a platform for individuals (as well as small businesses), allowing them to sell newly made items (e.g. jewellery) or resell used or unwanted items.

60% of all senders have done some online selling, and these people tend to send a relatively high number of parcels for this purpose (a median of four parcels sent for this purpose in the last year).³³⁴ Online sellers are more likely to make use of competing parcel operators, with 73% using non-Royal Mail providers (compared to the overall average of 63%). When asked why sellers used alternatives, the main reasons cited were price (35%) and tracking being included as part of the service (30%).

- **Returns:** A consumer returning an item purchased from an online retailer.

On average, people that return parcels send four parcels for this purpose per year.³³⁵ 36% of senders do returns that they have arranged and paid for themselves.³³⁶ Returners are also more likely to make use of competing parcel operators, with 73% using non-Royal Mail providers (compared to the average of 63%).^{337 338}

³³¹ Our User Needs quantitative research found that around four in five people sent at least one parcel in the last 12 months. Figure 9 https://www.ofcom.org.uk/data/assets/pdf_file/0014/208220/2020-review-of-postal-user-needs-report.pdf

³³² C2X quantitative research data tables, Table 6.

³³³ This category also includes SMEs that rely on single piece parcel services to send occasional parcels (rather than bulk contracts) to customers or other businesses.

³³⁴ C2X quantitative research data tables, Table 7.

³³⁵ C2X quantitative research data tables, Table 8.

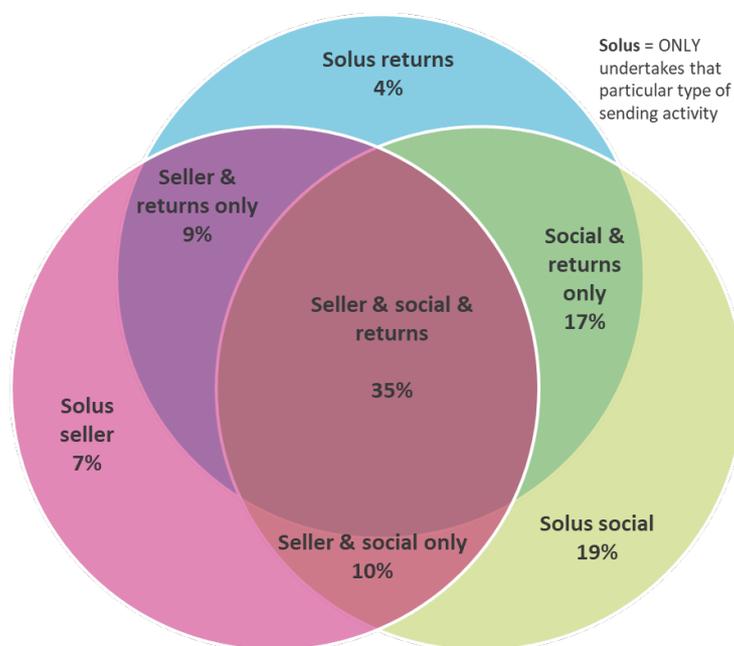
³³⁶ This excludes returns pre-paid by the retailer, which we generally consider as B2C.

³³⁷ C2X quantitative research data tables, Table 20.

³³⁸ Note, however, that this does not distinguish between ‘paid for’ and ‘non-paid for’ returns.

6.36 People rarely only do one type of C2X sending. Figure 6.4 shows that most C2X senders have carried out a combination of social sending, marketplace selling and returns, with 35% of senders doing all three.

Figure 6.4: Interaction of overall different sender types



Source: C2X research. Note: all groups are mutually exclusive, a respondent only sits in one part of the Venn diagram

Royal Mail continues to have a strong position in C2X

6.37 Royal Mail continues to deliver the majority of C2X parcels. As of 2020-21, we estimate Royal Mail’s share of domestic single piece parcel deliveries was over 70% of total volumes.³³⁹ The next closest competitor was Hermes, which accounted for approximately 10-20% of volumes, with all other operators having volumes shares below 10%. Our research data aligns with these estimates:

- Our C2X research showed that reported use of Royal Mail for parcels is significantly greater than for its competitors. When asked about which operators people used to send a parcel in the last 12 months, 82% said Royal Mail. The next most frequent was Hermes (37%).
- Similarly, our residential tracker asked participants which companies residential consumers had used to send a parcel and 76% of those said they had used Royal Mail. The next most cited competing postal operator was Hermes (20%).

6.38 The source of Royal Mail’s strong market position in C2X to date is likely due to a combination of supply and demand side advantages:

³³⁹ These figures are inclusive of Parcelforce. Ofcom analysis based on Annual monitoring update on the postal market: 2020-21 data. We calculate these figures by using single piece service shares as a proxy for C2X service shares. Some operators were unable to accurately distinguish between their bulk and single piece parcels. Therefore, these figures should be treated as an approximation only.

- **Habit, loyalty and trust.** Royal Mail has an incumbency advantage as the universal service provider, with alternative operators being relatively new in C2X by comparison. It takes time to win customers, and even where alternative operators are available, some consumers may not consider using them due to habit or satisfaction with the existing services. For example, our C2X quantitative research found that 72% of people used Royal Mail due to the familiarity and trust associated with them, and 68% of people cited Post Office convenience, accessibility and friendliness as a reason for using Royal Mail.³⁴⁰ Similarly, our C2X qualitative research found that participants did not shop around because they had ‘no idea how and where to access alternative operators’, and said that sending with Royal Mail via the Post Office was a ‘force of habit’.³⁴¹ Qualitative research from the CCP found that, across audiences, senders were exercising limited choice.³⁴²
- **Large network.** The network of post offices remains the most extensive, with 11,500 locations across the UK (CollectPlus has 10,000 and Hermes has 5,400). While alternative networks are growing, they tend to have lower coverage in rural areas compared to urban areas, meaning the Post Office (and therefore Royal Mail)³⁴³ is likely to still be the closest available to consumers in many rural areas, and some may find it difficult to access services from alternative providers.
- **Economies of scale and scope.** Royal Mail’s established collection, processing and delivery network combined with its large market share (and therefore high volumes) provide it with a significant cost advantage. This is particularly the case for small and lightweight parcels which can fit through a letter box, as these can easily share the letter foot delivery network.
- **VAT exemption.** Royal Mail’s universal services are exempt from VAT, whereas competitors’ parcel services are not.

But there is evidence of growing competition in C2X

- 6.39 Despite Royal Mail’s strong position, competition in the C2X segment has been growing in recent years.
- 6.40 Sender usage of competing parcel operators has been growing year on year. Our tracker data shows people using Hermes to send a parcel in the last twelve months is up from 15% in 2016-17 to 22% in 2020-21.³⁴⁴ DHL, DPD, FedEx and UPS have also seen higher usage for sending parcels over the past five years. Our C2X research found that 63% of C2X senders had used a supplier other than Royal Mail in the last 12 months. In addition, almost three in ten of senders identified an operator other than Royal Mail as the parcel company they use most frequently when sending parcels.

³⁴⁰ C2X quantitative research data tables, Table 29

³⁴¹ Similarly, our depth interviews found that the digitally excluded tended to be more reliant on Royal Mail and the Post Office. Royal Mail was seen in general as a trusted operator, in particular for rural area participants who found that local or familiar drivers were a real benefit.

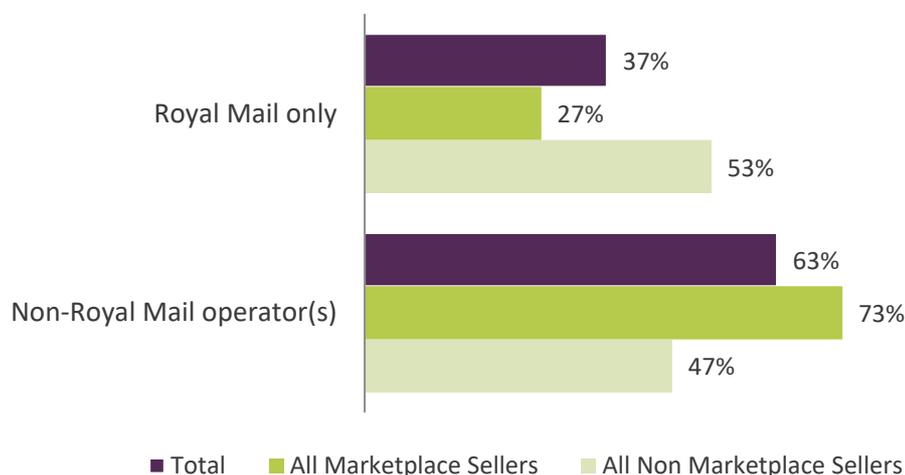
³⁴² Communications Consumer Panel, 2021. [*Delivering satisfaction? Meeting service users’ needs for parcel services in the pandemic*](#), paragraph 5.1.3.

³⁴³ Royal Mail and Post Office no longer have an exclusivity agreement, meaning the Post Office may open itself up to alternative operators in the coming years. Indeed, the Post Office has been trialling partnerships with other operators. See <https://www.onepostoffice.co.uk/secure/latest-news/general-news/post-office-partners-with-dpd-to-roll-out-click-and-collect-services/>, last accessed 2 December 2021.

³⁴⁴ Ofcom [2020-21 Residential Postal Tracker](#)

6.41 The growth in C2X use by marketplace sellers supports expansion by competitors. Our C2X research found that 73% of marketplace sellers had used a supplier other than Royal Mail in the last 12 months, which is significantly higher than for non-sellers (47%), illustrated in Figure 6.5 below.

Figure 6.5: Operators used to send a parcel in the last 12 months



Source: C2X research. Note: Senders in the non-Royal Mail operator(s) category may also use Royal Mail

6.42 Our C2X qualitative research supports these findings, and suggests that marketplace sellers can be more motivated to shop around for alternative providers:

- a) High frequency senders can be more aware that cheaper alternatives are available and so other providers can be sought
- b) Some sellers said they make use of price comparison websites such as Parcel Compare, Parcel2Go and Parcel Monkey.

6.43 There are other indicators that competitors’ position in C2X is improving:

- **Competitive offerings.** Alternative operators have been able to respond to the emergence of more price sensitive C2X senders by offering a comparable, competitively priced offering to Royal Mail at sub 2kg weight steps, as set out in Table 6.6 below (above 2kg, competing operators continue to be cheaper than Royal Mail services). Similarly, operators have also differentiated their services, to attract different customer types (e.g. in relation to tracking as discussed further in Section 7).

Table 6.6: Cheapest delivery prices across selected operators (updated 12/10/2021)

Weight Step	RM Special Delivery Guaranteed *	RM Second Class*	Hermes	DPD	DHL	Yodel
0-1kg	£8.95	£3.20	£2.95	£5.39	£5.89	£2.79
1-2kg	£11.15	£3.20	£4.40	£5.39	£5.89	£3.79

**Post Office Price. Source: Ofcom desk research. Note: Apart from Royal Mail's Special Delivery Guaranteed, all prices are for later than next day delivery (where available), for a 'non-letterboxable' small parcel sent from an access point to receiver's address. Prices are inclusive of VAT. Also note surcharges may apply to deliveries and/or collections for some postcodes.*

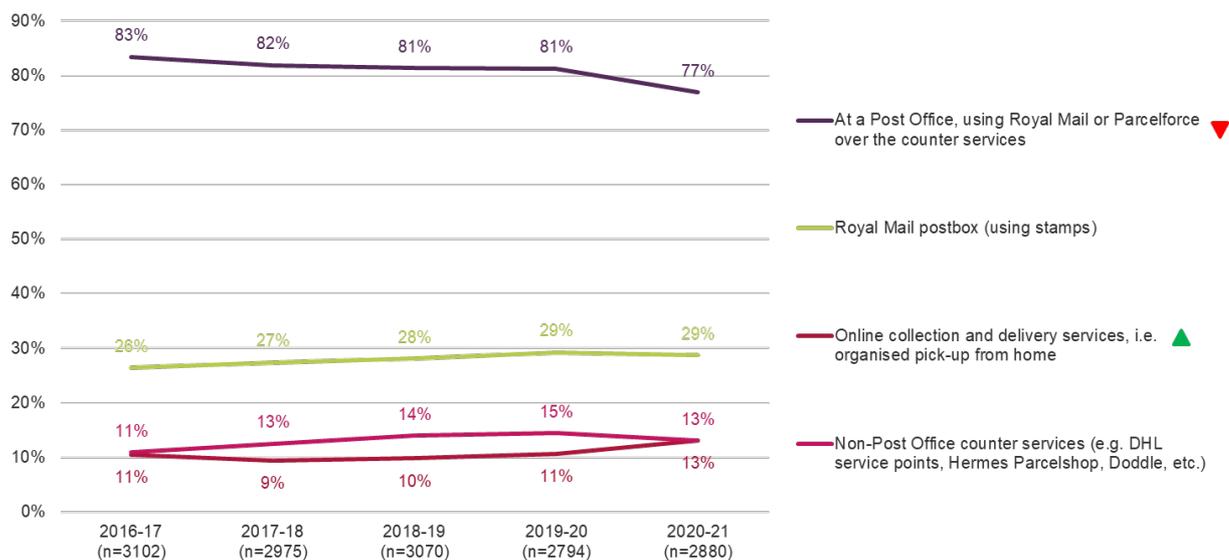
- **Brand awareness.** Historically, Royal Mail has had significant brand advantages over its competitors in C2X.³⁴⁵ However, awareness of other operators has grown significantly in recent years, driven in part by increased interactions with other operators when receiving parcels. Our Residential Tracker research found that while 94% of people had heard of Royal Mail, awareness of some other operators is now also high, at 84% for Hermes, 83% for DHL and 82% for FedEx.
- **Post Office access.** While one of the main reasons people use Royal Mail is due to the Post Office, we note that alternative operators have invested in improving accessibility and convenience of access (as discussed above), reducing potential barriers to switching.³⁴⁶ Our recent Residential Tracker research also suggests people are becoming more familiar with other methods. As shown in Figure 6.7, the proportion of people citing using the Post Office to send parcels has declined slightly from 83% in 2016-17 to 77% in 2020-21, while online methods have slowly increased since 2017-18.³⁴⁷ Similarly, our C2X research found that 36% of senders did not use the Post Office to purchase postage and/or to dispatch parcels in the last year, with marketplace sellers significantly higher at 44%.

³⁴⁵ Ofcom, 2019. [Review of Second Class safeguard caps](#) - Statement, paragraph 3.63.

³⁴⁶ Royal Mail and Post Office no longer have an exclusivity agreement, meaning the Post Office may open itself up to alternative operators in the coming years.

³⁴⁷ The 2020-21 decline in Post Office usage may in part be explained by increased caution and/or limited opening hours as a result of Covid-19.

Figure 6.7: How parcels are sent - Over the past year, usage of the Post Office to send parcels has dropped, while online collection/pick-up has become more popular



Source: Residential Postal Tracker

Summary

6.44 Overall, competition appears to be gradually developing in the C2X segment.³⁴⁸ While Royal Mail still retains significant competitive advantages, alternative operators have capitalised on the increased diversity of senders to increase their usage in C2X. We expect competition to continue to develop as more people become familiar with other operators and other methods of accessing C2X services.

Our assessment of how well the parcels market is working for consumers

Our approach

6.45 Since publishing the March 2021 CFI we have gathered evidence to inform our assessment of how well the parcels market is working for consumers. We draw on our consumer research (explained above) and information gathered from stakeholders (including from the responses to the CFI and information requests).

6.46 While this is an overall assessment of the parcels market (covering both the C2X and B2C segments), we do highlight important differences in consumer experience and research findings between the B2C and C2X segments. This is particularly relevant when discussing differences in experience between parcel senders and receivers.

³⁴⁸ Jigsaw, 2020. [UK Postal User Research: Quantitative Research Report](#), Figure 9.

Stakeholder responses to our March CFI

- 6.47 We received responses from stakeholders to our CFI, including from parcel operators, industry bodies and consumer groups.
- 6.48 Parcel operators were generally of the view that the parcels market is working well for consumers. Most said the market was highly competitive and therefore parcel operators already have incentives in place to identify and correct issues with deliveries and customer services as soon as they arise. For example, Royal Mail said that competition is leading to continuous innovation and a reduction in prices across the sector (which benefits consumers).
- 6.49 By contrast, consumer groups said that the parcels market is not working as well as it should, and that consumers are not benefitting from competition. For example, Citizens Advice said that consumers do not have the information and choices available to make the parcels market truly work for them. It identified multiple issues including parcels arriving late, being left in insecure locations and not being delivered even when people are home, reflecting a lack of reliability and security for consumers in both B2C and C2X services. It raised particular concerns for those who are time-poor, and those with specific access needs who rely on parcel services as an essential alternative to physical retail.
- 6.50 Generally, consumer groups said that regulation and consumer protections have not kept pace with rising parcel volumes, causing harm to consumers.

Competition is driving innovation in the parcels market

- 6.51 As explained above, there is end-to-end competition in the provision of parcels services in the UK. This has fuelled investment and innovation in the parcels market to the benefit of all users (C2X and B2C) as the market adapts to meet changing consumer demands. For example:
- **Improvements in the accessibility and convenience of accessing parcel services**, e.g.
 - with the expansion of consumer ‘pick up/ drop off’ locations (PUDOs). These provide both C2X and B2C services, allowing people to send, collect and return parcels from collection points, such as convenience stores or train stations. In addition, there are now more access methods available for C2X and B2C services, such as parcel lockers.
 - Home parcel collection services, whereby operators will collect parcels from the homes of consumers to deliver to other consumers, or back to retailers in the case of returns.
 - **Developments in proof of delivery (in addition to signature on delivery)**, e.g.
 - SafePlace Photos, which provides the consumer and retailer with photographic evidence of place of delivery.
 - ‘Geo fencing’, which provides a location of a delivery within a map, within a specified radius.

- **Improvements to consumer experience / control**, e.g. nominated delivery windows; inflight diversion options; and the ability for consumers to specify delivery preferences.

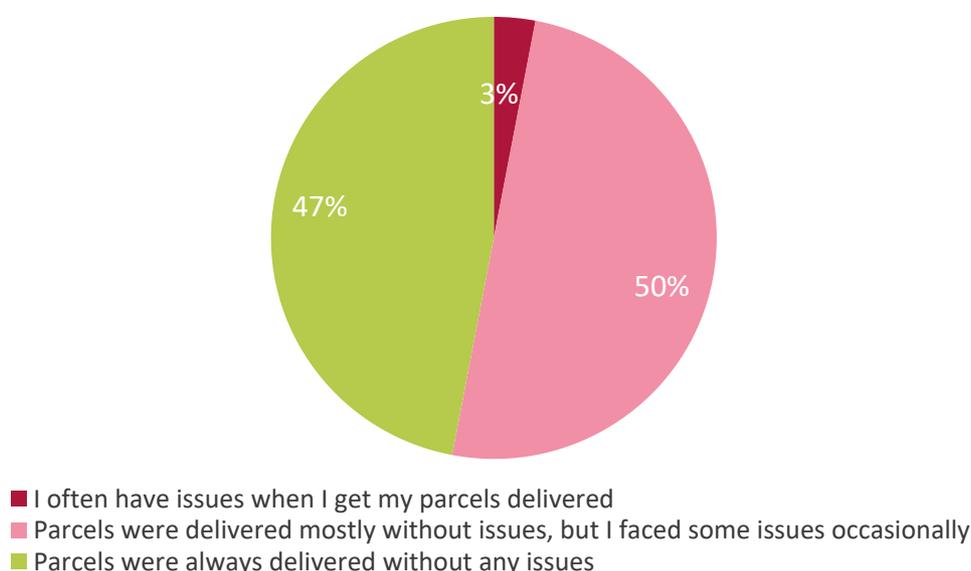
6.52 There is also some evidence to indicate that this competition between parcel operators is driving pricing pressures. Our annual monitoring update data shows that the average unit revenue across all domestic parcels in 2020-21 was £2.63, 7.8% lower than the 2019-20 average of £2.85 (although note that the reduction in average unit revenues may also be driven by a change in the volume mix rather than only a reduction in price).³⁴⁹

While many delivery issues occur, half of consumers told us their parcels were always delivered without any issues

6.53 Around four billion parcels are now received each year in the UK (more than ten million a day). Our B2C parcels consumer research found that, on average, users received around 18 parcels in the last three months, with 35% receiving parcels every week. Our C2X research found that people sent on average seven parcels in the past year.

6.54 Despite this significant volume of parcels, most people say that they do not experience any issues with parcel deliveries or only experience issues occasionally. In the context of receiving parcels, our B2C parcels consumer research found that in the three months leading up to the research, half said parcels were delivered mostly without issues, and just under half said parcels were delivered without any issues, as shown in Figure 6.8. Only 3% of respondents said they often experienced issues with parcel deliveries.

Figure 6.8: issues when getting parcels delivered in the last three months



Source: B2C parcels consumer research; Base: All respondents

³⁴⁹ Ofcom, December 2021. [Annual Monitoring Update](#), paragraph 4.18.

6.55 However, when prompted with a list of issues with deliveries, 64% of parcel receivers recognised they had experienced at least one.³⁵⁰ As set out in Figure 6.9, the main issues experienced were parcel delays (31% of all respondents), damaged packaging (18%), parcel left exposed to atmospheric conditions (17%) and parcel not being delivered (16%).

Figure 6.9: Experienced issues with deliveries in the last three months (Top 10 issues displayed)



Source: B2C parcels consumer research; Base: All respondents

6.56 For senders, our C2X research found that, when prompted with a list of issues around sending a parcel, 50% said they had experienced at least one. The most frequent issues were time taken for delivery not meeting expectations (26%), parcel delivered to wrong address/place or getting lost (23%), and incorrect tracking information (23%).

³⁵⁰ We note similar research findings from Citizens Advice, which finds 71% of consumers claimed to have experienced a parcel delivery problem. The most frequent issues identified were having to stay home to receive parcels, parcels arriving late, drivers leaving parcels or slips before they can get to the door, and deliveries being left in insecure locations. Citizens Advice response to our March CFI, 7.9-7.10.

Figure 6.10: Issues with any supplier when sending parcel in the past 12 months



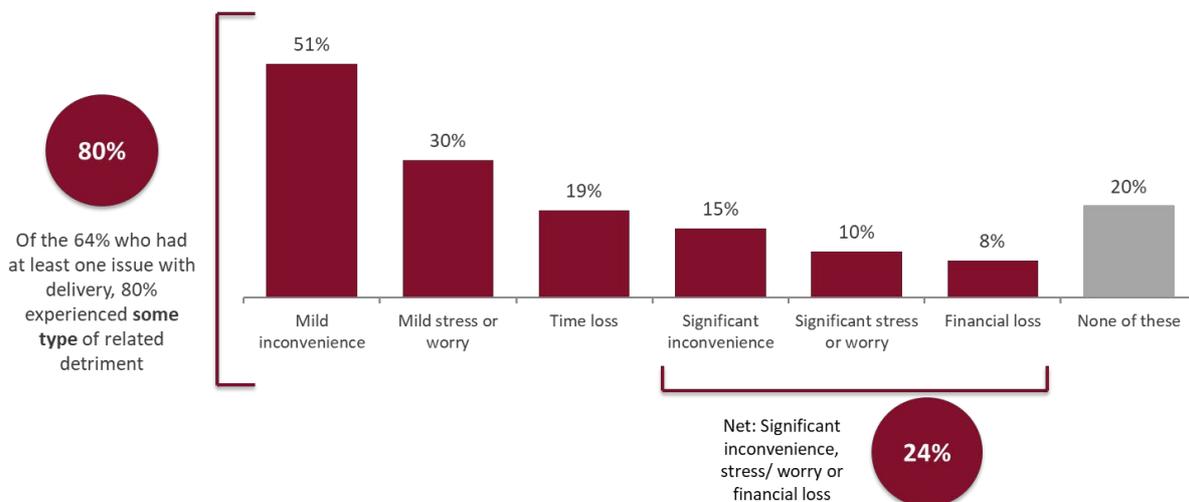
Source: C2X research; Base: All respondents

6.57 In addition, the C2X research found variation in issues experienced by senders across suppliers. Users of Royal Mail were significantly less likely to have experienced an issue (43%) compared to those using other suppliers (average of 64%).

When delivery issues do occur, they have a limited impact on most consumers

6.58 Most people only experienced mild inconvenience or stress as a result of a parcel delivery issue. Our B2C parcels consumer research found that 20% of receivers who had a delivery issue did not experience detriment. While 80% with a delivery issue experienced some type of detriment, half of them reported experiencing mild inconvenience, 30% faced mild stress of worry and 19% lost time.

Figure 6.11: Impact experienced in last three months



Source: B2C parcels consumer research. There were participants that had experienced multiple impacts; hence the sum is greater than 100%.

- 6.59 This finding is supported by other parts of the research that also suggest some delivery issues do not cause significant detriment to consumers. Among receivers who experienced a delivery issue but did not make contact, 65% said this was because they did not consider it to be a sufficiently big problem. For senders, the C2X research found that 33% did not contact the parcel operator after experiencing an issue with a parcel delivery. Where senders did not raise complaints or contact a provider, for many this was because it was not a major issue (21%), or the problem was sorted without needing to complain (23%).
- 6.60 We also note that a simple and straightforward complaints process which facilitates the fair and prompt settlement of an issue can help reduce the overall negative impact from a delivery issue. Of those that did make contact about an issue, our B2C parcels consumer research found that over two thirds said the issue was resolved to satisfaction. For senders, our C2X research found that just under one in ten said the issue was not resolved at all (although a significant proportion of issues were not fully resolved, which we discuss further below).

Overall consumer satisfaction with parcel services is high

- 6.61 Although issues do arise, satisfaction with parcel services is high. For senders, our C2X research data finds that the majority are satisfied with the parcel operators they have used. 89% of those who used Royal Mail were satisfied – the highest of all operators – compared to a mean average of 72% for other operators.
- 6.62 In the context of receiving parcels, there is variation in satisfaction with delivery companies. Our B2C parcels consumer research data shows that the net satisfaction for delivery companies was highest for Amazon (89%), DPD (85%), and DHL (81%) and lowest for Hermes (57%) and Yodel (61%). In all cases the majority were satisfied.

- 6.63 In addition, qualitative research from the Communications Consumer Panel (CCP) found that, in the context of sending parcels, participants overall felt neutral or positively about parcel sending services.³⁵¹ Parcels were described as tending to arrive at their destination in an acceptable timeframe and in good condition. However, consumers not exercising choice suggests that more could be done to ensure consumers are getting a value for money and affordable service.
- 6.64 The CCP also found that, in the context of receiving parcels, participants felt highly satisfied with their experiences. Consumers were particularly impressed with the reliability of services despite increased demand.

While overall the market appears to be working well, we have found some specific areas of concern

- 6.65 While the majority of consumers make contact with the parcel operator and/or retailer when they experience a delivery issue, our research does provide some evidence of problems with the **complaints process**. In particular:³⁵²
- a) Difficulties making a complaint: Our C2X research found that around a quarter of senders found it difficult to make a complaint or contact parcel operators;
 - b) Complexities with the process itself: Our B2C parcels consumer research found the experience of the process for resolving issues varied widely between parcel operators;
 - c) Unsatisfactory outcomes: Our C2X research found that 9% of the complaints described by senders were not resolved at all, and more than 40% were only partly resolved.
- 6.66 In addition, while many millions of parcels are delivered without issue, the research uncovered some concerns around the **safety and security of parcels**. Our B2C parcels consumer research found that almost one in five experienced damaged packaging (18%), 17% experienced a parcel being left exposed to atmospheric conditions and 16% experienced their parcel not being delivered.
- 6.67 **Users with disabilities** were more likely to have experienced significant issues. Our B2C parcels consumer research found that almost one in three that had a delivery issue experienced significant detriment, compared to one in five for consumers without disabilities.

Provisional conclusion

- 6.68 Overall, the evidence suggests that the parcels market (including the USO) is working well for customers, resulting in generally high levels of satisfaction. Increased competition in

³⁵¹ Communications Consumer Panel (CCP) (April 2021), [*Delivering satisfaction? Meeting service users' needs for parcel services in the pandemic*](#), 5.1.1.1, 5.13 and 6.1.1.

³⁵² In its response to our March CFI, Citizens Advice set out its research which found that 76% of consumers took no action after their latest parcel delivery problem, with 32% not taking action because they did not think it would make a difference and 12% because they did not have time. Citizens Advice response to our March CFI, Table 3.

both the B2C and C2X segments is providing benefits to consumers in the form of increased investment and innovation.

- 6.69 However, we have identified evidence of specific areas of concern. First, the complaints process appears to be a potential barrier to raising issues when they occur and is more difficult to navigate through than it should be. Second, a significant minority of customers do experience more material detriment, particularly those with disabilities. We discuss these areas in more detail in the following sections.

Improvements in complaints handling are needed

Our evidence and research have identified problems with the handling of complaints by parcel operators, leading to consumer harm. We expect parcel operators to make substantial improvements in customer service and complaints handling.

With the increasing importance of parcel deliveries to consumers across the UK it is crucial that parcel operators have appropriate processes and systems in place to deal effectively and efficiently with consumers when deliveries go wrong.

We are proposing new guidance to operators (including Royal Mail) on how complaints should be managed, and the information to be kept to ensure compliance on complaints handling. Our proposed guidance applies to consumer complaints relating to B2C and C2X parcel services. The information that operators should collect on complaints levels and customer satisfaction will also enable enhanced monitoring and scrutiny of operators' performance.

We will monitor operators' performance in these areas and may consider enforcement action or additional regulation, as appropriate, should it be necessary to protect consumers.

Introduction and background

- 6.70 Customers of parcel services should receive a service that meets their needs. Around four billion parcels are now received each year in the UK (more than ten million a day) and while the majority of deliveries are problem free and overall satisfaction is high, the service provided in some cases can be well below consumers' expectations.
- 6.71 Where consumers have a negative experience and have not received a satisfactory level of service, it should be simple and straightforward for them to complain and receive appropriate redress (where relevant).
- 6.72 Our regulation aims to protect consumers who may have negative experiences by imposing consumer protection conditions (CPs) on all parcel operators. CP 3, introduced in 2012 and modified in 2017, deals with complaints handling and redress.

- 6.73 CP 3.2 requires all postal operators, including parcel operators³⁵³, to establish, make available and comply with transparent, simple and inexpensive procedures for dealing with complaints of consumers of postal services, which facilitate the fair and prompt settlement of disputes. For the purpose of CP 3.2, a ‘consumer’ is any person who uses postal services either as a sender or an addressee.³⁵⁴
- 6.74 In addition to CP 3.2, Royal Mail is subject to more specific requirements under CP 3.3 in relation to complaints from consumers of universal services. CP 3.3 sets out, amongst other things, a requirement to establish a complaints handling procedure which complies with certain detailed conditions; a requirement to publish quarterly reports on complaints volumes; and a requirement to be a member of a qualifying redress scheme.³⁵⁵
- 6.75 Given the importance of these processes, we have undertaken consumer research to better understand the consumer experience of contacting parcels operators or retailers when they have delivery issues. We present key findings in relation to consumer contacts and complaints in this section.

For C2X parcels, consumer contacts and complaints are managed by the parcel operator

- 6.76 For C2X services the individual residential consumer, marketplace sender or small business sending the item will be entering into a direct relationship with the parcel operator. The sender and/or recipient will need to deal directly with the parcel operator to resolve delivery issues. These consumers will therefore rely on the quality of the complaints and contact handling services put in place by parcel operators.

Important role for the retailer for online shopping (B2C) delivery problems

- 6.77 Unlike C2X services, the retailer plays a key role in online shopping deliveries. For goods purchased online (B2C services) a consumer’s contract is with the retailer the customer bought the goods from. It is the retailer who is responsible for the goods until they are in a customer’s physical possession.³⁵⁶ If goods are not delivered to the customer (for example are lost or stolen) or the goods that are delivered are damaged, it is ordinarily the retailer who is legally responsible for resolving these issues.³⁵⁷
- 6.78 Given this legal position, it will often be more appropriate for the consumer to contact the relevant retailer in the first instance. However, in practice it can be unclear to a consumer whether they should contact the retailer or the parcel operator delivering their parcel. Furthermore, in some cases the consumer will complain to the parcel operators about the delivery service they received (either in addition to, or instead of, contacting the retailer).

³⁵³ For the purpose of CP 3.2 a ‘postal operator’ is defined by reference to s.27(3) of the PSA 2011: a person who provides (a) the service of conveying postal packets from one place to another by post, or (b) any of the incidental services of receiving, collecting, sorting and delivering postal packets.

³⁵⁴ CP 3.1.2(g).

³⁵⁵ For a more detailed description of the requirements set out in CP 3, please see Legal Annex 11.

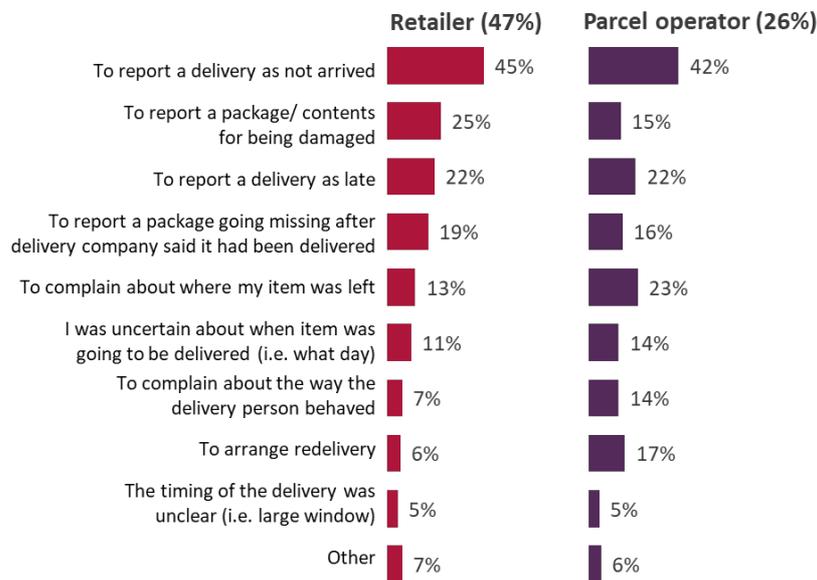
³⁵⁶ Or in the possession of someone appointed by the customer to accept them, or delivered to the customer’s nominated safe place.

³⁵⁷ Consumers’ statutory rights and remedies for goods contracts are set out in Chapter 2 of Part 1 of the Consumer Rights Act 2015. In relation to deliveries, see in particular section 28 of that Act.

In these situations, it is important that the parcel operator’s contacts and complaints process works well for recipients of B2C services (as parcel operators will need to ensure compliance with the obligation set out in CP 3.2).

6.79 Our research found that in practice for those that reported an issue with a B2C delivery, 47% of consumers contacted the retailer, compared to 26% who contacted the parcel operator. As set out in Figure 6.12 below, the consumer is around twice as likely to contact the parcel operator (than the retailer) for issues such as complaining about where the parcel was left, complaining about the behaviour of the delivery person or to arrange redelivery.

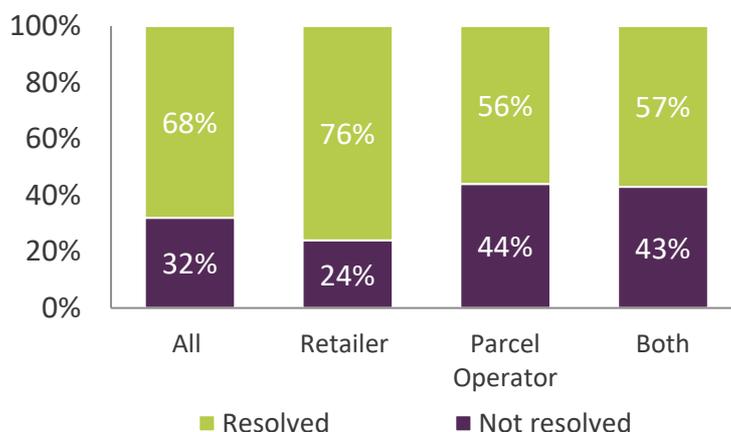
Figure 6.12: Why people contacted the retailer or parcel operator



Source: B2C parcels consumer research

6.80 We also found that retailers were more likely than parcel operators to have resolved the issue, with three quarters of consumers who contacted retailers feeling satisfied. By contrast, of those consumers who lodged a complaint with a parcel operator, 44% were not resolved to their satisfaction.

Figure 6.13: Who consumers complained to and whether the issue was resolved (B2C)



Source: B2C parcels consumer research

6.81 These findings demonstrate the importance of the retailer in the B2C complaints process, but also that parcel operators’ complaints and contacts handling processes need to work well for B2C services, as well as for C2X services.

Important distinction between consumer contacts and consumer complaints

6.82 In practice, consumers of parcel services will often want to contact the parcel operator and/or the retailer about their delivery to find out more information about their delivery (rather than to make a complaint). We also appreciate that with four billion parcels delivered a year the number of customer contacts could be extremely large and they will need to be managed cost effectively by parcel operators.

6.83 Our regulation focuses on complaints and ensuring customers have fair and prompt processes for dealing with delivery problems when they arise, as this is where consumer detriment has occurred. A complaint is clearly defined in our regulations as an expression of dissatisfaction.³⁵⁸ We expect parcel operators to be able to distinguish complaints from contacts and deal with them appropriately.

Stakeholder responses to our March CFI

6.84 The consumer advocacy bodies highlighted a series of problems faced by consumers when making a complaint. These included finding it difficult to find contact information for an operator, and then struggling to reach anyone who could help. They had also found evidence that some operators were slow to respond to complaints, or consumers had to contact them several times to get a response.³⁵⁹

³⁵⁸ In CP 3 “complaint” means any expression of dissatisfaction made to a postal operator, related to one or more of its products or services or the manner in which the postal operator has dealt with any such expression of dissatisfaction, where a response is explicitly or implicitly required or expected to be provided.

³⁵⁹ Citizens Advice response to our March CFI, page 84-86; Consumer Council Northern Ireland response to our March CFI, page 11.

- 6.85 Citizens Advice highlighted that in the case of online shopping, consumers are often unsure whether to contact the retailer or the parcel operator.³⁶⁰ Citizens Advice Scotland (CAS) highlighted its research which found that many respondents who had made a complaint to an operator were either quite or totally dissatisfied with the response.³⁶¹
- 6.86 The consumer advocacy bodies advocated the extension of more detailed complaints-handling rules to all parcel operators. These more detailed rules, set out in Consumer Protection Condition 3.3, currently apply to Royal Mail only. CAS argued that this would provide consumers with a “simple and understandable complaint procedure, no matter who the operator is.”³⁶² Citizens Advice said that this would help to bring operator complaints processes in line with best practice and provide complaints data for scrutiny.³⁶³
- 6.87 We are also aware of a number of reports into this issue published by the consumer advocacy bodies.³⁶⁴ Most recently, Citizens Advice published a comparison of the five largest parcel operators’ performance based on criteria including customer problems and customer service.³⁶⁵
- 6.88 Parcel operators and industry bodies, including UK Mail and the Mail Competition Forum, argued that the competitive nature of the parcels market was sufficient to ensure good customer service and effective complaints-handling processes.³⁶⁶ Hermes argued that it was fair that Royal Mail had more detailed requirements placed on it given its role as universal service provider. It added that it was investing in transforming its customer services, and highlighted that most customer contacts were seeking information on a parcel’s location and do not result in a complaint.³⁶⁷
- 6.89 Royal Mail argued that there was no need for any changes to the current consumer protection requirements, and that instead we should focus on increasing monitoring of the existing regulations across the industry.³⁶⁸ If the more detailed rules were to apply to all parcel operators, Royal Mail highlighted the need for consistency in reporting definitions to allow for meaningful comparisons.³⁶⁹ Whistl said more detailed rules should not apply to parcel operators who use others to effect their delivery, as they are dependent on the delivery quality of those end-to-end parcel operators.³⁷⁰

³⁶⁰ [Citizens Advice](#) response to our March CFI, page 88.

³⁶¹ [Citizens Advice Scotland](#) response to our March CFI, page 15.

³⁶² Citizens Advice Scotland response to our March CFI, page 16.

³⁶³ Citizens Advice response to our March CFI, page 92.

³⁶⁴ These include Citizens Advice, 2021. [Sorry we missed you](#); Citizens Advice, 2019. [The market which isn’t delivering](#); Citizens Advice, 2019; [Best Practice Guide for Parcel Complaints](#). Citizens Advice, 2019. [Parcel Complaints Journeys](#). Consumer Council Northern Ireland, 2018. [Stamp out complaints](#).

³⁶⁵ Citizens Advice, 2021. [Parcels league table](#) and [methodology](#).

³⁶⁶ [UK Mail](#) response to our March CFI, page 6; [Mail Competition Forum](#) response to our March CFI, page 11.

³⁶⁷ [Hermes](#) response to our March CFI, page 7.

³⁶⁸ [Royal Mail](#) response to our March CFI, page 74.

³⁶⁹ Royal Mail response to our March CFI, page 74.

³⁷⁰ [Whistl](#) response to our March CFI, page 14.

We have found evidence of problems with the complaints process

6.90 While the majority of consumers that make complaints have their issue resolved (as described above), there is a significant minority for whom this is not working well.

6.91 Across our B2C and C2X research, the issues raised with the complaints process can broadly be grouped into the following categories:

- Barriers to being able to make a complaint in the first place;
- Complicated, unclear and slow complaints process; and
- Outcomes of the complaint process were too often unsatisfactory for customers.

6.92 We now look at each of these issues in turn.

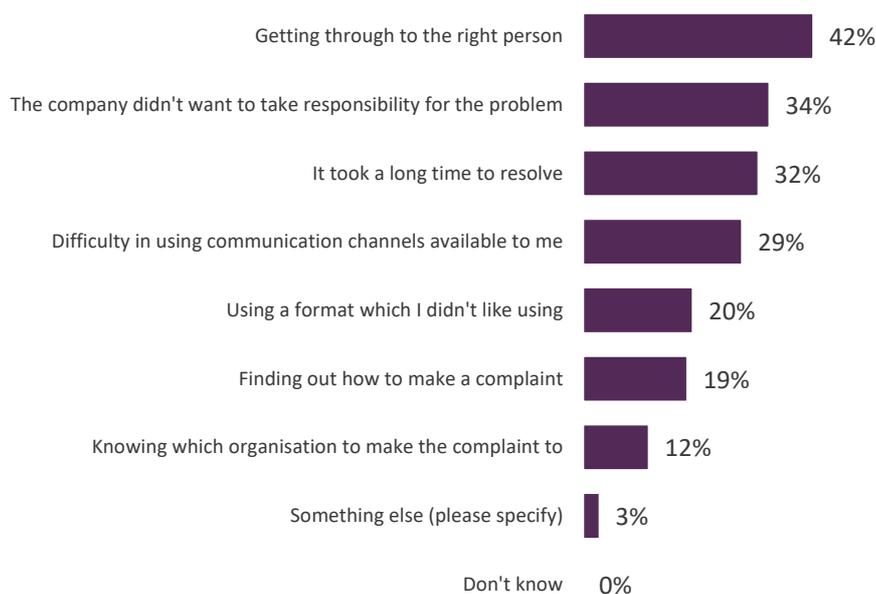
Barriers to being able to make a complaint in the first place

6.93 Our research found that some consumers find it hard to find the right contact details to make a complaint, or raise an issue, with their parcel operator. This was a common issue for both B2C and C2X services.

6.94 Our B2C parcels consumer research found that for some large parcel operators only 25% of consumers who want to get in touch with the operator about a delivery issue found it easy to find the operator's contact details. Even the operators that scored better on this measure still only had 55-59% of consumers who would consider it easy to find the appropriate contact details. This suggests that many people who experience problems with their delivery are forced to spend too much time searching for contact details when it should be easy for them to make contact.

6.95 In addition, our C2X research found that around a quarter of senders found it difficult to make a complaint or contact parcel operators. In terms of the nature of problems people have when contacting a parcel operator, we found that getting through to the right person was the most widely experienced difficulty, as set out in Figure 6.14 below. Nearly 20% of customers also had difficulty finding out how to make a complaint, and 29% had difficulty using the communication channel made available by the operator.

Figure 6.14: Difficulties experienced when making a complaint/ contacting a supplier (C2X)



Source: C2X research

6.96 Uncertainty around where to go/who to complain to was also cited by 19% of those who had a delivery issue but did not contact or make a complaint as the reason for not doing so in our C2X research.

6.97 These findings are broadly consistent with Citizens Advice’s research on consumer experience in the parcels market. It found that for consumers sending parcels more than 40% who had a problem said they found it difficult to find contact information for the parcel delivery company.³⁷¹

A complicated, unclear and slow complaints process

6.98 Once a complaint has been made, the process to be followed should be clear, transparent and easy to navigate for a consumer. A parcel operator should actively and promptly progress the complaint that has been raised and seek to find a solution that is satisfactory to the complainant. Communication with customers should also be clear, easy to understand and timely. Our consumer research suggests this often is not the experience of consumers.

6.99 We found the experience of the process for resolving issues varied widely between parcel operators. As set out in Table 6.15 below, we found that consumers had both good and bad experiences with the resolution process, depending on which operator they made contact with.

³⁷¹ Citizens Advice response to our March CFI, table 3, 6.31, 7.18.

Table 6.15: Consumer experience in resolving delivery issues

% of consumers...	Range of responses, by operator (lowest-highest)
...finding the process clear and easy to follow	25-64%
...saying the process for resolving the issues took a long time	28-59%
...that needed to make multiple contacts to resolve their delivery issue	33-57%

Source: B2C parcels consumer research

- 6.100 As Figure 6.14 shows, for C2X consumers, 34% of those who experienced difficulties in making a complaint /contacting the parcel operator found that the company contact did not want to take responsibility for the problem; and 32% said it took a long time to resolve the issue.
- 6.101 Our C2X qualitative research also uncovered individual examples of consumer experiences of the complaint handling process, which fell significantly short of their expectations for customer service.³⁷²

Outcomes of the complaints process are too often unsatisfactory

- 6.102 Parcel operators should work to resolve complaints from customers in a fair and timely manner, with the aim of reaching a resolution that is to the satisfaction of the consumer. Our research found potential problems with the level of consumer satisfaction with the resolutions provided by operators, and significant variation between operators.
- 6.103 Our C2X research found that 9% of complaints raised by senders were not resolved at all, and 42% were only partly resolved.³⁷³
- 6.104 The C2X research found that where financial compensation was sought from parcel operators following an issue, many were not satisfied with the outcome. Almost half (47%) of people who contacted a parcel operator about an issue did not receive the financial redress they were expecting.³⁷⁴ This may point to problems with operators’ transparency and communication over the level of compensation consumers are entitled to when deliveries go wrong.
- 6.105 Our B2C parcels consumer research found that when consumers complained to parcel operators about delivery issues, there was a large disparity between operators regarding satisfaction of outcome. For example, when asked if they were satisfied that their complaint was handled fairly, the percentage of complainants agreeing ranged from 29% for one operator to 71% for another.
- 6.106 Furthermore, expectations around the outcome prevented some consumers from contacting the parcel operator after experiencing an issue with parcel delivery in the first

³⁷² C2X research – slide 102.

³⁷³ C2X research – slide 101.

³⁷⁴ C2X research – slide 103.

place. Our C2X research found that 37% of consumers of those who did not contact or complain when they experienced a delivery issue said it *'wouldn't change anything anyway'*. Similarly, our B2C parcels consumer research found that among those who did not contact either the retailer or parcel operator after experiencing an issue, 23% said they did not think either of them would do anything about it, and 7% said they have tried contacting the delivery company before and nothing happened.

Provisional conclusion

- 6.107 The consumer experience of the complaints handling process appears to vary from one operator to another, both in terms of the outcome and the experience of the process itself. While some operators are performing better than others, we are concerned that in some cases performance is falling short of providing a simple, transparent process for settling consumers disputes fairly and promptly. We therefore propose to take targeted and proportionate steps to secure better outcomes for consumers.

Our proposals

- 6.108 As explained above, we already have a condition in place that requires parcel operators to have simple, transparent and inexpensive processes and procedures for the fair and prompt settlement of consumer disputes. We consider the principles set out in this condition remain appropriate for complaints and redress processes, and if applied effectively would address the issues we have identified above.
- 6.109 We recognise that different parcel operators have adopted different business models to compete to win customers, and the resulting differentiation and choice in services available can benefit consumers. This may, partly, explain some of the variations in complaints performance we have found between major parcel operators. However, regardless of the specific business model, all operators need to provide a resolution process that is sufficiently effective to ensure the prompt and fair resolution of disputes. As described above, our evidence and research have identified problems with the way complaints are being handled and we have found that in practice, some operators may be falling below the necessary standards.
- 6.110 We are therefore proposing ***new guidance on complaints handling processes for parcel operators***. The guidance proposes to describe the steps that we would expect all parcel operators to take to ensure compliance with our existing Consumer Protection Condition 3.2 (see Annex 7 for our proposed guidance for parcel operators on complaints handling).
- 6.111 As set out above, Royal Mail is subject to the complaints handling requirements of both CP 3.2 and CP 3.3. While the specific requirements of CP 3.3 only apply in relation to universal services, Royal Mail is subject to CP 3.2 for complaints regarding any 'non-USO' services (either in the C2X or B2C segment). Our research (which encompassed the services provided by Royal Mail) found evidence of problems with the consumer experience of complaints processes across the C2X and B2C segments. Our proposed guidance would apply to Royal Mail alongside other parcel operators providing parcel services within the C2X and B2C segments.

- 6.112 One of Ofcom’s regulatory principles is that Ofcom will regulate in a transparent manner.³⁷⁵ The objective of our proposed guidance is to ensure that parcel operators properly understand their obligations under CP 3.2. Though any potential enforcement action will turn on the specific facts and merit of the case, our intention is that we will have regard to our proposed guidance, and the steps taken by parcel operators in line with that guidance, when investigating potential non-compliance with CP 3.2.
- 6.113 Given the problems we have identified on complaints handling, and the growth in the parcels market over recent years, we also intend to investigate further what data will best help us to monitor complaints handling performance and parcels market issues more widely. Our proposed guidance describes the data and records we would expect operators to retain to monitor complaints handlings effectively. We will also engage further with major operators and consumer groups to consider what available data will be most useful to monitor improvements and identify any emerging issues in the parcels market more generally.
- 6.114 Our expectation is that these measures and increasingly active monitoring of parcel operators’ approaches to resolving complaints will improve outcomes for customers. If significant improvements are not made, we may consider enforcement or further regulation, as appropriate.
- 6.115 We explain and assess these proposals in more detail in the following section.

Guidance on complaints handling – more detail on areas where we expect to see improvements

- 6.116 Our proposed guidance is intended to describe the steps operators would be expected to follow when handling consumers complaints. The objective of the guidance is to ensure compliance with CP 3.2, by clearly setting out the steps we would have regard to if, and when, we were to investigate compliance with CP 3.2.
- 6.117 Our proposed guidance covers two main areas:
- ensuring clear and easily accessible complaints channels for consumers; and
 - resolving complaints through fair, transparent, and effective processes.

Clear and easily accessible complaints channels

- 6.118 Our research found that some consumers find it difficult to raise complaints with parcel operators, for example because they cannot find the right contact details. By setting out the need to have clear and easily accessible complaints channels, our proposed guidance is aimed at ensuring that consumers do not face any unnecessary barriers when raising complaints.
- 6.119 We would expect parcel operators to take steps in ensuring that consumers are clear as to who they should contact, and what contact channels they could use to make a complaint.

³⁷⁵ Section 3(3) of the CA 2003.

This should ensure processes and procedures are simple and transparent and help consumers when raising complaints with parcel operators.

- 6.120 It is essential that contact channels offered by parcel operators to make a complaint (or raise issues) are easily accessible to all consumers (including consumers with additional accessibility needs). The obligation to have transparent, simple, and inexpensive complaints procedures, as set out under CP 3.2, should benefit all consumers. We would expect parcel operators to take steps in ensuring that the contact channels they make available are also accessible to consumers who have additional needs (e.g. consumers with hearing or sight impairment).

Fair, transparent, and effective complaints processes

- 6.121 Our research found that the experience of the process for resolving issues varied widely between parcel operators. In many instances, consumers found the process they had to follow was unclear and took a long time, with them having to contact a parcel operator multiple times for the issue to be resolved.
- 6.122 Our proposed guidance sets out the steps we would expect operators to take to make complaints processes and procedures effective and transparent. We would expect operators to take active steps for the prompt and active management of complaints as well as ensuring clear and timely communications with the complainant.
- 6.123 We consider that it would be reasonable, for example, to expect operators to promptly inform the complainant of the process that will be followed to investigate the complaint, and the timeframes within which the operator will endeavour to carry out its handling of the complaint. To that end, we would expect operators to take the necessary steps to ensure that all staff communicating with consumers receive appropriate training on identifying complaints and managing the complaints process effectively.
- 6.124 To ensure effective complaints processes, our proposed guidance also sets out the data we would expect operators to keep so as to monitor the way complaints are handled internally (e.g. internal records of the number of complaints received, resolved and unresolved (or escalated) over a specific period (e.g. monthly)).
- 6.125 We would also expect parcel operators to keep records that are necessary to ensure individual complaints are being dealt with appropriately and in accordance with the operators' complaint procedures and processes (e.g. nature of the complaint; dates on which the complaint was received, resolved).
- 6.126 Our research also identified issues with the outcomes and resolutions provided by operators once a complaint has been processed. The objective of CP 3.2 is to ensure the prompt, but also fair, settlement of disputes with consumers. To ensure individual complaints are being dealt with fairly, we consider it reasonable to expect that parcel operators have appropriate internal processes in place (e.g. internal review; escalation) to address any concerns (or dissatisfaction) consumers may have with the way their complaint has been dealt with. As set out in our proposed guidance, we expect that we will

take account of these steps if, and when, considering potential non-compliance with CP 3.2.

Our assessment of the proposal

- 6.127 Our evidence suggests there is variation in parcels operators handling of consumer complaints, with some performing reasonably well, and others falling short of providing simple and transparent processes for settling consumers disputes fairly and promptly. We consider that, at this stage, introducing new prescriptive rules for all operators may be disproportionate and could potentially be counter-productive (it could potentially reduce the quality and flexibility of some complaints processes already in place for customers).
- 6.128 We have therefore decided to propose new guidance describing the steps we would expect parcel operators to take to ensure compliance with their obligation under CP 3.2. As explained above, we expect that we will take account of our proposed guidance if, and when, we were to conduct future investigations into potential non-compliance with CP 3.2.
- 6.129 Our proposed guidance will support parcels operators in complying with their obligations under CP 3.2 and improving their processes in these areas. We believe that it will help addressing the problems consumers have been experiencing, ultimately helping to resolve complaints more effectively and achieve better outcomes for consumers.
- 6.130 We welcome stakeholder input on our proposed draft guidance (found in Annex 7).

Better meeting the needs of disabled consumers

We have found that disabled consumers experience a higher frequency of parcel delivery problems and are more significantly affected as a result. We are therefore proposing a new Consumer Protection Condition that will require parcel operators (including Royal Mail) to establish, publish and comply with clear and effective policies and procedures for the fair and appropriate treatment of disabled consumers.

Stakeholder responses to our March CFI

- 6.131 Citizens Advice's response to our March CFI raised concerns about those with specific access needs who rely on parcels services as an essential alternative to physical retail.³⁷⁶ The response also highlighted that disabled consumers were more likely to experience delivery issues such as not being allowed enough time to get to the door. Citizens Advice also stated that disabled consumers experience greater impacts as a result of issues they face, including financial detriment.
- 6.132 The CCP and ACOD response highlighted that people with access requirements have distinct and often unmet needs around communication, familiarity and accessibility.³⁷⁷

³⁷⁶ Citizens Advice response to our March CFI, page 77.

³⁷⁷ CCP and ACOD response to our March CFI, page 2.

- 6.133 Hermes recognised that disabled consumers experience challenges in accessing postal services. It said it is working with retailers to allow disabled consumers to specify any additional delivery needs. Consumers are currently already able to do so via Hermes C2X services. Hermes said it has pledged to ensure its parcel shops meet accessibility requirements and it has made its website more accessible for blind and visually impaired consumers.³⁷⁸
- 6.134 Royal Mail acknowledged the findings of research from Citizens Advice demonstrating the difficulties faced by disabled consumers. It said that its postal staff do the same delivery rounds every day, so get to know the recipients and any needs recipients may have, such as taking longer to get to the door. Royal Mail also highlighted its planned parcel service improvements which could benefit disabled consumers, such as estimated delivery windows, expanded safe place and parcel collect.³⁷⁹

Evidence on the problem

- 6.135 Our research – and research conducted by other stakeholders – shows that disabled consumers are more likely to experience problems with parcel services across both the B2C and C2X market segments.

Disabled consumers are more likely to experience delivery issues

- 6.136 Our B2C parcels consumer research found the greatest gap in delivery issues experienced was being given insufficient time to answer the door as set out in Figure 6.16 below. 12% of consumers without disabilities experienced this in the last three months, compared with 19% of disabled consumers.

Figure 6.16: Experienced issues with deliveries in the last three months (B2C)

³⁷⁸ Hermes response to our March CFI, page 6.

³⁷⁹ Royal Mail response to our March CFI, page 72.

	Access needs	
	Yes	No/ prefer not to say
Net: Any	70% ▲	62%
Parcel delivery was delayed	28%	32%
Parcel packaging was damaged	22% ▲	16%
Parcel left exposed to atmospheric conditions	19%	17%
Parcel was not delivered	19% ▲	15%
Did not attempt to deliver in person	18% ▲	14%
I was not given sufficient time to answer the door	19% ▲	12%
Incorrect or insufficient tracking information	11%	12%
Goods in packaging were damaged	11%	9%
Unclear information on when and how it will be delivered	7%	9%
Package was not treated with respect	10%	8%

▲ Indicates significantly higher at 95%
▼ Indicates significantly lower at 95%

Source: B2C parcels consumer research

6.137 Qualitative research from the CCP also found that consumers with access requirements had some negative experiences in the context of receiving parcels. These include not being able to select certain delivery options (such as contact-free) or informing the courier that it may take them longer to get to the door, and these delivery instructions not being followed.³⁸⁰ These experiences tended to follow poor communication (or a lack of communication) about delivery requirements. These respondents wanted parcel operators to be more familiar with their needs.

6.138 Citizens Advice provided evidence that the parcels market does not work well for disabled users³⁸¹ and said it has identified three common issues³⁸² experienced by disabled consumers:

- Consumers missing their delivery because they were not given sufficient time to get to the door.
- Consumers being unable to retrieve parcels left in a “safe place” such as on high ledges or under ramps.
- Consumers feeling anxious or rushed when signing for a parcel.

6.139 Its research found that a third of disabled consumers missed a delivery because they were not given enough time to get to the door, and a quarter feel rushed, anxious, or irritated when signing for a delivery.³⁸³

³⁸⁰ Communications Consumer Panel (CCP) (April 2021), [Delivering satisfaction? Meeting service users’ needs for parcel services in the pandemic](#)

³⁸¹ [Citizens Advice - The missing link - Why parcel companies must deliver for disabled people](#)

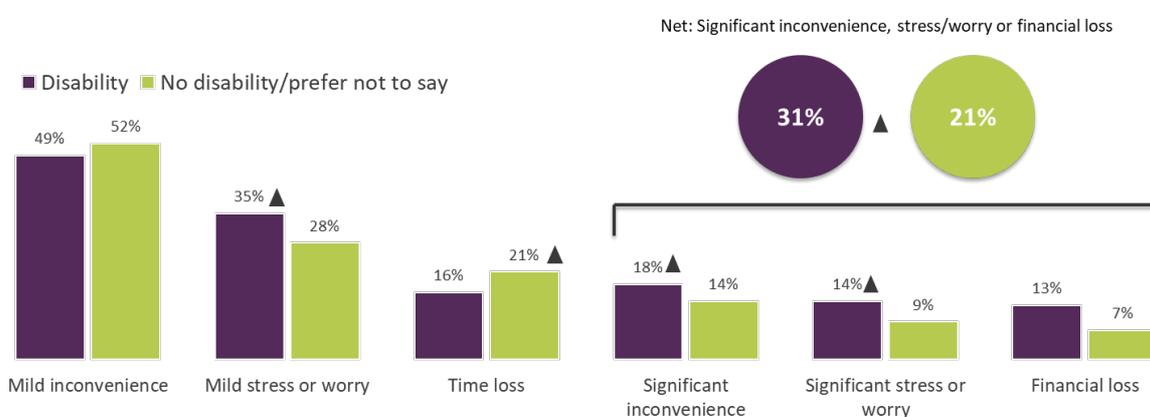
³⁸² [Citizens Advice - The customer journey: disabled people’s access to postal services](#)

³⁸³ [Citizens Advice - Delivery charter for disabled consumers](#)

6.140 Citizens Advice has established a delivery charter for disabled consumers that both retailers and parcel operators can sign up to. The parcel operators charter³⁸⁴ commits signatories to working with retailers to allow disabled consumers to specify any additional needs, and to ensure that all pick up drop off points are accessible to disabled consumers.

Disabled consumers are also more likely to experience harm when issues arise

6.141 When issues with parcel deliveries do arise, disabled consumers are more likely to experience significant harms. The B2C parcels consumer research found that 31% of disabled consumers who had a delivery issue experienced significant inconvenience, stress or financial loss - compared with 21% of consumers who did not identify as disabled. This is set out below in Figure 6.17.



Source: B2C parcels consumer research

6.142 We received a number of verbatims from disabled consumers through this research which provide more insight on the delivery issues faced. A few are highlighted in Figure 6.18 below.

Figure 6.18: Verbatims from disabled consumers regarding B2C deliveries

“As I am disabled it takes me a while to get to the front door and if I’m upstairs I need my stairlift to take me down and that isn’t fast, and even though I have a sign on the window next to the front door they still don’t wait for me to get there.”

“Despite clear instructions, the delivery person did not follow it and left parcels at common place not the safe place. The notes on parcel are never read.”

“I am disabled and the delivery person did not knock on the door he just left the parcel behind my grey bin. It wasn’t until the next day when I unlocked the door that I saw the parcel. As it was dog food and heavy, I had to call a neighbour to bring it inside for me.”

³⁸⁴ [Citizens Advice - Delivery charter: Operators](#)

Disabled consumers also experience more issues when sending parcels

- 6.143 Disabled consumers are more likely to be heavier senders of parcels. The C2X research found that disabled consumers sent an average of eight parcels per year (compared to the overall average of seven), and 22% of disabled users were ‘heavy’ senders (defined as sending over 21 parcels per year), higher than the overall average of 16%.
- 6.144 When prompted with a list of issues when sending parcels, 65% of disabled consumers in the C2X research stated that they had experienced an issue, compared with 50% overall. Disabled consumers were significantly more likely to experience all the specific delivery and collection issues tested when sending parcels, compared to senders overall.

Figure 6.19: Issues with any supplier when sending parcel



Source: C2X research. Note: Pink arrows indicate significantly higher than total at a 95% confidence level.

Parcel operators' procedures do not fully address disabled consumers' needs

- 6.145 We collected information from five of the main B2C/C2X parcel operators about the policies they have in place to identify users with additional needs, and any procedures to meet those needs.³⁸⁵
- 6.146 Some operators do have some facilities to allow senders and/or recipients to specify their delivery needs. However, we found limited evidence of policies specifically designed to meet the needs of disabled consumers and/or of implementation of procedures that focused on meeting the needs of disabled consumers, and note that the few policies we

³⁸⁵ Information request responses from Amazon, DHL, DPD, Hermes and Yodel.

have seen are limited in scope and relatively self-contained. Furthermore, our evidence above indicates that disabled consumers continue to be disproportionately affected by delivery issues. Therefore, we consider that the existing general practices/procedures of operators are insufficient in addressing the specific issues and harms experienced by disabled consumers that we have identified, particularly in relation to ensuring that delivery couriers take account of these needs.

Our proposal

- 6.147 We are proposing to put in place a new Consumer Protection Condition that will require operators to establish, publish and comply with clear and effective policies and procedures for the fair and appropriate treatment of disabled consumers, in relation to the collection, delivery and receipt of parcels in the UK.
- 6.148 This proposed condition will apply to all parcel operators,³⁸⁶ across the B2C and C2X market segments, that collect and/or deliver to disabled consumers, including Royal Mail.
- 6.149 We propose to include Royal Mail within the scope of our condition, as a major provider of parcel services to disabled consumers. Our research (which encompassed the services provided by Royal Mail) found that disabled consumers are more likely to experience problems with parcel services across both the B2C and C2X market segments.³⁸⁷
- 6.150 We have focused our proposed condition on disabled consumers in designing this remedy, rather than other consumer groups, as our research findings (and those of Citizens Advice and the CCP) suggest disabled consumers are more likely to experience delivery issues and associated detriment, relative to consumers as a whole. The main consumer harm issue here – challenges faced by people when receiving parcels – appears to be more prevalent among this category of consumers.

Operators should have policies on fair treatment of disabled consumers

- 6.151 Our research set out above shows the particular needs of disabled consumers, in relation to the sending and receipt of parcels, are not always being met by parcel operators. In

³⁸⁶ The statutory notification for the proposed new Consumer Protection Condition is contained in Annex 11 to this document. The new condition applies to 'relevant postal operators' - that is, operators providing 'relevant parcels postal services'. For the purpose of the proposed new condition, the definition of 'relevant parcels postal services' excludes specific services (as set out in proposed condition CP 5.1.2(h)). More specifically CP 5.1.2(h)(3) excludes, from the scope of the proposed obligation, the services of postal operators that are provided as intermediaries, while ensuring that services from operators that directly control or seek to influence the delivery are covered by the proposed condition (irrespective of whether operators use their own employees, self-employed workers, contractors or sub-contractors etc).

³⁸⁷ We note that DUSP 1.8.4 already requires Royal Mail to establish, maintain and review annually a statement of arrangements to ensure that users of postal services who are blind, partially sighted, infirm through age, chronically sick, or disabled are able to post postal packets using the universal services regularly and as far as possible without significant cost to those users attributable to their difficulties. The scope of our proposed new requirement for parcel operators is broader than DUSP 1.8.4 as (a) it covers deliveries, in addition to sending/collections; and (b) it relates to non-USO services, in addition to USO services. We anticipate that Royal Mail could make reference to its statement of arrangements within its policies and procedures for the fair and appropriate treatment of disabled consumers, as a part of how it is meeting the proposed new requirement.

particular, we found that disabled consumers experience more delivery issues than consumers without a disability.

- 6.152 We do not consider it appropriate at present for us to specify detailed requirements of what an operator must do, as the needs of consumers – and the capacity of operators to adapt to these needs – will vary, and may evolve over time. Instead we believe that it will be more effective to give flexibility to operators by requiring them to establish clear and effective policies and procedures for fair and appropriate treatment of disabled consumers. These policies could evolve and improve over time, as new systems or technologies develop.
- 6.153 Following our assessment of the consumer issues experienced across the market, which related to both sending and receiving of parcels, we consider it appropriate that these policies and procedures should cover the needs of disabled consumers both as senders and recipients. Therefore, the policies should address the fair treatment of disabled consumers as receivers across the B2C and C2X market segments and as C2X senders.³⁸⁸
- 6.154 We recognise that in the B2C market segment, retailers often have a primary role in communicating with consumers about deliveries of goods bought online. This may sometimes have implications for operators’ ability to communicate directly with the recipient. We expect that the operators will set out any challenges associated with this dynamic in the policies and procedures that they develop. But in so doing, they should consider how they can work with retailers to ensure fair and appropriate treatment of disabled consumers. It is important for the proposed policies to address the needs of disabled recipients in the B2C market segment, as when consumers purchase an item online, they usually will not get to choose the parcel operator that delivers the parcel to them.
- 6.155 We propose to include the sending of parcels by, and collections from, disabled consumers within the scope of the condition. But we propose that individual parcel operators should consider specifically what issues and approaches to cover within this aspect of their policies (rather than us specifying minimum components that the policies should cover, as we propose to do for deliveries). We note, however, that these policies may include addressing the specific needs of disabled consumers in relation to home collections and/or in the context of the accessibility of PUDOs.
- 6.156 In order to ensure that operators implement the policies that they develop, we propose that they should demonstrate how they will monitor and evaluate their effectiveness.
- 6.157 In addition, we propose that parcel operators must ensure that relevant employees³⁸⁹ are made aware of the policies and procedures for the fair and appropriate treatment of

³⁸⁸ B2C senders are generally businesses (rather than individual consumers), so we would not expect the proposed policies and procedures to address the needs of these senders.

³⁸⁹ ‘Relevant employees’ is defined in the proposed Consumer Protection Condition as ‘any employee or worker (within the meanings of those expressions under section 230 of the Employment Rights Act 1996)’. This is in line with the reference used in Consumer Protection Condition 1 (on consumer advocacy costs) and is meant to ensure that protection is granted irrespective of whether operators use their own employees, self-employed workers, contractors or sub-contractors etc.

disabled consumers and are appropriately trained to comply with the policies and procedures. Given that the service issues that disabled consumers encounter often relate to 'frontline' delivery staff, it is important for operators to take responsibility for training relevant employees on company policies in this regard.

6.158 We also propose that parcel operators should retain and provide to Ofcom, upon request, any information considered by us to be necessary to assess the effectiveness of these policies and procedures.

Operators should act on the specific delivery needs of disabled consumers

6.159 We found that the delivery issues experienced by disabled consumers (e.g. couriers not allowing enough time at the door, parcels being left in inaccessible places, operators not acting on the specific delivery instructions that have been provided) can arise from parcel operator couriers not being aware of, and/or not acting on, the specific delivery needs a user may have.

6.160 Therefore, we suggest these policies and procedures should, as a minimum, address:

- How disabled consumers can communicate their delivery needs to the parcel operator; and
- How relevant parcel operator employees should meet the needs of disabled consumers when delivering parcels.

Our assessment of the proposal

6.161 We consider that requiring operators to develop and implement their own policies on how they will meet the specific needs of disabled consumers could deliver significant consumer benefits by reducing the incidence of delivery issues and detriment experienced by disabled consumers.

6.162 We recognise there could be some potential costs for parcel operators including costs associated with:

- agreeing and implementing with retailers an approach to collecting information about specific delivery needs from disabled consumers for B2C deliveries;
- couriers acting on these delivery needs, such as spending more time waiting for recipients to open the door;
- ensuring fair and appropriate treatment of disabled consumers when sending parcels; and
- employee training.

6.163 The approach that we are proposing of asking operators to develop their own policies and procedures (rather than prescribing them in detail), should help to minimise costs, by allowing some flexibility for different business models, and permitting operators to take account of potential cost implications for consumers as a whole.

6.164 Furthermore, we understand that some operators already have processes in place for collecting specific delivery instructions from recipients and communicating them to delivery couriers. As such, we are mindful that any potential costs for establishing policies and procedures for the fair and appropriate treatment of disabled consumers, as well as

ensuring that relevant employees comply with these policies may be relatively contained.³⁹⁰

- 6.165 We also note that some parcel operators have already signed up to the Citizens Advice delivery charter. The charter commits signatories to working with retailers to allow consumers to specify additional delivery needs, and also to ensure that all PUDOs are accessible. Some of these operators may therefore have begun to address some of the issues for disabled consumers that we have identified. In addition, all service providers have responsibilities under the Equality Act 2010 to make reasonable adjustments for disabled consumers where appropriate in respect of the provision of services to the public.
- 6.166 The objective of ensuring fair and appropriate treatment of disabled consumers is important and is in line with our statutory duties, in particular section 3(4) of the Communications Act 2003. We believe that our proposed condition should offer significant benefits to disabled consumers. We therefore consider that, while there may be some additional costs potentially associated with achieving this aim, for the reasons set out above, these potential costs will remain proportionate, particularly in light of the benefits our proposal will bring to disabled consumers and the importance of the objective we are trying to achieve.
- 6.167 We would welcome any additional input from stakeholders on the benefits to disabled consumers arising from this condition. We will also consider any evidence from operators regarding estimated additional costs that could be incurred as a result of complying with the proposed condition and input on how these costs could be minimised.

Timing of implementation

- 6.168 We recognise that parcel operators will need some time to develop and implement their policies and procedures on fair and appropriate treatment of disabled consumers. We therefore propose that the requirements under the condition – including publication of the policies and procedures – should commence from April 2023.

Legal test

- 6.169 Pending consideration of any further evidence we may receive in response to this consultation, we consider that our proposal to introduce a new Consumer Protection Condition on Disabled Consumers, as described above meets the relevant tests set out in paragraph 1 of Schedule 6 to the 2011 Act. Namely that it is:
- objectively justifiable;

³⁹⁰ It is important to note that any costs incurred in connection with these pre-existing processes will not necessarily be linked to the implementation of our proposal as operators would have to incur some costs in relation to existing processes in any event (e.g. in updating processes). We are mindful that, in relation to these processes, only the costs that are directly linked, and incurred as a result of implementing our proposed new condition would be regarded as relevant to assess the proportionality of our proposal. As a result, and for the reasons set out above, we consider that any potential costs may be relatively contained.

- does not unduly discriminate against a particular person or a particular description of persons;
- is proportionate; and
- is transparent in relation to what it is intended to achieve.

6.170 We consider that our proposed new Consumer Protection Condition satisfies the above tests, in particular:

- **objectively justifiable** – we believe that our proposed new Consumer Protection Condition is objectively justifiable because it is aimed at remedying the harm that disabled consumers are suffering when receiving or sending parcels. In particular, it is aimed at ensuring that disabled consumers, who may have different needs due to their disability, do not suffer greater harm as a result of their disability. It is also aimed at ensuring equivalence of access for disabled consumers when using parcel services; that is ensuring that disabled consumers are not penalised due to their disability when using services from parcel operators:
- **not unduly discriminatory** – we believe that our proposed new Consumer Protection Condition is not unduly discriminatory as it is meant to apply to all postal operators providing ‘relevant parcels postal services’ (as defined in the proposed new condition). Our proposed new condition will also benefit all disabled consumers irrespective of the different needs they may have due to their disability, to address the specific issues they experience;
- **proportionate** – we believe that our proposed new Consumer Protection Condition is proportionate as it is targeted at remedying the harm suffered by disabled consumers by imposing a high-level obligation on operators to establish clear and effective policies and procedures for the fair and appropriate treatment of disabled consumers. We are proposing for the new condition to set out minimum requirements, rather than prescribe detailed rules, and to grant flexibility to operators in how they establish, publish and comply with their policies and procedures. For that reason, and for the reasons set out above, we also believe that any potential additional costs parcel operators may incur in order to comply with our proposed new condition will be contained. We also note that, in line with section 3(4) of the Communications Act 2003, the intended objective of ensuring equivalent access for disabled people to parcel services (equivalent to that enjoyed by the majority of people) is an important one.
- **transparent** – we believe that our new proposed condition is transparent as it clearly sets out what is expected from relevant postal operators. The reasons for proposing to introduce our new condition are set out in detail above.

Safety and security of parcels

The safety and security of parcels when they move through networks is a key consumer concern. We are not proposing to extend the scope of the Essential Condition to parcel operators at this stage, as the incidence of parcel loss and damage appears to be limited. But we will monitor the market to ensure that the risks of loss and damage are minimised and reasonable steps are taken by operators to address issues when they do arise.

Introduction and background

6.171 Our Essential Condition³⁹¹ is designed to protect the integrity of mail by imposing a high-level requirement on ‘relevant postal operators’ to:

- take all reasonable steps to minimise the exposure of relevant postal packets to the risk of loss, theft, damage and/or interference; and
- take all reasonable steps to address mail integrity issues promptly when they arise.

6.172 Currently the scope of the Essential Condition is effectively restricted to Royal Mail’s USO letters and parcels services, as access mail and ‘express and secured parcel services’ are excluded.³⁹²

6.173 The Essential Condition also applies more detailed requirements to Royal Mail, including in relation to recruitment and training policies, and reporting requirements for mail integrity incidents.

Stakeholder responses to our March CFI

6.174 Citizens Advice’s response to our March CFI said we should explore how the Essential Condition could be used to improve outcomes for consumers.³⁹³ A subsequent Citizens Advice report suggested extending the scope of the condition would increase the safety and security of parcels, and make it possible to fine companies who don’t take suitable measures to keep parcels safe.³⁹⁴

6.175 Hermes noted that while sometimes parcels do get lost or damaged, it takes steps to ensure that any detriment is minimal and resolved as efficiently as possible.³⁹⁵ It added that it offers varying levels of compensation and insurance for C2X customers, with a maximum cover level of £300.

³⁹¹ [Essential Condition 1](#). ‘Relevant postal operator’ is defined in the condition.

³⁹² Any other end-to-end letters operator would also be covered by the condition, but access mail is specifically excluded. The definition of express and secured services excludes the tracked and/or guaranteed time delivery services provided by parcel operators.

³⁹³ Citizens Advice response to our March CFI, page 67.

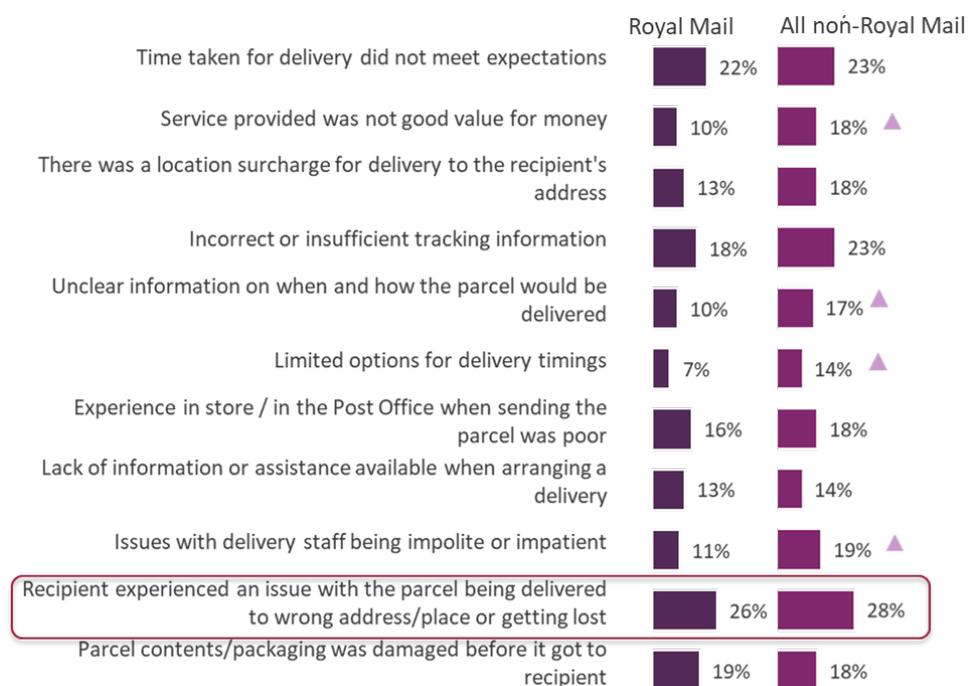
³⁹⁴ ‘Sorry we missed you’, [Citizens Advice report](#), page 20.

³⁹⁵ Hermes response our March CFI, page 4.

Consumers do occasionally experience loss of, or damage to, parcels

- 6.176 Our C2X research provides some evidence of consumers experiencing the loss of parcels or damage to contents/packaging. Among C2X senders, 23% said their recipients had experienced parcels getting lost or mis-delivered in the last 12 months. 22% had experienced parcel contents/packaging being damaged (see Figure 6.19 above).
- 6.177 Parcels being delivered to wrong address/place or getting lost is the most common reason for C2X senders contacting and/or complaining to a parcel operator, as shown in Figure 6.20 below.

Figure 6.20: Reasons for complaints or contacts per supplier



Source: C2X research

- 6.178 Our C2X qualitative research found recipients referenced issues with parcel operators including 'lax security' in drop-off shops, damaged parcels and parcels left in 'weird' places. It also suggested that SMEs sometimes experience financial loss/hassle if parcels are lost or damaged. Meanwhile, customers can face challenges in getting refunds/replacements.
- 6.179 Our quantitative B2C parcels consumer research in relation to parcel deliveries found:
- In the last three months, 18% had experienced 'parcel packaging was damaged'; 16% 'parcel was not delivered' and 10% 'goods in packaging were damaged'
 - Among those respondents who had experienced issues with deliveries, 15% had experienced 'significant inconvenience', 10% 'significant stress and worry' and 8% 'financial loss'.

- 6.180 Meanwhile, Citizens Advice research found that one in ten consumers have had a parcel lost or stolen in the last 12 months.³⁹⁶ Qualitative research from the CCP found that, across audiences, items being lost or damaged were identified as an issue (particularly for rural residents and microbusinesses). While participants tended to seek refunds, there was frustration that the delivery did not succeed as planned.³⁹⁷
- 6.181 We note, however, that our consumer research found that, on average, users received approximately 18 parcels in the last three months and sent seven parcels in the past year. Alongside information that we have collected under our formal powers regarding complaints to operators regarding lost and damaged parcels³⁹⁸, this suggests that the incidence of parcels that are lost or damaged is relatively small compared to the total number of daily deliveries.

There are incentives for operators to reduce the risk of parcels loss or damage

- 6.182 As described above, a significant minority of consumers has occasionally experienced a problem with parcel safety and security. While this needs to be considered in the context of the millions of parcels delivered every day, we note that some consumers do experience detriment as a result. The safety and security of parcels is key to consumers' experience, so it is important that all operators in the market have systems and controls in place to minimise the risk of loss, theft and/or damage of parcels.
- 6.183 In general, we would expect parcel operators to already have incentives to take reasonable steps to ensure the safety and security of parcels, for the reasons set out below.
- 6.184 In relation to the B2C segment of the parcels market, the commercial agreements between parcel operators and retailers are likely to include some performance indicators, as well as potential for redress if things go wrong, which should provide some incentives to minimise the risk of loss, theft and/or damage of parcels. For example, given consumer protection legislation offers rights of redress to consumers in the form of refund, repair or replacement for lost or damaged goods from retailers, they may seek compensation from operators where they are at fault. Further, as outlined above, there are a number of competing parcel operators, and so we would expect consistently poor service could risk the operator losing a retailer to a rival, which could also strengthen these incentives for secure delivery.
- 6.185 Similarly, in relation to the C2X segment, we note:

³⁹⁶ 'Sorry we missed you', [Citizens Advice report](#), page 10.

³⁹⁷ Communications Consumer Panel (CCP) (April 2021), [Delivering satisfaction? Meeting service users' needs for parcel services in the pandemic](#), pages 7, 38, 40 and 69-70.

³⁹⁸ We asked parcel operators about the volumes of complaints they receive from parcel users and how complaints are recorded and categorised. We found that there are differences in approach to this, partly because some complaints from recipients in relation to lost and damaged parcels are made directly to retailers. We plan to engage further with operators to help us understand the data that they collect on key delivery issues such as lost and damaged parcels. As outlined above, we are also proposing new guidance for parcel operators on monitoring outcomes and retaining records in relation to complaints-handling.

- Most consumers of C2X services can easily switch to other operators the next time they send a parcel if they experience a poor service and/or they do not receive adequate redress. This gives operators incentives to offer more secure services.
- While consumer protections for C2X parcel services can differ from a B2C service and it may sometimes be harder to replace lost/damaged items³⁹⁹, the consumer sending the parcel (for example, a private marketplace seller) enters into a contract with the parcel operator. Under the Consumer Rights Act 2015, the operator must perform the delivery service with “reasonable care and skill”.
- C2X operators will usually offer compensation and insurance options to senders at point-of-sale, to offer some protection and redress in the event the parcel is lost or damaged. Online marketplaces also provide guidance and expectation to buyers and sellers about what to do in the event of loss or damage, and some offer insurance options.⁴⁰⁰
- In addition, we expect that steps taken by parcel operators to mitigate the risk of loss or damage of B2C parcels are likely to also reduce these risks in relation to their C2X services, given that these parcels are likely to become integrated within networks before the ‘final mile’ delivery stage.

6.186 Furthermore, while appropriate controls should be in place to protect the security of parcels, we recognise that some loss or damage is to be expected given that millions of parcels are delivered each day in the UK. Regulation that sought to completely eliminate this risk would be disproportionate as it could expose all users of postal services to significant increases in costs. It is, therefore, also important that operators take steps to address the issues that do occasionally arise. In particular, operators should have in place accessible consumer contacts and complaints-handling processes. Our proposals to provide additional guidance in relation to complaints-handling should help ensure prompt and fair resolution of disputes. Parcel operators should also ensure that their customers have clear information about their insurance options and the limits to cover that may apply in the event of loss or damage.

6.187 We also note that our proposal to require parcel operators to develop policies and procedures for the fair treatment of disabled users could help to reduce the risk that parcels are lost or damaged if more care is taken to respond to the specific delivery needs of this group of recipients.

6.188 Therefore, given the existing incentives on parcel operators to take reasonable steps to ensure the safety and security of parcels, combined with legislation for redress as well as our proposals on complaints-handling and disabled consumers, it is not clear that additional consumer protection measures are required at this stage.

³⁹⁹ When a consumer buys a good via an online marketplace from a private seller who is not defined as a ‘trader’ they have fewer consumer rights than applies when buying from retail businesses. So there could be a greater impact on consumers if the parcel is lost, stolen or damaged before it arrives with the recipient. Furthermore, some items bought and sold via online marketplaces (e.g. second hand; handcrafted) may not be easy to replace.

⁴⁰⁰ See, for example, the [eBay Money Back Guarantee](#) and [Facebook Marketplace Purchase Protection Policies](#).

Our initial position

6.189 In conclusion, we are not proposing to extend the scope of the Essential Condition to include parcel operators at this point. But we plan to continue to monitor this aspect of how the parcels market is working for consumers, including engaging with operators to better understand the incidence of lost and damaged parcels, the controls they have in place to mitigate this risk, and redress that is available to consumers when parcels are lost and damaged (including in the C2X market segment where protection may differ). We would consider imposing new regulations if there is growing evidence of detriment.

Geographic variations in parcels services

We are not proposing any new regulations relating to geographic variations in parcel services. We will continue to engage with stakeholders and policy makers on this issue.

Introduction and background

6.190 Stakeholders have previously identified geographic variations in pricing for delivery of retail goods bought online as a concern.

6.191 As outlined in our March CFI, in 2019 we used our formal information gathering powers to collect information from parcel operators relating to variations in the delivery of B2C parcels based on geographical location. We published our findings in the 2020 Annual Monitoring Update for post and have presented our findings to consumer groups and interested parties. In summary, we found that:

- There were several providers offering B2C parcel services across the UK.⁴⁰¹
- Operators took different approaches to the pricing of parcel delivery based on geographic location. The approach taken could depend on the extent to which B2C is a core part of their business model. Negotiations with retailers will impact upon actual prices agreed.
- Some operators differentiated their delivery charging on the basis of geographic location to some extent. This was most likely to affect deliveries to the Scottish Highlands and Islands, and Northern Ireland. Operators provided some reasons why they may incur additional cost when delivering to these locations, such as lower volumes/drop density and higher transport costs.
- Retailers sometimes have the choice of operators that do not vary their prices on the basis of geography, or can negotiate universal prices with them.
- The retailer determines whether to pass on any differential charges incurred to the end customer.

6.192 Since we carried out the information gathering in 2019 there has been significant growth in the parcels market and some changes in geographic pricing policies from individual

⁴⁰¹ While some parcel operators sometimes used third-party 'last mile' delivery services for delivery to locations in the Scottish Highlands and Islands, we found that that they usually had a choice of at least two third parties they can use. In addition, Royal Mail has an end-to-end post network across the whole of the UK.

providers, so these findings will not fully reflect the current situation with regard to geographic variations in B2C parcel services.

- 6.193 Meanwhile, our new C2X research found that 19% of senders had experienced a location surcharge for delivery to the recipient's address in the last 12 months.⁴⁰²

Stakeholder responses to our March CFI

- 6.194 Citizens Advice Scotland (CAS) and the Advisory Committee for Scotland (ACS) stated that Scotland is disproportionately affected by variations in costs and service within the parcels sector.
- 6.195 CAS said there is a need for transparency about the costs of delivery to rural areas of Scotland and the reasons for any surcharges. It said there is an unfair disparity in these geographical areas as some retailers and operators refuse to deliver directly to them at all.
- 6.196 CAS believes further regulation may be needed to ensure minimum standards across the parcels market. ACS also said Ofcom has a contributing role to play in establishing a level playing field within this sector.
- 6.197 The Consumer Council for Northern Ireland (CCNI) highlighted that there is less competition in the parcels market in Northern Ireland, and noted that Hermes (the second largest operator after Royal Mail) had recently introduced a surcharge for C2X parcel deliveries between Great Britain and Northern Ireland. CCNI also highlighted the problems faced by Northern Ireland consumers when they shop online with GB retailers, since the UK left the EU, stating that this has exacerbated existing issues and created new ones.
- 6.198 Hermes set out its approach to the pricing of its B2C and C2X services, noting that the geography of the UK makes the transport of goods to certain parts of the country, including Northern Ireland and the Scottish Highlands & Islands, more expensive.⁴⁰³

Our initial position

- 6.199 Royal Mail continues to be subject to the uniform pricing obligations that are a core part of the USO for certain C2X parcel services, which helps ensure that consumers have an affordable option when sending parcels to all parts of the UK. Outside regulating Royal Mail, as the Universal Service Provider, the scope of Ofcom's powers under the existing regulatory framework limits the extent to which we can intervene in relation to specific aspects of parcel delivery:
- Parcel operators – with the exception of Royal Mail in the context of the USO – are able to choose where in the UK they offer delivery services, and they are not required to offer a uniform price for those services. As such, operators have flexibility as to whether, and how, they pass on

⁴⁰² The national breakdowns for this data (England – 19%, Scotland – 21%, Wales – 17%, Northern Ireland – 16%) do not show significant differences, perhaps because senders of parcels to areas subject to delivery surcharges can be based anywhere in the UK.

⁴⁰³ Hermes response to our March CFI, pages 4-5.

geographical differences in delivery costs to their customers (which include retailers for B2C services and residential consumers for C2X services).

- As noted above, it is retail businesses that ultimately set the delivery charges for B2C deliveries, and we do not have regulatory powers in relation to retailer charges.
- 6.200 In relation to geographical variations in C2X prices, differential prices could be consistent with competition, for example if they reflect differences in delivery costs.
- 6.201 We would be concerned if C2X senders have difficulty understanding where they might face surcharges. Therefore, where parcel operators do charge more than their standard rate for C2X deliveries to locations in certain postcode areas, we would encourage them to provide easily accessible information to consumers on where these apply.
- 6.202 We will continue to provide information on our findings and market analysis to interested stakeholders, to help inform the wider debate about market dynamics and consumer outcomes. Ofcom is attending meetings of the Consumer Protection Partnership sub-group on surcharging, for example.
- 6.203 As part of our postal market monitoring functions, we may carry out further information gathering in the future, if we consider that it will contribute to ongoing discussions.
- 6.204 In relation to CCNI's concerns about the impact of the UK's exit from the EU on the parcels market in Northern Ireland, we note that the implementation of the Northern Ireland Protocol is a matter for the UK Government. We continue to engage with the UK Government, postal operators and consumer groups to advise on, and understand, the implications for the postal market.

Pick Up Drop Off points

Stakeholder responses to our March CFI

- 6.205 Citizens Advice asked Ofcom to consider how to encourage the creation of a network of local, open-access Pick Up Drop Off (PUDO) points.⁴⁰⁴ It suggested that allowing drivers to deliver undelivered parcels to the nearest of the UK's 40,000 PUDOs, some of which are currently only accessible to a single delivery company, would improve consumer experience. It stated that this PUDO network would increase consumer confidence in delivery reliability and increase consumer convenience, while also reducing pressure on drivers.
- 6.206 Post Office requested that we create a regulatory process which would act as a default arrangement for all relevant parcel operators to ensure misrouted parcels are quickly identified and processed on fair terms.⁴⁰⁵ It called on us to define processes and standards in this space in anticipation of the growth of PUDO services.

⁴⁰⁴ Citizens Advice response to our March CFI, pages 65-66.

⁴⁰⁵ Post Office response to our March CFI, pages 23-25.

Our assessment

- 6.207 The growth in the number and types of PUDOs and ‘out of home’ deliveries (including post offices, convenience stores and parcel lockers) across the UK offers consumers more choice and flexibility. This growth has coincided with an expansion of the market, with more providers offering more access points, as seen in Table 6.3. There is no regulatory barrier to PUDO providers entering into access arrangements with multiple parcel operators, and indeed there are some examples of this.⁴⁰⁶ However, requiring PUDOs to offer open access would be a significant regulatory intervention, and might deter some PUDO providers (e.g. small retailers) from providing PUDO services at all.
- 6.208 As outlined above, we recognise that the loss of parcels can be a source of consumer detriment. However, we have not seen evidence that the increased use of PUDO services is a key driver of this problem. Parcels may be lost at other stages of the delivery chain, and we would expect parcel operators to take steps to reduce the incidence and impact of this risk when reaching agreements with PUDO providers. In the absence of evidence of significant detriment or market failure, we are not proposing to design a regulatory process in this area at this time.

Consultation questions

Question 6.1: Do you agree with our assessment of the parcels market, namely that it is generally working well for consumers, but improvements are needed in relation to complaints handling and meeting disabled consumers’ needs? Please substantiate your response with reasons and evidence.

Question 6.2: Do you agree with our assessment of the consumer issues in relation to complaints handling and our proposed guidance? Please substantiate your response with reasons and evidence.

Question 6.3: Do you agree with our assessment of the issues faced by disabled consumers in relation to parcel services and our proposed new condition to better meet disabled consumers’ needs? Please substantiate your response with reasons and evidence.

⁴⁰⁶ For example, the Collect+ network has arrangements with Yodel, DPD, DHL and FedEx <https://www.collectplus.co.uk/about>, last accessed 2 December 2021.

7. USO parcels regulation

This section focuses on the regulation of parcels services within the universal service. These ‘single piece’ or C2X parcel services are an important part of the postal market and make up around 10% of total parcel volumes. They could be individual consumers sending a birthday present to friends and family, marketplace sellers sending items sold on eBay (or another marketplace platform) to their buyers, or small businesses sending goods to customers placing online orders.

The C2X parcels segment is growing and competition is emerging. Royal Mail’s share of C2X parcel deliveries is still over 70% in terms of both volumes and revenues. However, there is developing competition from Hermes and others, and we are keen to encourage this.

Our proposals for USO parcel regulation seek to ensure postal users continue to have access to simple, affordable and reliable parcel services that meet their needs, while supporting effective competition for the benefit of consumers.

We propose to:

- **Maintain the current restriction preventing Royal Mail from incorporating tracking facilities on First and Second Class USO services**, to support emerging competition in the C2X segment, and given that our research shows high levels of user satisfaction with current USO services.
- **Maintain the current requirements on Royal Mail to deliver USO parcels on a minimum of five days per week**, and not increase that requirement, which is already exceeded in practice by Royal Mail.
- **Maintain the current requirements on Royal Mail to provide USO services for parcels weighing up to 20kg**, given some risk of consumer detriment from reducing the limit.

7.1 In this section⁴⁰⁷ we consider the following USO parcels regulation issues:

- Rules around tracking facilities on First and Second Class USO parcels services;
- The number of parcel delivery days per week that is required by USO rules; and
- The rules around the weight limit for parcels within the universal service.

⁴⁰⁷ Our discussion in this section is informed by our analysis of the parcels market as a whole which we set out in Section 6.

USO for First and Second Class services - Tracking

To support the further development of competition in the C2X parcels market segment, and taking account of our new research suggesting limited unmet user needs in relation to tracking, we do not propose to add tracking to the First and Second Class USO parcel services. These USO services are VAT exempt so permitting tracking would give Royal Mail an advantage over competitors' C2X services.

Introduction and background

- 7.2 A tracked service enables a sender and/or a recipient to monitor the progress of an item through the postal network.
- 7.3 Our current regulation specifies that First and Second Class services within the USO should not include a tracking facility.⁴⁰⁸ However, tracking is required to be included as part of the USO Special Delivery service. In addition, Royal Mail offers a 'Signed For' service option within the USO for First and Second Class services, and a free confirmation of delivery feature as standard for all its universal service parcel products.⁴⁰⁹
- 7.4 In the 2017 Review, we considered that the potential detriment to parcels market competition from including tracking in the USO was unjustified, given there was insufficient evidence that consumers considered tracking to be a necessary feature of the universal service.⁴¹⁰
- 7.5 As part of this Review, we have reassessed this position to determine whether there are changes in the evidence of user need for tracking to be included within First and Second Class services, and the potential impact on competition.

Stakeholder responses to our March CFI

- 7.6 In its response to our March CFI, Royal Mail argued that it should have the flexibility to include tracking services within First and Second Class USO services, on the grounds that:⁴¹¹
- a) the universal service needs to be able to flexibly innovate and meet changing customers' needs;

⁴⁰⁸ See Ofcom, Securing the Universal Postal Service – Decision on the new regulatory framework, 27 March 2012, paragraphs 4.39 to 4.43 and 8.135. The requirement to provide priority and standard service(s) that do not include the provision of a tracking facility is set under DUSP Condition 1.6.1 (a) and (b). In the context of the DUSP Condition 1, 'Tracking facility' is defined as a 'facility enabling a sender to monitor the progress of a postal packet through the postal network.'

⁴⁰⁹ While these services are not tracked, both provide varying degrees of proof of delivery. With Signed For services, recipients sign for the item on delivery, to provide proof that the recipient has received it. Online delivery confirmation allows senders (and recipients if they have access to a reference number) to check online if a parcel has arrived.

⁴¹⁰ 2017 [Review of the Regulation of Royal Mail](#), 4.30.

⁴¹¹ Royal Mail response to our March CFI, 6.4.

- b) tracking is now seen as a ‘hygiene factor’ for many consumers and SMEs in light of the growth of e-commerce and new technology;
- c) the rest of the market does not meet the need for an affordable, UK-wide tracked service due to competing parcel operators applying geographically variable delivery timeframes and prices; and
- d) there is a material risk to the ongoing financial sustainability of the Universal Service if tracking is not able to be provided on USO services and marketplace sellers require a tracked service.

7.7 Several other respondents were in favour of amending the DUSP Condition to include tracking.⁴¹² For example, the Post Office said that preventing tracking in the USO risks ‘fossilising’ the universal service when it needs to remain relevant.

7.8 Consumer groups also favoured the inclusion of tracking within the USO, provided that it does not increase the costs to consumers or create affordability issues.⁴¹³ For example, Citizens Advice said tracking provides benefits for consumers including the ability to forward plan, providing consumers with peace of mind and assisting in dispute resolution.

7.9 By contrast, a number of other stakeholders – in particular, competing parcel operators⁴¹⁴ – were against the inclusion of tracking. These respondents said the market was already supplying tracking and it would give Royal Mail a competitive advantage due to the VAT exemption that applies to USO parcel services. For example, Hermes argued there was no clear reason to add to the USO something which the market is already providing at competitive rates, adding there was no evidence that consumers who wish to access tracked services cannot do so at affordable prices. Some respondents predicted some customers may end up paying more for tracking even when it is not wanted if Royal Mail withdraws its ‘non-tracked’ services.

Our assessment

Analytical approach

7.10 Taking account of responses to the CFI, we have considered whether to propose changes to our rules on USO services that relate to tracking.⁴¹⁵

7.11 To inform our assessment, we have:

- undertaken consumer research to help us determine whether the user need for tracking is such that it should now be regarded as a core feature of the universal service;

⁴¹² Responses to CFI from ACS, CWU, Mail User Assoc, NFSP, Pitney Bowes, Post Office, Quadiant and Whistl.

⁴¹³ Responses to CFI from Citizens Advice, CAS, CCNI.

⁴¹⁴ Responses to CFI from AICES, Hermes, [3<], MCF, UK Mail (DHL) and UPS.

⁴¹⁵ In line with the Universal Service Order, Royal Mail is required to include a tracking facility as part of registered and insured services (items up to 10kg). As set out above, DUSP 1 states that priority and standard services should not include provision of a tracking facility. Royal Mail can – and does – provide ‘non-USO’ C2X services that include tracking facilities.

- considered the extent to which the wider parcels market is providing alternatives to consumers that need and value tracking facilities; and
- assessed the potential impacts of a change in approach to tracking on competition in the C2X market segment.

7.12 Finally, we have considered whether our proposed policy position would have any substantive implications for the financial sustainability of the universal postal service.

User needs in relation to tracking

7.13 Since publishing the March 2021 CFI we have undertaken qualitative and quantitative consumer research to inform our assessment of user needs in relation to tracking, which we outline in paragraphs 6.3-6.6.⁴¹⁶ We have also taken account of research findings submitted by stakeholders as part of their CFI responses. The main findings are set out below.

The current 'untracked' First and Second Class services meet the needs of most users

7.14 We found relatively high levels of satisfaction with Royal Mail's existing services. Our C2X research found nine in ten of those using Royal Mail are satisfied with the service they receive, compared to an average of around seven in ten for other operators.

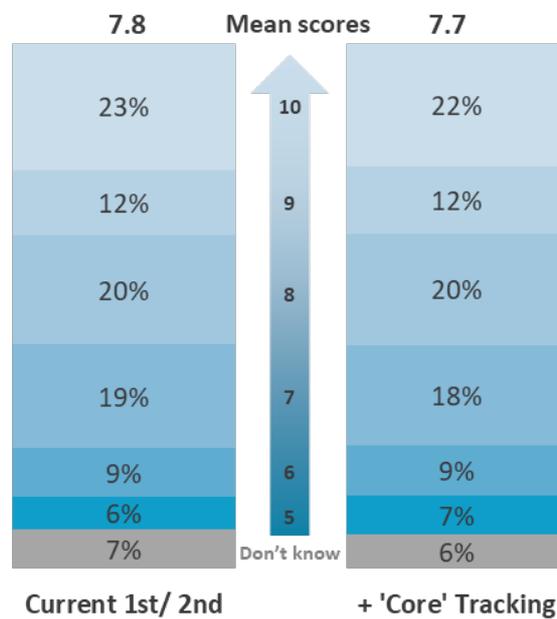
7.15 In addition, people who use Royal Mail's First or Second Class services (which do not include tracking) said that these services have most of the features they were looking for. In our C2X research, we asked people whether the last Royal Mail First or Second Class parcel sent met the requirements they had for sending that parcel. Overall, respondents gave high scores, as set out in Figure 7.1. The mean score was around eight, with zero being 'None of the product features I require' and 10 being 'All of the product features I require'.

7.16 We then hypothetically added 'core tracking'⁴¹⁷ to the product design of the standard First or Second Class service and asked the question again. As shown in Figure 7.2, this did not enhance the mean scores.

⁴¹⁶ Our C2X research explored views on tracking across C2X sender types, with the objective of gathering evidence to feed into our assessment of whether tracking is generally perceived to be a 'user need' for parcel senders. The research included attitudinal questions, analysis on the relative importance of tracking compared to other factors, and a willingness to pay analysis on the value placed on tracking.

⁴¹⁷ 'Core' tracking was defined as stage and day of delivery tracking, as opposed to 'enhanced' tracking, which was defined as real time information and a two-hour delivery slot.

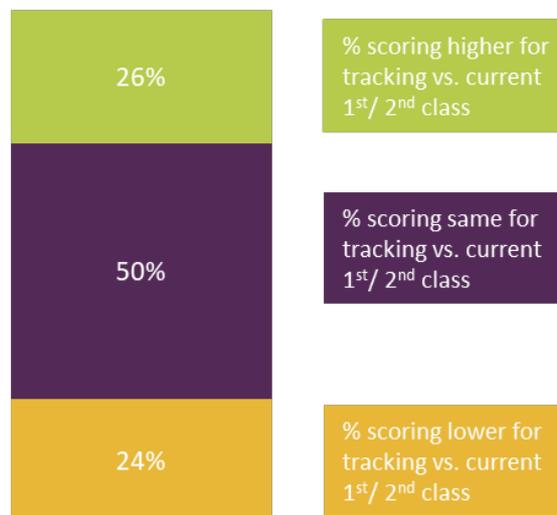
Figure 7.1: Extent to which each service did/would meet each user’s requirements they had for sending that parcel



Source: C2X research. Note: Respondents answer on a scale of 0-10, with 0 being ‘None of the product features I require’ and 10 being ‘All of the product features I require’.

7.17 Furthermore, Figure 7.2 below shows that three quarters of people did not increase their individual score at all when tracking was added to First/Second Class parcels.

Figure 7.2: Score for the tracking service compared to current First and Second Class services



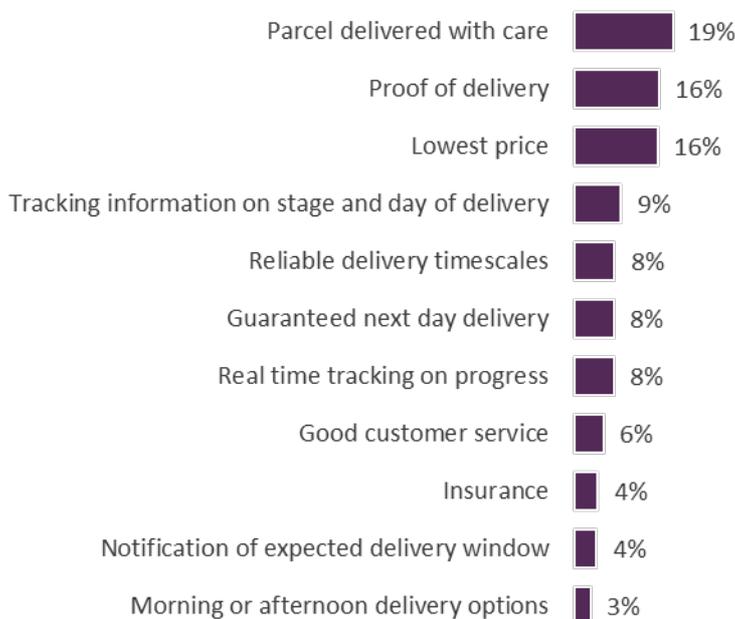
Source: C2X research

7.18 People in rural areas that only use Royal Mail for sending parcels gave the highest scores of any subgroup for the existing services. This suggests that users who are most reliant on the universal service consider that it is already meeting their requirements.

Adding tracking to the USO for First and Second Class services is not a high priority for most users

7.19 The research also shows that other service features are more important to consumers when compared to tracking. As part of our C2X research, we performed a Maximum Difference analysis to ascertain the relative perceived importance of different factors when choosing a parcel operator, as set out in Figure 7.3.⁴¹⁸ We found that ‘parcel delivered with care’, ‘proof of delivery’ and ‘lowest price’ were around twice as important for consumers when choosing a parcel operator than ‘Tracking information on stage and day of delivery’. Other features relating to tracking, such as ‘Real time tracking on progress’ and ‘Notification of expected delivery window’ were rated as even less important. This finding was consistent across subgroups.

Figure 7.3: Important factors when deciding how to send a parcel (Maximum Difference analysis)



Source: C2X research. Note: These percentages sum to 100 across all attributes, and show the **relative** importance of each attribute. An attribute with a utility score of 10%, for example, is half as important as one with a utility score of 20% and twice as important as another with a utility score of 5%.

7.20 This analysis suggests that the ongoing availability of a ‘proof of delivery’ option – Royal Mail’s Signed For service – within the USO, may be more important to users than the addition of tracking facilities to First and Second Class parcels. This was reinforced by qualitative insights from the C2X research which found that while Signed For was rarely used by social sender participants, it is important for marketplace seller participants sending high value items. It is seen to provide more effective protection against perceived

⁴¹⁸ Maximum Difference analysis or ‘MaxDiff’ is a trade-off methodology in which respondents are presented with small groups of the attributes of interest and asked to indicate which is most and least important. The analysis is used to generate utility scores showing the relative importance of each statement.

fraud than online delivery confirmation (given that recipients have to sign for the item on delivery, it can provide greater proof that the recipient has received it).

- 7.21 In addition, the research suggested that online confirmation of delivery would suffice on many occasions. Sellers sending cheaper items said that tracking was less sought after, and that it was more important that the item ‘just gets there’.

Tracking is increasingly regarded as important but not essential

- 7.22 Data from the attitudinal questions in the C2X research indicated that tracking is becoming more important to some users and when sending some types of parcels. Over seven in ten agree that they ‘Increasingly expect to be able to track . . . items they send’ and a similar proportion agree that they ‘try to use tracking information to plan when to be home’. Similar numbers of marketplace sellers agree with the statement that, ‘increasingly people expect to track . . . items bought from smaller online sellers’. In addition, 84% agree tracking is important when returning an item.⁴¹⁹

- 7.23 However, while tracking is becoming more important, the C2X research suggested that tracking facilities are commonly regarded as a ‘nice to have’, rather than as a core component of a parcel service. Approximately half indicated agreement with statements that tracking is:

- ‘only useful if sending or receiving high value/urgent items’;
- ‘nice to have but not essential when sending parcels’;⁴²⁰ and
- ‘when they are sending parcels to friends and family they don’t need to be able to track them’.

While a significant minority of senders value tracking, the majority would not pay even a small amount extra for it

- 7.24 In our C2X research, we tested user willingness to pay⁴²¹ more for a First or Second Class parcel service if it included tracking facilities.⁴²² We asked participants how much they would pay for tracking to be added if they were sending a similar parcel to the last parcel they sent using First or Second Class. To understand how the value of tracking differs across types of parcels, we also asked questions on how much the contents of the parcel was worth, the type of package (small, medium or large) and the postage costs. The overall results of the analysis are presented in Table 7.4 below.

⁴¹⁹ Our Residential/SME Tracker Research also consistently finds that the majority of receivers (and to a lesser extent, senders) of parcels regard the ability to track delivery as an important factor when choosing parcels (alongside many other factors rated as important).

⁴²⁰ 52% agreed with the statement ‘Tracking is nice to have but not essential when sending parcels’, 21% neither agreed nor disagreed and 26% disagreed with the statement.

⁴²¹ To determine users’ willingness to pay, we use the Gabor-Granger pricing method. Users’ willingness to pay for tracking is used as a proxy for the value of adding tracking to users. An explanation of the analysis, including details on the weights applied to the responses, is presented in slide 76 of the C2X research deck.

⁴²² In assessing the user need for tracking, we would ideally consider both the additional benefits to consumers and the additional costs of providing tracking. This is because if the costs were to exceed any additional benefits, then there would be a risk that consumers in aggregate pay more for a service that is over scoped for their needs. In regard to additional costs, Royal Mail has not yet provided detailed cost information on its proposed approach to tracking so we have focused on the extent to which consumers value tracking.

Table 7.4: Proportion estimated to be willing to pay for tracking at each price point

Price point tested	% Uptake for core tracking
25p	47%
75p	33%
£1.25	24%
£1.75	19%
£2.25	14%

Source: C2X research. Note: All C2X senders who had used Royal Mail in the last 12 months.

- 7.25 We found that the majority of senders (53%) would not be prepared to pay even a small amount extra for tracking facilities to be included in the service.⁴²³ This was consistent across marketplace sellers and non-marketplace sellers (52% and 55% respectively). It was higher for people that only used Royal Mail, where 56% said they would not pay 25p extra for tracking facilities. CAS and CCNI have also provided research findings suggesting that many consumers are unwilling to pay anything more for the addition of tracking facilities to the universal service.⁴²⁴
- 7.26 Our C2X qualitative research found that the one scenario where tracking was valued and seen as necessary by some seller participants, was when sending an item that is unique and valuable. Knowing where the parcel is in the journey to its destination was rarely identified as a core need in of itself.
- 7.27 Our research also shows that the value placed on tracking by users is highly context dependent, with willingness to pay increasing with the value of the items in the parcel. When the item being sent is of low value, the value placed on tracking is significantly lower – particularly for non-sellers, as illustrated in Table 7.5 below.

⁴²³ These are respondents who we estimate would not be prepared to pay 25p; 25p was the lowest price point tested in the willingness to pay analysis.

⁴²⁴ CAS found 38% of respondents were against any sort of price increase if tracking were to be included, with a further 40% stating they would only pay more on high value parcels, while only 14% were willing to pay more on all parcels for tracking. CAS [response to the CFJ](#), Q6.4. Meanwhile CCNI found that over 60% of Northern Ireland consumers would consider paying for tracking. When asked for how much each consumer would pay, the median additional value for parcels was 20p. The Consumer Council, [The Universal Postal Service and Northern Ireland Consumers](#). August 2020, 5.10.

Table 7.5: Proportion estimated to be willing to pay at least £1.25 for tracking by type of sender and item value

		Item Value	
		Under £5	Over £40
Type of sender	Sellers	18%	40%
	Non-sellers	14%	28%

Source: C2X research. Note: All C2X senders who had used Royal Mail in the last 12 months. For the purpose of this analysis and the paragraph below, £1.25 is used due to it being the middle price point tested.

7.28 In addition, our research shows that the value placed on tracking by users also varies across subsets of senders. While we estimate that 24% across the sample would be willing to pay at least £1.25 for tracking, it was higher for marketplace sellers (27%) and lower for non-marketplace sellers (20%). It was also lower among parcel senders that only use Royal Mail (18%). In terms of UK nations, the estimated proportion willing to pay at least £1.25 for a core tracking service was highest among senders in Northern Ireland and Scotland (28% and 29% respectively).

Potential impact on costs of USO services

7.29 Using our formal information gathering powers, we asked Royal Mail to provide information on the design and scope of its proposed tracking facilities, the costs of adding tracking facilities to its services, and the potential implications for pricing were it to introduce it as a USO service. Royal Mail indicated it was at an early stage of developing its plans and hence does not yet have detailed information on these matters.⁴²⁵

Summary

7.30 Our research suggests satisfaction with the current First and Second Class USO services is high, and for most users of these services there does not seem to be a strong need for the addition of tracking facilities. There is a minority of users for whom adding tracking is highly valued, and more generally, tracking is a feature that is becoming increasingly important to users, particularly marketplace sellers. However, around half said they would not pay a small amount extra for tracking facilities, and it is not high priority for users compared to other features such as proof of delivery. Hence, at this point in time, the evidence does not show that users consider tracking to be a necessary feature of the universal service, nor does it seem to be regarded as a ‘hygiene factor’ as suggested by Royal Mail.

⁴²⁵ Royal Mail’s response to the information request said it [redacted].

Market provision of tracked parcel services

7.31 There are a number of options for users if and when they have a need for tracking facilities, including Royal Mail's USO and non-USO services and market alternatives (as summarised in Table 7.6 below).

The market provision of tracked services is extensive and growing

7.32 Several non-Royal Mail operators now offer single piece tracked parcel services at prices that are competitive with Royal Mail's First and Second Class services. These services have become easier to access for consumers, with the expansion in alternative PUDO networks, and an increase in the number of ways people can access C2X services (for example, with home collections or via parcel lockers).

7.33 As set out in detail in Section 6, C2X senders are making more use of competing operators. Indeed, our C2X research found that almost two in three C2X senders had used a supplier other than Royal Mail in the last 12 months.

Royal Mail offers both USO and non-USO options with tracking facilities

7.34 Consumers can access tracked facilities, or other options with similar features that may meet their needs, from Royal Mail within the USO:

- **Special Delivery Guaranteed:** The only USO service which includes tracking facilities and is offered at post offices. This is priced significantly above tracking alternatives because it includes other premium service features.
- **Confirmation of delivery and Signed For options.** Royal Mail offers two optional service features alongside First and Second Class USO products – Confirmation of delivery online (a free option) and the Signed For (a paid for add-on option) – which may provide some of the benefits of tracked services to the sender. For example, offering reassurance that a parcel had been dispatched and has arrived, or the proof required to support a complaint with a retailer or customer.⁴²⁶

7.35 Royal Mail also offers a Tracked service outside of the USO:

- **Tracked 24/48:** A single-piece service outside of the USO which includes tracking facilities. It is also universally priced, though this is not a regulatory requirement. Royal Mail only makes these services available to purchase online, and senders can only drop off the parcel at a Customer Service Point (usually located in a Delivery Office). However, Royal Mail's Parcel Collect service, which was launched in 2020, does offer Tracked 24/48 services to online customers, who can access home collections for an additional fee of 72p (which is priced at a uniform level across the UK). It has so far chosen not to make these services available via post offices, though there is no regulatory barrier to Royal Mail taking this step. Even so, there has been a

⁴²⁶ See, for example, Vinted: "Keep your postage receipt! If something goes wrong, we may ask you to send a copy of it as proof of your postage." <https://www.vinted.co.uk/help/528-royal-mail-standard-2nd-class-shipping>, last accessed 2 December 2021.

significant increase in the take up of Tracked 24/48 services over the past year, albeit from initially low volumes.⁴²⁷

Table 7.6: Cheapest delivery prices for tracked C2X services (updated 30/11/2021)

Weight Step	RM Special Delivery Guaranteed*	RM Second Class*	RM Tracked 48	Hermes	DPD	DHL	Yodel
0-1kg	£8.95	£3.20	£4.74	£2.95	£6.47	£5.89	£2.79
1-2kg	£11.15	£3.20	£4.74	£4.40	£6.47	£5.89	£3.79
(+home collection)	+60p	+60p	+60p	+72p	+£3.12	+£4.00	-

*Post Office price. Source: Ofcom research. Note: Apart from Royal Mail's Special Delivery Guaranteed, all prices are for later than next day delivery (where available), for a 'non-letterboxable' small parcel sent from an access point to receiver's address. Prices are inclusive of VAT. Also note surcharges may apply to deliveries and/or collections for some postcodes.

For some consumers there is variability in the accessibility and availability of tracked services

7.36 The tracked services outlined above are widely available to most users, and many are making use of them. However, we note there is some variation in the geographical accessibility and the prices/availability of these services:

- Geographic accessibility:** The tracked parcel services offered outside of the USO could be less accessible to people living in some parts of the UK when sending parcels. Other access points can be harder to reach in deep rural areas than post offices, as there is a comparatively lower density of access points in these areas. Our research found that people in deep rural areas were more likely to use a Post Office counter for sending parcels (65%) than the average (58%).⁴²⁸ While home collections of parcels may be an option for people who struggle to reach access points, some operators apply geographical surcharges to these collections in some postcode areas.⁴²⁹
- Delivery surcharges/restrictions:** Some parcel deliveries are subject to higher prices because parcel operators apply geographical surcharges for C2X deliveries to parts of the UK (in contrast to the universal pricing requirements that apply to Royal Mail's USO services). For example, Hermes applies an additional location charge of £2.40 for the delivery of parcels to some locations which it says are more expensive to deliver to

⁴²⁷ From 2019/20 to 2020/21, consumer Tracked 24/48 single piece parcel volumes increased from [3<] to [3<], representing a [3<]% year-on-year increase.

⁴²⁸ Our research also found that 10% of people that only use Royal Mail/Parcelforce to send parcels were 'not aware of other delivery companies in my area'. This figure was higher for senders in Wales (15%), Scotland (14%) and Northern Ireland (13%) than for England (9%).

⁴²⁹ For example, Hermes applies the £2.40 surcharge to home collections from properties in the same postcode areas which are subject to delivery surcharges (unless sending parcels within the same postcode area), Email from Hermes, 20 October 2021.

than other locations (except those sending within the same postcode area).⁴³⁰ The affected postcodes include Northern Ireland and the Scottish Highlands & Islands, though senders from all parts of the UK could be subject to surcharges when sending parcels to these areas.⁴³¹

- 7.37 While most C2X senders make use of market alternatives, there are still significant numbers that only ever use Royal Mail's services when sending parcels, and are likely to access them via post offices. Our C2X research found that 37% of senders use Royal Mail only. This is significantly higher for elderly senders (52% 65+), rural senders (43%) and light senders (57%).⁴³² Furthermore, elderly senders were significantly more likely to say they used Royal Mail due to the Post Office (83% 65+) and familiarity/trust with Royal Mail (83% 65+).⁴³³ When asked why they only used Royal Mail, the main reason they gave was that they were 'happy with the service' (70% 65+).⁴³⁴
- 7.38 In summary, in many cases existing USO and non-USO services offered by Royal Mail and other operators provide customers with tracking facilities or reassurance that the parcel has reached its intended destination safely. However, there is some variability in the availability of market options, and in some instances, these can be less accessible and/or higher priced when users are sending parcels to, and/or from, Northern Ireland and the Scottish Highlands & Islands. We will continue to monitor how consumer needs for tracking evolve in future, including the extent to which the market meets these needs across the whole of the UK.

Potential impact on competition in the C2X market segment

- 7.39 We consider that consumers' interests in the parcel sector are best served by effective competition, as it promotes increased choice, product innovation and value for money. Therefore, we have considered the extent to which competition could be negatively impacted by including tracking in USO First and Second Class services, by enhancing Royal Mail's competitive advantages in the C2X segment of the market.

Competition in C2X is emerging and has the potential to develop further

- 7.40 We set out in Section 6 how competition in the parcels market is growing across segments, with multiple parcel operators competing for both retailer and residential customers. The degree and model of competition varies by segment.
- 7.41 While Royal Mail continues to deliver the majority of C2X parcels, competition from rival operators has developed in recent years. Sender usage of competing parcel operators has

⁴³⁰ <https://www.myhermes.co.uk/location-charge-postcodes>, last accessed 2 December 2021.

⁴³¹ Other C2X operators such as DPD also apply higher charges for deliveries to Northern Ireland and the Scottish Highlands & Islands and/or don't offer next day delivery services to some postcodes (see [DPD Local Tariff Guide](#) and [list](#) of services in the Scottish Highlands & Islands). Meanwhile, Yodel Direct does not currently offer a service for parcels being sent from Great Britain to Northern Ireland (search of Yodel Direct's 'How to Send a Parcel' [webpage](#), 1 November 2021).

⁴³² C2X quantitative research data tables, Table 20.

⁴³³ C2X quantitative research data tables, Table 29.

⁴³⁴ We also note our C2X qualitative research found participants who are digitally excluded tend to be more reliant on Royal Mail and the Post Office for sending parcels.

been growing year on year. Our tracker data shows Hermes usage is up from 15% in 2016/17 to 22% in 2020/21.⁴³⁵ DHL, DPD, FedEx and UPS have also seen higher usage for sending parcels over the past five years. In addition, our C2X research found that 63% of C2X senders had used a supplier other than Royal Mail in the last 12 months, suggesting they will choose the service that best matches with their needs when sending different parcels.

- 7.42 To help counter Royal Mail’s competitive advantages in the C2X segment (described in Section 6), alternative providers have mainly been able to compete in two ways - by offering products at competitive prices relative to Royal Mail, and/or by differentiating their C2X products by providing enhanced product characteristics, such as by offering tracking as standard:
- a) Our C2X research found that price was the main reason for senders using other operators (34%). Table 7.6 above shows how the market provides comparable, competitively priced offerings to Royal Mail.
 - b) Our C2X research found that tracking was the second most cited reason as to why people used another operator (32%). This suggests that the differentiation between Royal Mail’s USO First and Second Class products and competing tracked products may have contributed to the growth of other operators and the strengthening of competition in this segment.
- 7.43 The characteristics of the C2X segment suggest that there is scope for competition to grow further. Barriers to switching to other operators – and back to Royal Mail - for C2X senders are low. Senders of single piece parcels can choose which parcel operator to use on a parcel-by-parcel basis (as opposed to being tied into a contract with an operator). In addition, the expansion in the number of alternative access points means the ability to use competing services in C2X has increased.
- 7.44 Furthermore, people are now more familiar with alternative providers. The upsurge in B2C deliveries has meant senders were more frequently exposed to other operators through regular interactions as receivers of parcels. Our Residential Tracker research found that while 94% of people had heard of Royal Mail, awareness of some other operators is now also high (e.g. 84% for Hermes, 83% for DHL and 82% for FedEx). Higher familiarity and brand recognition mean people are more likely to consider and use alternatives.
- 7.45 Going forward, competition has the potential to develop further as operators continue to expand their networks and people become more familiar with and increase their usage of market alternatives.

The inclusion of tracking in First and Second Class USO services could adversely impact the emergence of competition in the C2X segment

- 7.46 Royal Mail is already able to offer tracked USO services (i.e. Special Delivery) and services outside the USO (e.g. Tracked 24/48) to those users who value tracking facilities. If tracking

⁴³⁵ [2020/21 Residential Postal Tracker](#)

becomes more important for some consumers, Royal Mail can improve and promote its commercial non-USO tracked products.

- 7.47 However, the inclusion of tracking in First and Second Class USO services could adversely impact the emergence of competition in the C2X segment. Royal Mail's products provided under the universal service – including First and Second Class parcels – are exempt from VAT.⁴³⁶ This exemption does not extend to other non-USO services provided by Royal Mail, including the single-piece Tracked 24/48 services. Nor does it apply to the tracked services that are provided by other parcel operators (which are not subject to universal service obligations).
- 7.48 Therefore, one of the consequences of permitting the inclusion of tracking facilities within the existing First and Second Class USO services would be to broaden the application of the VAT exemption to include tracked services (in addition to Special Delivery, which is already within the USO). This would mean that for most customers who are unable to reclaim VAT, such as residential consumers and very small businesses,⁴³⁷ Royal Mail would have a price advantage in the provision of tracked single-piece parcel services (all other things being equal).
- 7.49 Moreover, tracking as standard has been a point of differentiation for competitors. Adding tracking to First and Second Class parcels would therefore extend the VAT exemption to, and create an unlevel playing field in a part of the market where competition is emerging.
- 7.50 The research data provides evidence for this competition concern, as a significant number of people used rival operators for tracking services. In particular, people cited tracking being included as part of the service and price as the top reasons for why people switched to Hermes (34% and 43%, respectively). This change in competitive dynamics at a time when competition is developing (and any consequential reduction in C2X volumes) could reduce other operators' ability and incentive to compete in C2X. This in turn could cause them to scale back their operations and investment in C2X services, with negative implications for the number and spread of access points, for example.
- 7.51 If this were to occur to a material degree and the development of C2X competition was impaired, it could undermine the benefits consumers have gained (and could continue to gain) in terms of choice, innovation and value for money from an increasingly competitive market.

⁴³⁶ <https://www.gov.uk/guidance/vat-on-postage-delivery-and-direct-marketing-notice-70024>, last accessed 2 December 2021. The current UK VAT rate stands at 20%.

⁴³⁷ Some business users that are registered for VAT can claim back VAT on delivery services. The current registration threshold for taxable supplies is an annual turnover of £85,000, meaning few C2X senders would qualify. See: [VAT Notice 700/1](#).

Potential impact on the financial sustainability of the universal service

- 7.52 Royal Mail's CFI response stated that its current modelling indicates a long-term c.£[X] revenue and c.£[Y] profit risk p.a.,⁴³⁸ if tracking is not able to be provided on Universal Service parcel products and marketplace sellers and platforms require a tracked service.⁴³⁹
- 7.53 We do not consider this analysis to be supported by any evidence we have seen so far. There is nothing preventing Royal Mail from improving its distribution and pricing of its non-USO tracked parcel services on marketplace platforms (and/or in post offices) in response to an increase in demand for tracked services. Nevertheless, we have considered Royal Mail's analysis in more detail and assessed whether there is a risk to the financial sustainability of the universal service arising from our proposal to maintain the current position on tracking and USO products.

Royal Mail's response and modelling

- 7.54 We have considered the assumptions made by Royal Mail in its model. In particular, the model assumes:
- a) All marketplaces platforms require a tracked service and as a consequence, up to [X] of Royal Mail's marketplace volumes could be lost.⁴⁴⁰
 - b) All the lost Royal Mail volumes switch to market alternatives, i.e. there is no up trading to tracking alternatives within Royal Mail's product offering (to Special Delivery or Tracked 24/48).
- 7.55 The evidence we have gathered does not seem to support Royal Mail's assumptions:
- a) While some marketplace users value tracking services, Royal Mail's First and Second Class services remain the most popular options, with 62% offering the Second Class service and 50% offering First Class to buyers.⁴⁴¹ This suggests significant numbers of marketplace sellers will continue to use these services even if they remain 'untracked'.
 - b) We have not seen evidence that marketplace platforms are intending to require tracked postal options to be provided as a condition of selling on their marketplace. Indeed, some marketplaces even require the Second Class service to be offered as a delivery option to buyers.⁴⁴²
 - c) However, in the event that some marketplaces – or indeed sellers and buyers – were to require a tracked service to be provided, Royal Mail does already offer single-piece Tracked 24/48 services outside of the USO. We expect that it would have an incentive

⁴³⁸ Using 2019/20 revenues and volumes.

⁴³⁹ Royal Mail response to CFI, 6.54.

⁴⁴⁰ [X]

⁴⁴¹ In addition, our C2X research found that marketplace sellers who use First or Second Class services said that they had most of the features they were looking for.

⁴⁴² See Vinted, for example: "The Royal Mail Standard 2nd Class shipping is turned on by default for you as a seller and you cannot turn it off." <https://www.vinted.co.uk/help/528-royal-mail-standard-2nd-class-shipping>, last accessed 2 December 2021.

to make this option more easily accessible – such as making these services available at post offices – if there is increased demand for such a service.

- 7.56 As a consequence, we do not consider Royal Mail’s assumptions to be supported by the evidence we have seen so far. Given that we do not have evidence that marketplaces will require tracking, we anticipate the extent of switching to market alternatives will be driven by user behaviour (e.g. from consumer demand or sender peace of mind).

Our view of the potential impact on sustainability

- 7.57 We have modelled the potential profit risk of maintaining our existing approach to the USO on tracking, using different switching assumptions from Royal Mail.⁴⁴³ We assume between 5-15% of USO parcel users are at risk from switching to another operator to access a tracked service, based on the C2X research evidence:

- 26% of total senders said that adding tracking to the last Royal Mail parcel they sent would have better met their requirements. This group are most likely to switch to market alternatives.
- Of that 26%, we expect most users to continue to use Royal Mail due to its significant loyalty advantages. Indeed, our C2X research found that over seven in ten said they use Royal Mail due to familiarity, trust and/or habit.
- The 5-15% range reflects uncertainty around (i) how many of the 26% will consider switching to alternatives to access a tracked service, and (ii) the degree of loyalty advantage that Royal Mail has over some of its consumers.

- 7.58 Accounting for the revenue⁴⁴⁴ and cost⁴⁴⁵ impacts, this leads to a low profit risk of £[X] p.a., equivalent to a [X]% EBIT impact. This is an upper-bound estimate because we have not modelled these potential mitigating factors:

- **Up trading:** We expect some of those that highly value tracking to up trade to Royal Mail Tracked products - leading to a revenue gain.
- **Commercial responses:** Royal Mail would be able to respond commercially to increasing demand for tracking. For example, it could promote and/or make more accessible its non-USO Tracked services (e.g. by making them accessible at post offices).

- 7.59 Consequently, we do not consider there is a material risk to the financial sustainability of the USO arising from our proposed position on tracking.⁴⁴⁶

⁴⁴³ We used 2019-20 data on volumes, revenues, average unit revenues (AURs) and long run average incremental costs (LRAICs) for First and Second Class parcels – assessing both Signed For and non-Signed For Parcel services.

⁴⁴⁴ The revenue impact is a calculation of the volumes lost to market alternatives multiplied by their respective AURs.

⁴⁴⁵ The cost impact is a calculation of the volumes lost to the market multiplied by their respective LRAICs.

⁴⁴⁶ While our consumer research did find evidence that marketplace sellers [find tracking increasingly important / that it allows smaller marketplace sellers to be perceived as more professional], the current and foreseeable demand for tracking is not at the point where we would consider excluding tracking from the USO a risk to the sustainability of the universal service. We will monitor how demand for tracking develops over the next review period.

Provisional conclusion

- 7.60 The strategic aims of this review include the promotion of effective competition in postal services for the benefit of consumers and ensuring postal users have access to simple, affordable and reliable postal services that meet their needs.
- 7.61 We welcome the emerging competition in the C2X parcels market segment and consider there is further potential for that to develop to the benefit of consumers.
- 7.62 The market – including Royal Mail’s non-USO services and services provided by other parcel operators – offers a range of tracked parcel services which compete on a ‘level-playing field’. We are mindful that expanding the scope of the USO to incorporate tracking facilities for First and Second Class parcel services would put Royal Mail at a pricing advantage, and could hamper the further development of competition.
- 7.63 Given this risk to competition, any change in USO products requires there to be reasonable user need for tracking facilities, which is not being met by the market. Although our consumer research found that a significant minority of users value tracking facilities when sending some C2X parcels, it does not suggest that tracking should be regarded as a ‘hygiene factor’ for all First and Second Class USO services. Furthermore, for those users that require tracking facilities when sending parcels, there are a range of options provided by parcel operators and by Royal Mail. The market generally meets the needs of most users for tracking, though there is some variability in the accessibility and/or pricing when sending parcels to, and/or from, Northern Ireland and the Scottish Highlands & Islands.
- 7.64 We have provisionally concluded that Royal Mail should not be given the flexibility to determine its approach to revising First and Second Class services to incorporate tracking facilities. We are therefore not proposing to change our regulations on tracking and USO services at this stage – tracking should continue to be a required feature of the Special Delivery Guaranteed product, and we propose to maintain the requirement that the First and Second Class services should not include tracking facilities.
- 7.65 We plan to continue to monitor any developments in the extent to which users need tracking facilities when sending/receiving parcels and the degree to which the existing USO and the market is meeting those needs for users in all parts of the UK.

USO for parcels - Delivery Days

We are not proposing to make any changes to the current regulations on delivery days. Specifically, we are not proposing to extend the USO to include parcel delivery on Saturday.

Introduction and background

- 7.66 The minimum requirements set out in section 31 of the PSA 2011 require Royal Mail to deliver specified parcel services five days a week (Monday to Friday) to every address

across the UK. When making the Universal Service Order in March 2012, Ofcom did not add to these minimum parcel delivery requirements.⁴⁴⁷

- 7.67 Royal Mail has stated that the “best way to ensure that the USO meet customers’ needs is to rebalance our business model more towards parcels”.⁴⁴⁸ In practice, Royal Mail already delivers USO parcels on Saturdays, so it is providing this service six days a week.⁴⁴⁹ This may partly be a consequence of the synergies arising from Royal Mail meeting the requirement to deliver letters on Saturdays. It may also reflect the need to respond to competition in the parcels market due to the growth in online shopping, with other parcel operators offering a six (or, in some cases, seven) day delivery service. We note, however, that the focus of other parcel operators is usually on providing parcel services to online retail businesses (rather than on the C2X services met by the USO), and there are some differences in the services offered when delivering to some geographical locations.

Stakeholder responses to our March CFI

- 7.68 In its response to the CFI, Royal Mail highlighted that it currently delivers parcels six days a week, adding that it sees no immediate need to add Saturday (or Sunday) deliveries to the USO. It suggested that the current regulations reflect consumer demand and market dynamics in the parcel sector. Royal Mail also said that it welcomes ongoing dialogue with Ofcom and the Government to ensure that the Universal Service regains relevance and is sustainable.⁴⁵⁰
- 7.69 The CWU said the USO should be extended to cover parcel delivery six days a week. It said this would help to meet increased demand for parcels whilst also strengthening the universal service and making six days letter delivery more efficient.⁴⁵¹

Provisional conclusion

- 7.70 Our research, set out in our 2020 Review of User Needs document, suggests very high levels of user satisfaction (98% for residential users, 97% for SME users) with the current six day parcel delivery service provided by Royal Mail. It also suggests that satisfaction would remain at these high levels (98% for residential users, 96% for SME users) in the event of Royal Mail withdrawing its Saturday delivery service (in line with current minimum requirements set out in legislation).⁴⁵²

⁴⁴⁷ Section 30(3) of the PSA 2011 specifies that before modifying the universal postal service order, Ofcom must carry out an assessment of the extent to which the market for the provision of postal services in the UK is meeting the reasonable needs of the users of those services.

⁴⁴⁸ Royal Mail, 18 November 2021. Royal Mail plc results for the half year ended 26 September 2021.

⁴⁴⁹ Royal Mail has recently introduced Sunday parcel deliveries for some large retailers and says it envisages seven day parcel services in the future. Royal Mail, 18 November 2021. Royal Mail plc results for the half year ended 26 September 2021.

⁴⁵⁰ Royal Mail response to the CFI, p86.

⁴⁵¹ CWU response to the CFI, p14-15.

⁴⁵² Ofcom, 2020. Review of postal users’ needs, pages 61-63 and Jigsaw, 2020. [UK Postal User Needs: Qualitative Research Report](#), page 33.

- 7.71 We note the CWU's input, but we consider that Royal Mail's current delivery services (which go beyond the minimum requirements) and the parcel services offered by other parcel operators, appear to be meeting user needs. We are therefore not proposing to make any changes to the current rules on delivery days at this time.

USO for parcels - Weight Limit

We are not proposing to make any changes to the current USO requirements relating to parcel weight limits.

Introduction and background

- 7.72 The USO requirements on Royal Mail only exclude parcels that weigh in excess of 20kg. There is some evidence suggesting that the market is offering C2X services for heavier parcels that may meet the needs of individuals and/or SME users. In particular, there are a number of operators who offer C2X parcel services for heavier parcels at prices that are lower than Royal Mail prices.⁴⁵³
- 7.73 In our CFI, we suggested that there may be a case for exploring a reduction in the weight limits for parcels covered by the USO, if there is compelling evidence that the market is meeting user needs below the current weight limit.

Stakeholder responses to our March CFI

- 7.74 Royal Mail stated that the current USO parcel weight limit should be retained, as reducing the limit to below 20kg could be detrimental to customers. It stated that there are some areas of the country where the market is not providing a reliable, affordable collection and delivery service at these parcel sizes.⁴⁵⁴
- 7.75 The CWU said it did not accept that there is any case for reducing the weight limit for parcels covered by the USO. It noted high surcharges imposed by courier services for non USO services delivered to remote and other difficult to serve areas.⁴⁵⁵

Provisional conclusion

- 7.76 Taking account of stakeholder responses, we do not consider it necessary to propose changes in this area as part of this review.

⁴⁵³ Ofcom (Nov 2020), [Review of postal users' needs](#), Figure 6,

⁴⁵⁴ Royal Mail response to the March CFI, p86-87.

⁴⁵⁵ CWU response to the March CFI, p15.

Consultation questions

Question 7.1: Do you agree with our proposal not to include tracking facilities within First and Second Class USO services? Please substantiate your response with reasons and evidence.

Question 7.2 Do you have any further evidence or views on other issues relating to USO parcels regulation? Please substantiate your response with reasons and evidence.

8. Access for bulk mail

Bulk mail refers to mail sent in large volumes, typically by big organisations such as banks or charities and is therefore distinct from single-piece mail services such as those included in the universal postal service. Royal Mail has the only significant letter delivery network in the UK but access regulation allows a party other than Royal Mail to collect and sort the bulk letters, before handing them over to Royal Mail for delivery. In 2020/21, bulk letters collected by access operators continued to make up the majority of bulk letters sent and a large proportion of total addressed letter volumes, at 5.01 billion items.

This existing access framework has worked well in promoting effective retail competition in bulk letter services, bringing benefits to its users. In 2020/21, competing access-based operators accounted for over 70% of bulk letter volumes. Although stakeholders raised some issues in relation to certain aspects of our access framework, we have not seen evidence to suggest that the framework itself needs to change and/or that we should do more to promote competition in retail bulk letters.

Therefore, we are proposing to retain all the current access regulatory safeguards, which provide backstop protections for access users while still providing them and Royal Mail with commercial and operational flexibility to respond to market changes. We are not proposing to extend these safeguards to bulk parcels, nor to exclude fulfilment Large Letters from the scope of access regulation, as was suggested by Royal Mail. We believe our proposals will continue to promote effective retail competition in bulk letters and parcels, to the benefit of postal users, and support a financially sustainable and efficient universal postal service.

Current access regulation

Existing access framework

8.1 The current access regime imposes a universal service provider access (“USPA”) condition on Royal Mail to provide certain wholesale bulk mail services. Specifically, the USPA condition⁴⁵⁶ requires Royal Mail to offer access, on reasonable request, to its postal network for:

- D+2 and later than D+2 Letter and Large Letter services⁴⁵⁷ (‘D+2’)⁴⁵⁸; and

⁴⁵⁶ [USP Access Condition](#)

⁴⁵⁷ Retail services that aim to deliver two working days (or later) after collection from the sender, also known as a day C service, or later.

⁴⁵⁸ ‘D+X’ (e.g. D+1, D+2, D+5) means the total time between the sender sending the postal packet, and it being delivered to the recipient. For example, D+2 refers to the customer (sending the letter) to be injected into Royal Mail’s network for it to then be delivered 2 days later i.e. on D+2.

- D+5 Letter services ('D+5')⁴⁵⁹. We extended the USPA condition to cover this new D+5 service in March 2021.⁴⁶⁰
- 8.2 Royal Mail is required to provide access to its network for these services at its Inward Mail Centres (IMCs). The IMC is the point at which access operators inject their mail (after having collected and sorted it themselves) for Royal Mail to deliver.
- 8.3 To date, we have allowed Royal Mail to have commercial and operational flexibility to set the terms, conditions and charges of its access services, but subject to some important safeguards. These safeguards include a requirement on Royal Mail to:
- provide access on fair and reasonable terms, conditions and charges;
 - not unduly discriminate, and to restrict its use of information obtained in connection with giving access;
 - publish a copy of its standard terms and conditions and provide notification of changes to these terms and conditions (in accordance with rules on minimum notice periods);
 - comply with a control to prevent a price squeeze on mandated access services;
 - have a statement of the process that will apply to requests for new access services, or to variations to existing mandated access contracts (commonly referred to as the Statement of Process); and
 - publish such information as is reasonably necessary for the purposes of securing transparency as to the quality of service of its downstream access services.

Structure of this section

- 8.4 In the remainder of this section we provide an overview of the market developments in bulk mail since our 2017 review. We then consider stakeholder responses to our March CFI in relation to our existing access framework and set out our proposals for consultation.
- 8.5 We have grouped our proposals around the following three themes:
- scope of access regulation;
 - approach to access price regulation; and
 - approach to regulating non-price terms of access.

Market context

Bulk letter volumes

- 8.6 The number of bulk letters delivered in the UK continues to decline, reducing from [X] items in 2015/16 to [X] items in 2020/21.⁴⁶¹ This represents an average yearly decline of [X] over this period.⁴⁶² A similar trend was followed by bulk letters collected by access

⁴⁵⁹ The D+5 Letters access service allows access customers to inject bulk letters into the Royal Mail network for delivery up to four working days from the injection date. This access service is available for Letter formats only (i.e. not Large Letters or parcels).

⁴⁶⁰ Ofcom, 2021, [Statement: Modifications of the USP Access Condition for regulating access to Royal Mail's postal network](#)

⁴⁶¹ Royal Mail's regulatory financial reporting to Ofcom. Volumes include bulk letters only.

⁴⁶² This reflects the compounded average growth rate between 2015/16 and 2020/21.

operators, which make up the majority of total bulk letters. Access bulk letters reduced from 7.12 billion items in 2015/16 to 5.01 billion items in 2020/21, representing an average yearly decline of 6.9% over this period.⁴⁶³

- 8.7 An important driver of letter volume decline to date is the migration of bulk letter customers to online methods of communication (i.e. e-substitution). Other factors affecting letter volumes include GDP growth and letter prices (which have been increasing over the last 5 years).
- 8.8 Bulk letter volumes were particularly affected by Covid-19. In 2020/21, bulk letters declined by [X].⁴⁶⁴ Royal Mail reported that its addressed advertising mail volumes were down 49% in the first half of 2020-21, whilst it said business mail volumes declined at a rate “just under half that seen for advertising mail.”⁴⁶⁵ This compares to an average annual drop of [X] in the preceding four years, and reflects the major impact Covid-19 had on mailings as many companies shut down operations during the initial lockdown only to see a gradual recovery throughout the rest of the year, with some sectors such as theatre, entertainment, travel and holiday companies not mailing at all.
- 8.9 Bulk letter volumes have been recovering since then and recent data suggests that this trend has continued in the first quarter of 2021/22, supported by the recovery of the wider UK economy.⁴⁶⁶
- 8.10 However, we expect the long-term declining trend in bulk letters to continue over the next few years, as bulk mail users continue to migrate to online communication. Regulatory requirements for paper correspondence and difficulty in moving some customers online however means that bulk letters will continue to be important. Therefore, our expectation is that bulk letters will remain a core postal service and core contributor to a financially sustainable universal service for the period of this review.

Market competition

- 8.11 Royal Mail is currently the only postal operator with a nationwide end-to-end letter delivery network in the UK. Although Whistl began to roll out a competing letter delivery network in 2012, it ceased its end-to-end mail delivery operations in 2015.⁴⁶⁷

⁴⁶³ Ofcom Annual Monitoring data.

⁴⁶⁴ This is in line with the drop observed for addressed letter volumes which declined by 22% in 2020/21.

⁴⁶⁵ Royal Mail plc, 19 November 2020, Results for the half year ended 27 September 2020, page 5. [Accessed 1 December 2021]

⁴⁶⁶ Royal Mail’s regulatory financial statement for Q1 2021/22.

⁴⁶⁷ In 2018, Ofcom concluded an investigation into a complaint brought by Whistl against changes being made by Royal Mail to its wholesale access letters contracts. This complaint was submitted in 2014, prior to Whistl’s exit from the end-to-end letters market. As a result of our investigation, we found that Royal Mail had abused its dominant position in the market for bulk letters delivery services in the UK by seeking to introduce discriminatory prices, and that this breached competition law. This resulted in a £50 million fine for Royal Mail. This decision was later upheld by the Competition Appeal Tribunal in November 2019 (*1299/1/3/18 Royal Mail plc v Office of Communications*), and by the Court of Appeal (*Royal Mail Plc v Office of Communications and Whistl* [2021] EWCA Civ 669). We note that Royal Mail has applied for permission to appeal this matter to the Supreme Court.

- 8.12 Retail competition is strong, supported by access regulation. There are currently over 10 access operators⁴⁶⁸ which use Royal Mail's postal delivery network to compete for retail bulk letter users. Access operators competing with Royal Mail account for over 70% of retail bulk letter volumes. This share has been growing in the last five years, rising from [X]% in 2015/16 to [X]% in 2020/21.
- 8.13 Consolidation in the industry continues, both between access operators and across the postal sector more generally. Since 2016, there have been a number of mergers/acquisitions, including the following: DHL acquired UK Mail, The Delivery Group (owners of end-to-end letter operator CMS and access operator Secured Mail) acquired OnePost, Paragon Group acquired Northern Mail and Critiqom was acquired by Opus Trust.⁴⁶⁹ Currently [X] access operators account for over 90% of total access bulk mail volumes.
- 8.14 As we noted in our 2017 Statement⁴⁷⁰, given declining letter volumes, we consider it is unlikely that nationwide end-to-end competition will emerge in bulk letters in the future.

Retail and access prices

- 8.15 Retail bulk letter prices and access charges have risen in recent years. Price increases have not been uniform across all bulk letter services though. For advertising mail services, access charges have remained relatively flat (in real terms) during the period from January 2016 to January 2021; while for business mail services, access charges have risen on average by 5.9% (in real terms) during the same period.⁴⁷¹
- 8.16 Business mail access charges have increased particularly in the years 2019, 2020 and 2021 – see Figure 8.1. Most recently, Royal Mail announced a further price rise for access business mail which will come into effect in January 2022.⁴⁷²
- 8.17 While average access charges have increased in real terms, the net revenue per unit earned by access operators (i.e., the differential between the retail price offered by access operators and Royal Mail's access charge) increased by less than 1% per annum (in real terms)⁴⁷³, suggesting that the upstream margin has remained relatively flat over the period from 2016 to 2021.
- 8.18 We expect bulk letter unit costs to continue to face upward pressure over the next five years as letter volume decline trends will continue to put pressure on Royal Mail's (largely

⁴⁶⁸ Based on the 2019/20 data for the Annual Monitoring Report.

⁴⁶⁹ Ofcom, 2019. [Annual Monitoring Update on the postal market 2018-19](#), paragraphs 4.27 to 4.28; Ofcom, 2020. [Annual monitoring Update on postal services 2019-20](#), paragraph 3.66.

⁴⁷⁰ Ofcom, 2017. [Review of the Regulation of Royal Mail: Statement](#), paragraph 3.105.

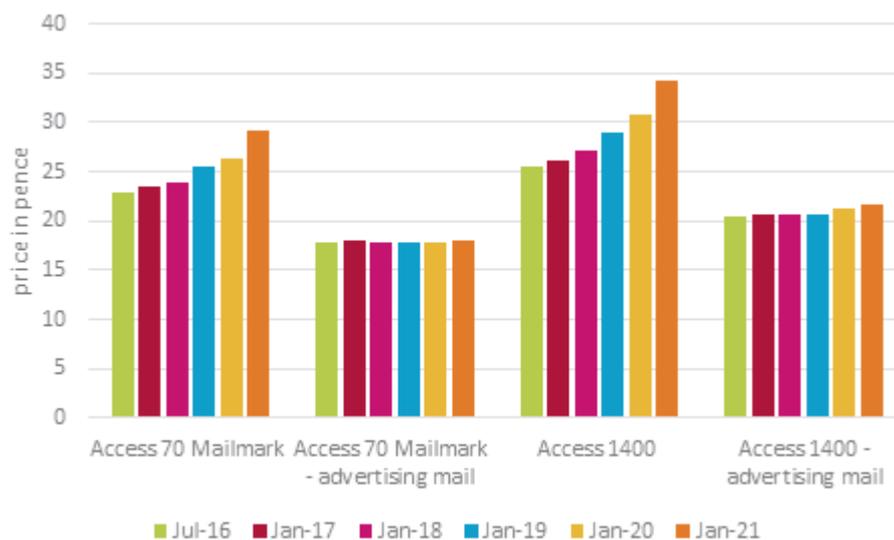
⁴⁷¹ Ofcom calculations based on Royal Mail [wholesale price list](#). The figure is the average real compound growth rate (between 2016-2021) in price of the three main business mail products (Mailmark 70, Access 1400 and Access 70 OCR). Not all products had the same rate of real growth rate. Mailmark 70 had a price growth rate of 5.01%, compared to 6.17% for access 1400 and 6.56% for Access 70 OCR. Note that the real prices for 2021 were calculated based on forecast data from the Office for Budget Responsibility.

⁴⁷² <https://www.royalmailwholesale.com/news/access-notice-price-changes-for-the-access-letters-contract-from-4-january-2022>.

⁴⁷³ Ofcom Annual Monitoring data for revenue information and Royal Mail's financial reporting (financial year 2019/20) for volume information. We use CPI to convert to real figures.

fixed) costs. However, as discussed in Section 4, Royal Mail acknowledges that it needs to improve its efficiency, and has a plan to achieve cost efficiencies until 2023/24. If successfully executed, we expect this plan will help offset the impact of declining letter volumes on Royal Mail’s costs to some degree.

Figure 8.1: Access charges for a selection of access products (real prices as of 2020), July 2016 to date



New products and services

- 8.19 Since our last review, the adoption of Mailmark services has grown significantly and new services have emerged.
- 8.20 Mailmark is an access product variant which allows more efficient processing through the higher quality identification of addresses/information and involves adding a barcode to each item for its unique identification and tracking through the network.⁴⁷⁴ Over the last five years, the proportion of access volumes that is Mailmark has grown to around 90% for Letters and nearly 60% for Large Letters.⁴⁷⁵ Our expectation is that this proportion will continue to grow during the review period.
- 8.21 New services launched by Royal Mail over the last five years include 48-way sort for machine-readable letters, partially addressed services for advertising/direct mail customers and magazine subscription services.
- 8.22 More recently, Royal Mail introduced a D+5 Letters access service. This new service aims to offer a cheaper but potentially slower service to access customers, with the aim of allowing Royal Mail to achieve cost savings in the delivery of mail by enabling it to consolidate mail

⁴⁷⁴ Further information can be found in Royal Mail’s [Mailmark Customer Presentation](#).

⁴⁷⁵ Ofcom/Royal Mail meeting, November 2020, [3<].

at the IMC and reduce the frequency at which a post person needs to visit each address. Given the lower price of the service and the willingness of some bulk letter users to trade-off lower price for a slower service (with less certainty over the day of delivery)⁴⁷⁶, we expect a material proportion of existing bulk letter users to migrate to the new D+5 service across the review period. Nonetheless, we expect current and future bulk letter users to continue to require D+2 services.

- 8.23 There have also been a number of new service requests (NSRs) that access operators have raised with Royal Mail, but which have not yet resulted in new services:
- In 2016/17, a number of access operators submitted a NSR for a Confirmation of Delivery (COD) Large Letter product. This did not proceed to the product being launched.
 - In 2019, a number of access operators submitted a NSR for a Scan on Delivery Letter, Large Letter and parcel product. At the start of the COVID-19 pandemic, Royal Mail and access operators agreed to not progress the NSR further.
 - In 2021, an access operator submitted an NSR for a tracked Large Letter product. We understand that this remains under discussion between the access operator concerned and Royal Mail.

Provisional conclusion

- 8.24 Overall, we believe that the current access framework is working well in supporting retail competition in bulk letters, with Royal Mail having a minority share of retail bulk letters and facing a few large, and five to ten smaller, retail competitors.
- 8.25 Although bulk letter volumes will likely continue to decline, mainly driven by e-substitution, we expect bulk letters to remain a core postal service and a core contributor to a financially sustainable universal service for the period of this review.
- 8.26 The declining volume trend in the market means that bulk letter unit costs are likely to continue to face upward pressure over the next five years, though we expect this pressure to be somewhat mitigated by Royal Mail's efficiency initiatives.
- 8.27 We have developed our proposals on access regulation for this consultation taking account of this broader market context. In particular, given that nationwide end-to-end competition is unlikely to emerge in the future and bulk letters will remain an important service for postal users, we see a continued role for access regulation to support retail competition for bulk letters in the UK for the period of this review.

⁴⁷⁶ As set out in our decision on mandating D+5 access letter services, the price differential (excluding VAT; as of January 2021) between comparable D+2 access and D+5 access services is roughly 3%.

Scope of access regulation

Introduction

- 8.28 Royal Mail is currently required to provide access at its IMC to third party operators for the supply of D+2 Letters and Large Letters and D+5 Letters. In addition, Royal Mail provides access to third parties on a commercial basis for the supply of D+1 letters and small bulk parcel services.
- 8.29 In response to our March CFI, no stakeholder suggested that we should remove access regulation for bulk letter services. However, some stakeholders suggested some changes to the scope of our access regulation.

Stakeholder responses to our March CFI

- 8.30 In response to our March CFI, Royal Mail called for ‘fulfilment Large Letters’ (FLLs)⁴⁷⁷ to be removed from the scope of the access mandate as, in their view, they are used by access operators to address the parcels market, which Royal Mail considers competitive.
- 8.31 On the other hand, some access operators called for access regulation to be expanded to small bulk parcels and to other access points within the Royal Mail postal network.
- 8.32 In this subsection we set out our provisional view on these matters. Our provisional view is that access regulation should continue to require D+2 Letters and Large Letters and D+5 Letters for the period of this review.⁴⁷⁸ In addition, for the reasons set out further below, we are not proposing to expand access regulation to small bulk parcels, nor to remove FLLs from the scope of access regulation.

We are not proposing to extend access regulation to small bulk parcels

Introduction

- 8.33 In response to our March CFI, some access operators called for access regulation to be imposed on Royal Mail’s small bulk parcel services. They argued that Royal Mail is dominant in the provision of these services, claiming that:
- a) Royal Mail accounts for a substantial share of the parcel volumes carried on behalf of access operators in the sub 2kg weight category⁴⁷⁹;
 - b) Royal Mail has recently applied large price increases to its access parcels, which would not be possible in a competitive market;

⁴⁷⁷ FLL is defined and discussed further above in the section.

⁴⁷⁸ In our 2012 Statement we found that significant barriers to entry exist in developing a delivery network that predominantly relate to Royal Mail’s economies of scope and scale advantages that were likely to limit the extent of end-to-end competition. As we have already established above, we consider it unlikely that there will be an end-to-end letter competitor to Royal Mail in the immediate future, and therefore, access operators will remain reliant on access to Royal Mail’s postal network to supply retail bulk letter services to their customers.

⁴⁷⁹ Royal Mail offers wholesale parcel services for two weight categories: 1g to 1000g and 1001g to 2000g.

- c) Royal Mail is not yet offering a tracked parcels access service despite requests from access operators; and
- d) some other end-to-end parcel operators are reluctant to carry small parcels on behalf of access operators.

8.34 Royal Mail contended that alternative end-to-end parcel operators already provide effective competition for all types of parcels, and hence did not see the need for access regulation.⁴⁸⁰ It argued that in 2017, Ofcom found no evidence to warrant mandating parcels, which provided it regulatory certainty to invest in modernising its parcels business. Mandating access parcels now would dampen its incentives to invest in the future. [§] ⁴⁸¹ Moreover, it contended that if mandation leads to it losing retail parcel volumes this would affect its ability to recover the fixed costs of the universal service network, with negative consequences for the financial sustainability of the universal service.

8.35 Hermes suggested that parcels mandation could damage competition in the parcels market.⁴⁸² [§] It contended that access operators can and do negotiate wholesale contracts with alternative parcel operators. It also stressed that mandation could lead to alternative parcel operators exiting the small parcel segment of the market, reducing competition for all consumers if Royal Mail secures significant access volumes.

Our provisional assessment and view

8.36 The PSA 2011 only allows Ofcom to impose a universal service provider access condition if it appears to Ofcom that it is appropriate to do so for the purpose of promoting efficiency, promoting effective competition and conferring significant benefits on the users of postal services.⁴⁸³

8.37 To reach a view on whether this legal test would be satisfied by the extension of access regulation to small bulk parcels, we consider below the extent of competition in the provision of retail bulk small parcels. We then consider the impact that extending access regulation to small bulk parcels could have on effective competition.

⁴⁸⁰ Royal Mail response to our CFI, page 94.

⁴⁸¹ Royal Mail response to our CFI, page 100.

⁴⁸² Hermes response to our CFI, pages 8 and 9.

⁴⁸³ As noted in Annex 6, Ofcom's power to impose a USPA condition is also subject to our duty to secure the provision of a universal postal service, having regard to the need for that service to be financially sustainable and efficient.

There is competition in the provision of retail bulk small parcels and this is improving over time

8.38 In our 2017 Statement, we recognised that Royal Mail was likely to have a competitive advantage in the supply of small bulk parcels given its position as universal service provider and its ability to deliver small parcels through the universal service network.⁴⁸⁴ This has resulted, to date, in Royal Mail being the largest provider of small bulk parcels in the UK.

8.39 However, as we discuss in Section 6, there is evidence of competition in small bulk (B2C) parcels growing over time. This is evidenced by alternative parcel operators increasing their presence in the small B2C parcel segment over the last five years and Royal Mail losing share of small B2C parcels over this same period of time.

Extending access regulation to small bulk parcels carries the risk of harming parcels competition

8.40 As set out in Section 2, our regulatory objective for the parcels market is to support effective competition for the benefit of consumers. For the reasons set out below, we are concerned that extending access regulation to small bulk parcels carries the risk of harming end-to-end competition in the parcels market, and so could be contrary to our overall aims.

- Small parcels account for a significant portion of the parcels market. Royal Mail estimates that [X]% of total parcel deliveries in the UK are small or lightweight⁴⁸⁵, and we consider that their importance is likely to grow over time with the growth of e-commerce.
- As set out above, end-to-end competition for smaller bulk parcels has been growing. Although access competition could in theory result in increased competitive pressure on Royal Mail in the retail part of the supply-chain, this only accounts for a fraction [X]⁴⁸⁶ of the price/value of the end-to-end parcel service, so benefits from access competition are likely to be smaller than those from end-to-end competition.
- In addition, extending access regulation to small bulk parcels could give access operators a competitive advantage (relative to alternative parcel operators) for parcel customers who are exempt for VAT purposes.⁴⁸⁷ This is because small bulk parcels mandation would mean that VAT is not chargeable by Royal Mail to access operators on the downstream charge for small parcels carried by Royal Mail, hence the total charged to these companies would be lower (all else equal).⁴⁸⁸ Although alternative parcel operators could overcome this disadvantage by becoming access operators themselves, this would have the downside of weakening end-to-end competition.

⁴⁸⁴ 2017 Statement, see paragraph 3.157.

⁴⁸⁵ Royal Mail response to our March CFI. Proportion of total parcel deliveries includes those parcels which have a weight of 2k or less, or a size which means that items can be foot deliverable (i.e. letterboxable or non-letterboxable but foot deliverable).

⁴⁸⁶ While access parcel charges are around [X]p per item, the upstream parcel value is around [X]p.

⁴⁸⁷ For example, banks and charities. This would not benefit those end customers who are able to claim back VAT on their inputs.

⁴⁸⁸ VAT legislation is a matter for HM Revenue and Customs (HMRC) and Government, thus does not fall under Ofcom's remit.

- The effects of intervention may not be limited to small bulk parcels. Given that bulk customers often send a mix of small and larger parcels⁴⁸⁹, the intervention could have a knock-on effect on the way that carriers compete for these types of customers.

Our provisional view on mandation of access in respect of small bulk parcels

- 8.41 In light of the above, our provisional view is that extending access regulation to small bulk parcels would not satisfy the legal test for imposing a universal service provider access condition. We are therefore not proposing to do this.
- 8.42 In particular, there is evidence indicating that competition in small bulk parcels has been growing over the last five years, and extending access regulation to this type of parcels carries the risk of weakening competition for these services (and other parcel services). This could reverse the positive trend in competition observed in the last few years, and hence would be contrary to our regulatory objective of supporting effective competition in the parcels market.

We are not proposing to extend access regulation to other bulk letter services nor to other points in the Royal Mail postal network

Introduction

- 8.43 In response to our March CFI, some access operators called for access regulation to be extended to other bulk letter services (i.e. business reply mail), and to additional points in the Royal Mail network.
- 8.44 UK Mail pointed out that the Royal Mail network may change significantly with the deployment of parcel hubs and dedicated parcel routes, which could mean that points other than the IMC could become more appropriate points of access.⁴⁹⁰ Whistl made a similar point suggesting that access should be expanded to other parts of the Royal Mail network, such as Royal Mail's new parcel hubs, with the purpose of encouraging innovation in other parts of the supply-chain.⁴⁹¹
- 8.45 UK Mail also mentioned that in the past, access operators have requested access regulation to be expanded to outward mail centres (OMCs) to enable them to collect mail when handing over mail for delivery.⁴⁹² UK Mail argued that this would introduce competition for services such as Business Reply mail and Selectapost which are generally paid for by businesses who typically use access services for their outbound mail.⁴⁹³

⁴⁸⁹ In response to our statutory information request, Hermes stated that [redacted]. Likewise, DPD indicated that [redacted]. DHL explained that [redacted]

⁴⁹⁰ UK Mail response to CFI, page 7.

⁴⁹¹ Whistl response to CFI, paragraph 7.1.12.

⁴⁹² UK Mail response to CFI, page 7.

⁴⁹³ These are prepaid services offered by postal operators to bulk mail users for their own customers to reply back at no extra cost.

Our provisional view and assessment

- 8.46 We have not been presented with the evidence needed to fully consider whether it would be appropriate to mandate additional handover points for access services. However, we note that, given the declining nature of the letters market, we would not be inclined to extend access regulation unless it appears necessary to support access-based competition, promote efficiency and/or confer significant benefits to postal users. As we already noted in this section, the current access framework has enabled access operators to compete successfully against Royal Mail in retail bulk letters. We are therefore not persuaded that the scope of access regulation needs changing to support effective competition for these services.
- 8.47 In relation to Whistl's call to extend access regulation to Royal Mail's new parcel hubs, we note that Royal Mail is planning to use these hubs to process parcels only. Given that we are not proposing to extend access regulation to small bulk parcels (as explained in the subsection above), we do not see merit in extending access regulation to Royal Mail's new parcel hubs.
- 8.48 Regarding UK Mail's request to impose access regulation on Royal Mail's OMCs for the provision of business reply services, we note that these services account for less than 1% of total bulk mail volumes. They are also declining over time, dropping from [X].⁴⁹⁴ Moreover, the USO already provides some indirect protection for bulk users of this type of mail, via requirements on the frequency and quality of service of collections, as well as a cap on the end-to-end price of Second Class single-piece mail.⁴⁹⁵ Therefore, our provisional view, based on the information we have now, is that it would be disproportionate to extend access regulation to the OMC for the provision of business reply mail.⁴⁹⁶
- 8.49 We remain open to considering additional forms of access in accordance with the statutory tests set out in the PSA 2011. As per our 2017 Statement⁴⁹⁷, we would expect any future requests for these (or other) forms of access to be supported with detailed evidence from access seekers on:
- a) the access seeker's business case for the proposed form of access;
 - b) a description of the perceived operational requirements of the proposed form of access; and
 - c) an assessment of how the form of access meets the tests set out in the PSA 2011 for the imposition of an access condition (on which, see Annex 6). In addition, an assessment of how this form of access would be consistent with Ofcom's primary duty

⁴⁹⁴ Information from Royal Mail's Regulatory Accounts, data extracts.

⁴⁹⁵ This means that if Royal Mail were to increase prices for 'Reply' mail services excessively, bulk mail users could ask customers to use USO services to reply back and offer them reimbursement for the cost of these services.

⁴⁹⁶ Imposing access regulation on Royal Mail's business reply services would also likely require Royal Mail to incur costs in relation to developing new systems and adapting its postal network and processes in order to offer the new access service.

⁴⁹⁷ See paragraph 5.69 of our 2017 Statement.

to secure the provision of a universal postal service, having regard to the need for that service to be financially sustainable and efficient.

We are not proposing to remove access regulation for FLLs

Introduction

- 8.50 Access FLLs (also known as General Large Letters) are a Large Letter service offered by Royal Mail to carry goods and paper-based mail on behalf of access operators. Royal Mail currently solely provides an untracked version of this service. Unlike with Advertising Mail and Business Mail Large Letter services, there is no contractual prohibition on the carrying of goods (i.e., items with an intrinsic value) with access FLLs, and there is greater flexibility on the type of packaging allowed.⁴⁹⁸
- 8.51 Royal Mail introduced access FLLs in 2014 with the main purpose of enabling it to separate, more efficiently, Large Letters which can be sorted using mechanical means from those which require manual sortation, and thus achieve cost efficiencies in the processing of mail. This is because, unlike with Advertising Mail and Business Mail Large Letter services, access FLLs are generally sorted by Royal Mail using manual processes.
- 8.52 Royal Mail claims that FLLs look more like a parcel than a letter, as they are often used to send goods. It also claims that FLLs are treated more like parcels in its operations as they require manual sortation. In addition, Royal Mail does not see substantial supply and demand side differences between FLLs and small parcels. Therefore, it argues that, given that the parcels market is competitive across all segments, FLLs should be removed from the scope of access regulation.

Our provisional view and assessment

- 8.53 The existing mandated access services are specifically for Letters and Large Letters⁴⁹⁹, which are defined based on dimensions, rather than contents. This means that mandated access services can be used to deliver both paper-based mail and ‘goods’, provided the items fit within the defined dimensions of the mandated access service.
- 8.54 The use of FLLs by access operators is currently small relative to other access services. Access FLLs account for [X] of total access volumes (including Letters and Large Letters), and [X] of total access Large Letters volumes.⁵⁰⁰
- 8.55 Access operators and bulk mail users use FLLs to fulfil the provision of retail bulk letters.⁵⁰¹ They use FLLs to carry:

⁴⁹⁸ Unlike business mail Large Letter, FLLs can be used with padded envelopes, cardboard and any other stiff or inflexible packaging that cannot easily be manually folded.

⁴⁹⁹ With the exception of D+5 Access, where the scope of mandate includes standard letters only. This was because Ofcom did not consider it appropriate to require the provision of a D+5 Large Letter service if, as we understand, it would be a higher cost to deliver than the existing D+2 service: see paragraph 5.54 of [Ofcom's D+5 statement](#)

⁵⁰⁰ Figures are based on information provided by Royal Mail in response to our CFI and Royal Mail's regulatory accounts.

⁵⁰¹ Meetings between Ofcom and access operators.

- a) Paper-based mail that has more protective packaging and which therefore does not meet the packaging requirements for Advertising and Business Mail Large Letters. Examples of this include university certificates, business reports which are carded in the rear and welcome packs which are not foldable;
 - b) Goods which are posted by bulk mail users to their own customers, such as bank card readers, tokens, NHS test kits, and Wi-Fi routers which are sent by telecom operators to their own customers.
- 8.56 Access operators also use FLLs to carry goods on behalf of retail bulk parcel customers. Examples of items carried for these purposes include DVDs, books, contact lenses and seeds.
- 8.57 We are concerned that removing FLLs from the scope of our access remedy could undermine the effectiveness of our regulations in supporting competition in retail bulk letters. We note that:
- a) Some bulk letter users do use FLLs to send letters which do not meet standard packaging requirements and/or to send physical items to their own customers, such as bank card readers and Wi-Fi routers.
 - b) We understand that these bulk letter users tend to send these types of mail occasionally so having to contract with multiple carriers in order to carry a small number of items is unlikely to be attractive to them.
 - c) Moreover, there are likely to be efficiencies from having the same carrier collecting FLLs and non-FLL Letters and Large Letters as they are likely to be collected from the same site. This could make multicarrier contracts more costly for business letter users than having a single carrier contract, particularly given the lower volumes of FLLs.
- 8.58 Therefore, we consider that there is a real risk that the ability of access operators to compete for bulk letter users could be impaired, without access to a mandated FLL service.
- 8.59 There are also practicality issues and additional costs which could arise if FLLs are removed from the access condition. This is due to the difficulties involved in controlling the content included in the letters posted by access users. Indeed, Royal Mail recognises in its internal board papers that [X].⁵⁰² These difficulties could worsen if there is regulatory divergence between FLLs and standard Large Letters.
- 8.60 We do recognise the possibility that large-scale unintended use of FLLs to deliver goods could harm competition in the parcels market. However, the evidence available to us now suggests that the use of FLLs by access operators is unlikely to harm parcels market competition in a material way.
- 8.61 As already mentioned, the number of access FLLs is small relative to total access volumes. This number is also very small relative to total domestic parcels in the UK, as access FLLs

⁵⁰² Royal Mail response to question 4 of our statutory information request dated 8 June 2021.

represent [3<] of these volumes.⁵⁰³ This proportion has also been declining in recent years, falling from [3<]% in 2017/18 to [3<]% in 2019/20.

- 8.62 Furthermore, as we have already mentioned, end-to-end competition has emerged across all segments of the parcels market, including the small/lightweight segment (as described above). We also understand that other parcel operators have been growing their presence in the small segment of the parcels market. Moreover, there are indications that Royal Mail has been losing share of retail small bulk parcels (including letterboxable items) over the last five years (see Section 6). This suggests that the presence of mandated FLLs is not currently impeding other parcel carriers from competing for small bulk parcels.
- 8.63 Taking account of the above, our provisional view is that it would not be appropriate to remove FLLs from the scope of access regulation. We consider that there is a real risk that the ability of access operators to compete for bulk letter users could be impaired, without access to a mandated FLL service. And we do not have evidence to suggest that a mandated FLL service is (or is likely to) harm parcels market competition in a material way.

Access price regulation

Introduction

- 8.64 Our current approach to access price regulation is to provide Royal Mail with commercial flexibility to manage the structural decline of letters and support the financial sustainability of the universal service, subject to some important safeguards.
- 8.65 In our March 2012 Statement, we removed most price controls on Royal Mail, and moved the focus of regulation from price controls to measures to prevent Royal Mail from imposing a price squeeze to stifle retail competition in bulk letters. Royal Mail is also required to ensure that its access charges are fair and reasonable.
- 8.66 As set out above, we believe that the current access framework is working well in supporting retail competition in bulk letters. This is evidenced by the fact that access operators have been growing their share of retail bulk letters, as set out above.
- 8.67 However, in response to our March CFI, stakeholders raised some concerns with regards to Royal Mail's ability to set access charges, and the extent to which the existing access regime should be modified to reflect changing market conditions.

Stakeholder responses to our March CFI

- 8.68 In response to our March CFI, stakeholders broadly agreed that the current approach to price regulation has facilitated access-based competition but suggested some modifications are needed to improve market outcomes.

⁵⁰³ This is based on information provided by Royal Mail in response to our March CFI. This figure will be lower given that we know that some FLLs are indeed used to serve bulk letter customers.

- a) Some access operators raised concerns that our current regulatory approach may be giving Royal Mail too much pricing freedom to increase access charges.⁵⁰⁴ They argue that this reduces pressure on Royal Mail to become efficient, as well as accelerating e-substitution. To remedy this problem, some access operators have called for the introduction of price caps on Royal Mails' access charges. They also stressed that this is more important now because of access charges now making up a larger proportion of the overall value of the service than 10 years ago.
- b) Conversely, Royal Mail argues that its access pricing behaviour has been fair and reasonable and that there is no evidence of it setting excessive prices, as it has been making a loss on access services. It also contends that the introduction of price caps carries a significant risk of regulatory failure given the difficulty in forecasting volumes in the industry. Although Royal Mail states that Ofcom's current approach to price regulation is working well in supporting access competition, it argues that the current margin squeeze control is overly restrictive, and that the price point test should be dropped or adjusted to reflect Royal Mail's true long-run incremental costs (LRIC), particularly given that the margin squeeze control now covers a larger set of services following our D+5 Statement.

8.69 Royal Mail has recently launched a consultation on changes to its access price plans. Royal Mail proposed to simplify the current access price structure by moving from the existing four access price plan system to a single access price plan. In response to this proposal, access operators expressed concerns that moving to a single access price plan could reduce their pricing flexibility and potentially harm competition in the market, to the detriment of bulk mail users. Royal Mail subsequently announced it would no longer pursue this proposal and said it will engage with access operators in the coming months to discuss ways to improve the existing access price plan system.⁵⁰⁵ We welcome Royal Mail's decision to engage with access operators on this matter and expect any future decision to be guided by the requirement for its access charges to be fair and reasonable, and not unduly discriminatory.

8.70 We address the concerns/comments set out above as follows:

- a) We first consider the concerns regarding excessive access charges and whether it would be appropriate for us to impose a price cap on Royal Mail's access charges;
- b) We then discuss whether our current margin squeeze control remains fit for purpose.

We are not proposing to impose a price cap on Royal Mail's access charges

Introduction

8.71 The PSA 2011 establishes that Ofcom may not impose a price cap on Royal Mail's access services unless it appears to us that Royal Mail might otherwise fix and maintain some or

⁵⁰⁴ See responses from CFH; the MCF, pages 15-16; [redacted]; UK Mail, page 7; Whistl, page 21-22.

⁵⁰⁵ <https://www.royalmailwholesale.com/mint-project/uploads/663520471.pdf>

all of its prices at an excessively high level with adverse consequences for users of postal services.

- 8.72 Further, Ofcom's ability to impose access and other regulatory conditions is subject to its duty to secure the provision of a universal postal service and having regard to the need for that service to be financially sustainable and efficient.
- 8.73 Our current approach to access price regulation is to allow Royal Mail to have commercial flexibility to support the financial sustainability of the universal service, subject to a margin squeeze control and an obligation to offer access prices which are fair and reasonable.
- 8.74 Our provisional view is that this approach remains appropriate. In particular, sustainability challenges remain in the long-term and we consider that the commercial flexibility we have provided to Royal Mail will help it tackle these challenges more effectively. Imposing a price cap on Royal Mail's access charges would be contrary to this aim. For this reason, we do not consider it appropriate to impose a price cap on Royal Mail's access charges for the period of this review.
- 8.75 We will keep monitoring Royal Mail's access pricing decisions over the next five years. Specifically, we will seek to understand the rationale underpinning future pricing decisions, and the impact these decisions have on long-term letter volumes. We will use this analysis to inform our future reviews.
- 8.76 We set out our reasoning underpinning our provisional view on this matter in more detail below.

Our current regulatory strategy is to allow commercial flexibility to support the financial sustainability of the universal service

- 8.77 When we set up the current access regime back in 2012, we considered the challenges posed by the structural decline of letters and the threat this posed to the financial sustainability of the universal service. We took the view that allowing Royal Mail commercial flexibility in relation to the pricing of bulk letters, subject to a margin squeeze control and requirement for access charges to be fair and reasonable, would allow Royal Mail the scope to address these challenges, while promoting effective competition in retail bulk letters.
- 8.78 As set out in Section 3, we consider that Royal Mail's latest business plan, if successfully executed, indicates that the provision of the universal service will be financially sustainable for the duration of the plan and possibly beyond. However, this outlook relies on Royal Mail being able to deliver larger cost savings than it has achieved in the recent past. While making progress with the efficiency challenges is a key factor, we consider that the commercial flexibility afforded by the current access regime will help Royal Mail address these sustainability challenges by allowing it to respond to changes in market conditions more effectively.
- 8.79 We note that although we have given Royal Mail commercial flexibility to set access charges, Royal Mail's regulatory accounts suggest that it has not been setting charges at levels which are significantly above costs. As volumes decline Royal Mail's unit costs

increase, so price increases need not imply higher or excessive profits. Information from Royal Mail's regulatory accounts indicates that Royal Mail has been setting access charges below its fully allocated costs in the last three years. Moreover, and as highlighted in Section 3, the returns achieved by the universal service⁵⁰⁶ has been below the 5 to 10% EBIT margin range we consider as indicative of a reasonable commercial rate of return.

- 8.80 In its response to our March CFI, Royal Mail suggested that its access pricing decisions have been driven by both market dynamics and the fixed cost nature of its letters business.⁵⁰⁷ It explained that, when making its pricing decisions, it 'actively considers market dynamics including significant competition from e-substitution and the risk of tipping points' and its 'cost base⁵⁰⁸ and the need to have a market funded Universal Service'.⁵⁰⁹

We would be concerned if Royal Mail sets access charges at levels which are detrimental to the sustainability of the universal service, but our analysis suggests this is not currently the case

- 8.81 We would be concerned if the level at which Royal Mail sets its access charges would be detrimental to the financial sustainability of the universal service. This could be the case, for example, if Royal Mail were to apply access price increases which might boost revenues in the short term, but which have the effect of accelerating e-substitution in a way that reduces Royal Mail's revenue in the long-term.
- 8.82 We have sought to understand the motivations for Royal Mail's recent access pricing decisions and the extent to which Royal Mail does consider the impact of the scale of its price increases on long-term volumes. To this end, we looked at Royal Mail's internal pricing documents informing its access pricing decisions in 2018, 2019 and 2020. These are the years when Royal Mail applied large price increases. In addition, we assessed the presence of systematic underestimation of volume impacts in Royal Mail's own forecasts by comparing outturn volumes against Royal Mail forecasts at the time when Royal Mail made its pricing decisions.
- 8.83 Our analysis suggests that Royal Mail has considered the impact that price increases may have on long-term revenue when making access pricing decisions. In particular, Royal Mail's internal documents indicate that Royal Mail factors this impact into its pricing decisions by way of considering the risk and reward balance offered by different pricing options over a number of years [(X)]. Moreover, we did not find that Royal Mail has systematically underestimated the volume impact of its access price increases. Our provisional view therefore is that Royal Mail's recent pricing decisions have been consistent with supporting the financial sustainability of the universal service.
- 8.84 Annex 10 sets out our analysis and findings in more detail.

⁵⁰⁶ The Reported Business is the regulatory entity which contains the universal postal service network and all the products provided through or in relation to that network.

⁵⁰⁷ Royal Mail response to our March CFI, paragraph 7.36.

⁵⁰⁸ [(X)]

⁵⁰⁹ Royal Mail response to our March CFI, paragraph 7.36.

We are proposing to maintain the margin squeeze control on Royal Mail's D+2 and D+5 retail services

Introduction

- 8.85 As set out above, to support access competition for bulk mail, the current access regime imposes a margin squeeze control on a specified set of D+2 Letter and Large Letter services and D+5 Letter services (and for any similar, successor retail services). This set includes pre-sorted business and advertising mail services but excludes services such as publishing mail and unsorted business mail.⁵¹⁰
- 8.86 This control is implemented via a basket control ('basket test') and price point control ('contract test'):
- a) the **basket test** requires Royal Mail to have a reasonable expectation⁵¹¹ that, at the time of setting new prices, the total upstream revenues of all services in the basket will be equal to or greater than the total upstream costs of those services (such costs being based on Royal Mail's upstream FAC);⁵¹² and
 - b) the **contract test** requires Royal Mail to have a reasonable expectation that, at the time of setting new prices (including the time of offering prices for each new individual contract), the total upstream revenues of the relevant services in the contract are equal to or greater than 50% of the total upstream costs of those services.⁵¹³
- 8.87 As per our 2018 Statement on changes to the margin squeeze control⁵¹⁴, the calculation of relevant upstream revenue in both tests needs to reflect the surcharges⁵¹⁵ that an access operator would face in similar circumstances.⁵¹⁶

⁵¹⁰ See, in particular, USPA Condition 6 for the full list of products which are covered by the control. Unsorted business mail is not sorted prior to delivery to the Royal Mail network and Royal Mail does the sorting. Unsorted business mail was not included in Postcomm's headroom control as it was seen as low risk and predates the introduction of USPA 6 in 2012. Publishing Mail access services were introduced in 2018. At the time we said we would monitor the market and would consider including it in the margin squeeze basket if there was any evidence that Royal Mail was price squeezing access operators. To date we have seen no evidence of this.

⁵¹¹ In our 2018 Statement on changes to our margin squeeze control, we stated that it is for Royal Mail to determine whether the forecast available at the time of offering prices allows it to have a reasonable expectation it will comply with the condition. When Royal Mail submits contract test submissions, we do check the data used is consistent with the *ex-ante* forecast submitted. In its submissions to Ofcom, Royal Mail also includes actual revenue and cost information, so we are able to review Royal Mail's reasonable expectations on a backward-looking basis.

⁵¹² Where total upstream costs relate to the collection, sorting and conveying of mail to the point where downstream services begin, less general overheads and including a rate of return.

⁵¹³ It should be noted that if products are offered at rate card prices, they are not included in the contract test, however the volumes are included in the basket test.

⁵¹⁴ Ofcom, 2018. [Statement - Amendments to the Universal Service Provider Access Condition in relation to the margin squeeze control](#)

⁵¹⁵ Examples of surcharges include those applied in instances where access operators do not meet the national volume profile or the volume forecasts submitted as part of their access contract.

⁵¹⁶ In our 2018 Margin Squeeze Statement, we recognised that retail and access customers might have different mail profiles and that, to the extent that surcharges are levied on access customers and it can be adequately evidenced by Royal Mail that its own retail customers would not incur these surcharges as a result of legitimate operational differences or differences in customer behaviours, these should be excluded from the margin squeeze tests.

- 8.88 In response to our March CFI, UK Mail suggested that the current scope of the control could allow Royal Mail enough headroom to impose a price squeeze.⁵¹⁷
- 8.89 In addition, Royal Mail called for changes to our margin squeeze control. It reiterated its view that the contract test should be removed or refined to better reflect long-run incremental costs (LRIC). It argued that, given its low retail share of the market, the basket test provides a greater constraint than the contract test. It also argued that based on its own LRIC modelling, the level of the contract test should be lower at [30]%, rather than the current 50%, and that this ratio should decrease over time with declining volumes.
- 8.90 Although Royal Mail acknowledged that we might not be minded to use their LRIC model given the concerns we have previously expressed about it⁵¹⁸, it suggested that we should use our own bottom-up cost model of Royal Mail's postal network to refine the level of the contract test.
- 8.91 In this subsection we look at these issues. We first consider the current scope of the margin squeeze control. We then address the question of whether we should remove the contract test or adjust its level.
- 8.92 Our provisional view is that it is appropriate to retain the margin squeeze control, as defined today. We believe that the current margin squeeze control has been successful in supporting access-based competition. As we note above, access competition remains strong with access operators holding over 70% share of retail bulk mail volumes. We consider that the contract test, together with the basket test, continue to provide regulatory certainty to access operators that they will be able to compete against Royal Mail on a level playing field, both at a market and contract-level, and this certainty is important for promoting and protecting competition in retail bulk letter services. Furthermore, we have not been presented with new evidence suggesting that the current level of the contract test is no longer appropriate.

The scope of the current control focuses on a subset of D+2 Letters and Large Letters and D+5 Letters services and market developments suggest this remains appropriate

- 8.93 As discussed above, the current margin squeeze control applies to a specified set of D+2 Letter and Large Letter services and D+5 Letter services (and for any similar, successor retail services).
- 8.94 When we implemented the control in 2012, we decided to limit the scope of the control to Second Class pre-sorted mail (i.e. Second Class Mailsort and Second Class Walksort services), and any current, new or successor retail services that were substantially similar services). This mirrored the deferred⁵¹⁹ bulk mail services which were captured under Postcomm's headroom control. These were also the services that were likely to pose the greatest risk of a price squeeze by Royal Mail, as pre-sorted service customers may pay bespoke/discounted prices whereas unsorted service customers generally pay a standard

⁵¹⁷ UK Mail response to March CFI, page 7.

⁵¹⁸ See our 2018 Statement on changes to the margin squeeze control.

⁵¹⁹ D+2 and later than D+2.

tariff which is visible to everyone.⁵²⁰ Moreover, these services account for the majority of access operators' revenue.⁵²¹ For access services not captured under the control, Royal Mail is still subject to a fair and reasonable charge obligation under the USPA condition. Royal Mail also remains subject to *ex-post* competition law more generally.

- 8.95 At the time we did not extend the scope of the control to other products such as unsorted business mail given evidence that access operators were successfully competing against Royal Mail for services outside the headroom control.⁵²²
- 8.96 In March 2021, we expanded the scope of the control to include a specified set of D+5 Letter services as a result of our decision to extend access regulation to Royal Mail's new D+5 access service.⁵²³
- 8.97 Information from Royal Mail's margin squeeze submissions suggests that the upstream revenue captured by our margin squeeze control accounts for a small fraction [\times] of the total upstream market revenue for bulk letters (estimated at [\times] in 2020/21).⁵²⁴ This is a result of the control applying to a subset of Royal Mail's D+2 and later than D+2 services, and Royal Mail's declining share of bulk letter volumes, which is now lower than 30%.
- 8.98 As already discussed, competition in retail bulk letters remains strong, and access operators have been growing their share of bulk letters.⁵²⁵ So, although our current control applies to a subset of D+2 and later than D+2 services, and accounts for a small fraction of the total upstream market revenue, we believe it continues to support effective retail competition in bulk letters. In particular, we consider that the control applies to those services which are at most risk of a price squeeze by Royal Mail and which account for the most revenue of access operators. The growing market share of access operators suggests that this has been sufficient to promote effective competition. Therefore, our provisional view is that the current scope of the control remains appropriate.

We consider that it is appropriate to retain the contract test given the regulatory certainty it provides to access operators

- 8.99 The main purpose of the margin squeeze control is to ensure that access operators are able to compete with Royal Mail in the bulk letters market given the level of retail prices, access charges and surcharges which Royal Mail has control over. The current control achieves this through the basket test and contract test, which we have described above.

⁵²⁰ [Royal Mail business mail rate card– January 2021](#).

⁵²¹ Based on 2021 AMR data.

⁵²² [Securing the Universal postal service, Ofcom, March 2012 – Annex 7](#), paragraph 7.43. This implied that the control was already providing sufficient protection to access operators for the full range of deferred bulk mail services.

⁵²³ See our [D+5 Statement](#).

⁵²⁴ This is an estimate for upstream bulk revenues based on access operator submissions per the [AMR 2020/21](#) and an estimate of Royal Mail's upstream bulk revenues from the Q4 2020/21 Regulatory Submission.

⁵²⁵ This is also true for publishing mail where access operators have increased their volume market share since Royal Mail introduced a publishing mail access product in 2018.

- 8.100 While the basket test aims to ensure that access operators are able to earn a sufficient margin for a specified set of products, the contract test seeks to prevent Royal Mail from pricing individual contracts at such a low level that may be indicative of predatory pricing.
- 8.101 Information from our monitoring of the margin squeeze control suggests that Royal Mail has considerable headroom in the basket test. [£<] in upstream profit].⁵²⁶ This means that, in the absence of the contract test, Royal Mail would be able to use this headroom to win individual contracts at prices below 50% FAC and still meet the basket test.⁵²⁷
- 8.102 In addition, the contract test ensures that Royal Mail reflects the surcharges that an access operator would face in similar circumstances when bidding for a new contract. This is because Royal Mail does not apply surcharges to itself, so the contract test provides a safeguard for access operators against the risk of Royal Mail imposing a price squeeze through the application of surcharges.
- 8.103 In our D+5 Statement, we pointed out that the contract test can also provide early warnings of possible cross-subsidisation practices by Royal Mail between its D+2 and D+5 letter services.⁵²⁸ This is because D+2 and D+5 services are part of the same regulated basket, so even if Royal Mail passes the basket test, Royal Mail could still cross-subsidise between the two services. Therefore, the contract test also ensures that access operators are able to compete in both D+2 and D+5 letter services.
- 8.104 Therefore, for the reasons set out above, we believe that the contract test, together with the basket test, provide regulatory certainty to access operators that they will be able to compete with Royal Mail on a level playing field, and this is important for protecting and promoting competition in retail bulk letter services. Therefore, our provisional view is that it is appropriate to retain the contract test for the period of this review.

We are not convinced by the evidence presented by Royal Mail that the current level of the contract test is no longer appropriate

- 8.105 In our 2012 Statement, we said that we would ideally base the level of the contract test on LRIC as this provides the correct signals for entry and investment in the market. We noted however that no reliable LRIC data was available, so we looked at what might be an appropriate proxy for LRIC. We looked at a range of evidence and 50% of FAC fell within the middle of the range, so we set the level of the contract test at 50% FAC.
- 8.106 In our 2017 review, Royal Mail submitted evidence from its own LRIC modelling suggesting that [£<]% FAC was a more appropriate level for the contract test. We reviewed Royal

⁵²⁶ Royal Mail's Q4 2020-21 Margin Squeeze Model submitted to Ofcom on 24 June 2021. Total upstream revenues for bulk retail products included in the margin squeeze control amounted to £[£<]m in 2020/21.

⁵²⁷ We have conducted analysis to examine the extent to which Royal Mail could win individual contracts before breaching the basket test for different levels of the contract test. To inform this analysis, we used both the current headroom level in the test as well as the forecast headroom at the end of 2021/22. This suggests that Royal Mail could win contracts worth [£<] in upstream revenue, which implies a potential overall contract value (upstream and downstream) of [£<] given that upstream revenue accounts for a fraction of the overall value of bulk mail services.

⁵²⁸ See paragraph 5.75 of our D+5 Statement.

Mail's LRIC model and expressed concerns around its robustness and reliability, and decided to keep the level of the contract test at 50% FAC.

- 8.107 Since then, Royal Mail does not appear to have updated its LRIC modelling to address our concerns. In response to our March CFI, Royal Mail reiterated its view that its LRIC modelling indicates a [8] LRIC to FAC ratio for the contract test.
- 8.108 Since our 2017 review, and as Royal Mail suggested in its response to our March CFI, we have developed our own bottom-up cost model of Royal Mail's postal network. We note however that this model does not have the capability of estimating the upstream LRIC for bulk letters. Therefore, we do not consider that this model can be used to inform the level of the contract test.
- 8.109 Given that Royal Mail has not presented new evidence on this point, and the evidence currently available to us does not suggest that the current level of the contract test is inappropriate, we are proposing to maintain the level of the contract test at 50% FAC.

Regulation of non-price terms of access

- 8.110 Our current approach to the non-price terms of access has been to afford Royal Mail commercial flexibility in deciding the detailed and specific terms, with regulatory backstops put in place to ensure access operators have appropriate protections.
- 8.111 We have recognised in the past that, while this less prescriptive approach to regulation of non-price terms provides flexibility to Royal Mail and industry to set the terms of access, it also reduces the risk of regulation inadvertently hindering the market from responding to changing market conditions in an efficient and timely manner. This is particularly important in the context of declining letter volumes.
- 8.112 In summary, access operators suggested in response to the March CFI that Ofcom needs to go further than the current approach, including by:
- a) separating Royal Mail's retail bulk business into a separate business (or entity) which purchases delivery services from Royal Mail on the same basis as any other operator;
 - b) setting out its views on specific terms such as those regarding new service requests and quality of service, and a general desire for greater Ofcom involvement in future negotiations relating to terms, conditions and charges. Some access operators also expressed their dissatisfaction with Royal Mail's proposals to reduce some of its contractual notice periods;
 - c) suggesting that there be an industry body (with some stakeholders further suggesting Ofcom should have a role in such a body) to either discuss or decide issues regarding terms and conditions of the access contract, quality of service and new service requests.
- 8.113 We are proposing to maintain our current approach and framework for non-price terms of access. We have not seen evidence to suggest that our regulatory framework itself is not fit for purpose or not effective, and we note that the retail bulk letters market continues to be

competitive. Given this, and the declining letter volume trends in the market, our provisional view is that more prescriptive, or interventionist regulation would be disproportionate.

8.114 Whilst we are proposing to continue to give Royal Mail and industry the commercial flexibility to set the terms and conditions of access, there remain important safeguards, such as the requirement that Royal Mail's terms, conditions and charges be fair and reasonable and that it not unduly discriminate, which are intended to address any imbalance in negotiating power between Royal Mail and access operators. Should Royal Mail seek to abuse its power, by introducing changes to terms and conditions that are unfair or unreasonable, our provisional view is that the existing requirements on Royal Mail under the existing USPA condition can address any concerns around such conduct.

8.115 We set out our reasoning underpinning our provisional view, and further detail, in Annex 10.

Consultation questions

Question 8.1: Do you agree with our proposals on the scope of access regulation? Please substantiate your response with reasons and evidence.

Question 8.2: Do you agree with our proposals on access price regulation? Please substantiate your response with reasons and evidence.

Question 8.3: Do you agree with our approach and proposals for the non-price terms of access regulation? Please substantiate your response with reasons and evidence.

A1. Responding to this consultation

How to respond

A1.1 Ofcom would like to receive views and comments on the issues raised in this document, by 5pm on Thursday 3rd March 2022.

A1.2 You can [download a response form](#) from the Ofcom website. You can return this by email or post to the address provided in the response form.

A1.3 If your response is a large file, or has supporting charts, tables or other data, please email it to postalreview@ofcom.org.uk, as an attachment in Microsoft Word format, together with the [cover sheet](#). This email address is for this consultation only, and will not be valid after Thursday 3rd March 2022.

A1.4 Responses may alternatively be posted to the address below, marked with the title of the consultation:

Postal Review
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA

A1.5 We welcome responses in formats other than print, for example an audio recording or a British Sign Language video. To respond in BSL:

- Send us a recording of you signing your response. This should be no longer than 5 minutes. Suitable file formats are DVDs, wmv or QuickTime files. Or
- Upload a video of you signing your response directly to YouTube (or another hosting site) and send us the link.

A1.6 We will publish a transcript of any audio or video responses we receive (unless your response is confidential).

A1.7 We do not need a paper copy of your response as well as an electronic version. We will acknowledge receipt if your response is submitted via the online web form, but not otherwise.

A1.8 You do not have to answer all the questions in the consultation if you do not have a view; a short response on just one point is fine. We also welcome joint responses.

A1.9 It would be helpful if your response could include direct answers to the questions asked in the consultation document. The questions are listed at Annex 4. It would also help if you could explain why you hold your views, and what you think the effect of Ofcom's proposals would be.

A1.10 If you want to discuss the issues and questions raised in this consultation, please contact Sinead Lee by email to Sinead.Lee@ofcom.org.uk.

Confidentiality

- A1.11 Consultations are more effective if we publish the responses before the consultation period closes. In particular, this can help people and organisations with limited resources or familiarity with the issues to respond in a more informed way. So, in the interests of transparency and good regulatory practice, and because we believe it is important that everyone who is interested in an issue can see other respondents' views, we usually publish all responses on [the Ofcom website](#) as soon as we receive them.
- A1.12 If you think your response should be kept confidential, please specify which part(s) this applies to, and explain why. Please send any confidential sections as a separate annex. If you want your name, address, other contact details or job title to remain confidential, please provide them only in the cover sheet, so that we don't have to edit your response.
- A1.13 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and try to respect it. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.14 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's intellectual property rights are explained further in our [Terms of Use](#).

Next steps

- A1.15 Following this consultation period, Ofcom plans to publish a statement in Q2 2022/23.
- A1.16 If you wish, you can [register to receive mail updates](#) alerting you to new Ofcom publications.

Ofcom's consultation processes

- A1.17 Ofcom aims to make responding to a consultation as easy as possible. For more information, please see our consultation principles in Annex 2.
- A1.18 If you have any comments or suggestions on how we manage our consultations, please email us at consult@ofcom.org.uk. We particularly welcome ideas on how Ofcom could more effectively seek the views of groups or individuals, such as small businesses and residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.19 If you would like to discuss these issues, or Ofcom's consultation processes more generally, please contact the corporation secretary:

Corporation Secretary
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA
Email: corporationsecretary@ofcom.org.uk

A2. Ofcom's consultation principles

Ofcom has seven principles that it follows for every public written consultation:

Before the consultation

- A2.1 Wherever possible, we will hold informal talks with people and organisations before announcing a big consultation, to find out whether we are thinking along the right lines. If we do not have enough time to do this, we will hold an open meeting to explain our proposals, shortly after announcing the consultation.

During the consultation

- A2.2 We will be clear about whom we are consulting, why, on what questions and for how long.
- A2.3 We will make the consultation document as short and simple as possible, with a summary of no more than two pages. We will try to make it as easy as possible for people to give us a written response. If the consultation is complicated, we may provide a short Plain English / Cymraeg Clir guide, to help smaller organisations or individuals who would not otherwise be able to spare the time to share their views.
- A2.4 We will consult for up to ten weeks, depending on the potential impact of our proposals.
- A2.5 A person within Ofcom will be in charge of making sure we follow our own guidelines and aim to reach the largest possible number of people and organisations who may be interested in the outcome of our decisions. Ofcom's Consultation Champion is the main person to contact if you have views on the way we run our consultations.
- A2.6 If we are not able to follow any of these seven principles, we will explain why.

After the consultation

- A2.7 We think it is important that everyone who is interested in an issue can see other people's views, so we usually publish all the responses on our website as soon as we receive them. After the consultation we will make our decisions and publish a statement explaining what we are going to do, and why, showing how respondents' views helped to shape these decisions.

A3. Consultation coversheet

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts? _____

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

A4. Consultation questions

Section 2: The postal services market and our proposed approach to regulation

Question 2.1: Do you agree with Ofcom's proposed regulatory approach for regulating postal services over the next 5-year period (2022-2027)? If not, please explain the changes you think should be made, with supporting evidence.

Section 3: Financial sustainability

Question 3.1: Do you agree with our proposed approach to sustainability of the universal service? Please substantiate your response with reasons and evidence.

Section 4: Efficiency

Question 4.1: Do you agree with our proposal to maintain the historic approach but with the additional requirement on Royal Mail to set and report against a five-year expectation? Please substantiate your response with reasons and evidence.

Question 4.2: Do you agree with our proposals in relation to the monitoring and publication of the efficiency expectations prepared by Royal Mail? Please substantiate your response with reasons and evidence. Please substantiate your response with reasons and evidence.

Section 5: USO letters regulation

Question 5.1: Do you agree with our proposed approach of maintaining the current regulatory safeguards of the safeguard cap, high quality of services standards, and requirements on access to universal services? Please substantiate your response with reasons and evidence.

Question 5.2: Do you agree with our proposal to not impose further regulatory requirements on Royal Mail in relation to Redirection pricing, following implementation of its improved Concession Redirection scheme? Please substantiate your response with reasons and evidence.

Question 5.3: Do you have any further evidence on other issues raised in this section?

Section 6: Parcels market regulation

Question 6.1: Do you agree with our assessment of the parcels market, namely that it is generally working well for consumers, but improvements are needed in relation to complaints handling and meeting disabled consumers' needs? Please substantiate your response with reasons and evidence.

Question 6.2: Do you agree with our assessment of the consumer issues in relation to complaints handling and our proposed guidance? Please substantiate your response with reasons and evidence.

Question 6.3: Do you agree with our assessment of the issues faced by disabled consumers in relation to parcel services and our proposed new condition to better meet disabled consumers' needs? Please substantiate your response with reasons and evidence.

Section 7: USO parcels regulation

Question 7.1: Do you agree with our proposal not to include tracking facilities within First and Second Class USO services? Please substantiate your response with reasons and evidence.

Question 7.2 Do you have any further evidence or views on other issues relating to USO parcels regulation? Please substantiate your response with reasons and evidence.

Section 8: Access for Bulk Mail

Question 8.1: Do you agree with our proposals on the scope of access regulation? Please substantiate your response with reasons and evidence.

Question 8.2: Do you agree with our proposals on access price regulation? Please substantiate your response with reasons and evidence.

Question 8.3: Do you agree with our approach and proposals for the non-price terms of access regulation? Please substantiate your response with reasons and evidence.