Legal & Regulatory Update

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Full market opening of the UK postal market: Postcomm — Breathing life into a 350-year-old industry

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Abstract

This paper explains the background behind the removal of restrictions that has allowed a fully open mail market in the UK for the first time in 350 years, and looks at the implications and opportunities.

Introduction

A recent survey commissioned by Postcomm revealed that eight out of ten business mailers expect a competitive mail market to reduce prices, improve choice and improve the quality of Royal Mail's service. They also believed the postal market should be opened to full competition as soon as possible.

Since 1 January 2006 businesses throughout the UK have had the chance to see if these expectations would turn into reality. For on that day more than 350 years of Royal Mail full monopoly of the letters market came to an end and mailers are now able to use other companies, licensed by Postcomm, to collect all their mail.

Background to Postcomm

The journey to full market opening began in Europe with the 1997 Postal Services Directive, which establishes common rules concerning:

Postcomm

- the provision of a universal postal service within the European Community
- the criteria defining the services which may be reserved for universal service providers and the conditions governing the provision of non-reserved services
- the tariff principles and the transparency of accounts for universal service provision
- the setting of quality standards for universal service provision and the setting up of a system to ensure compliance with these standards
- the harmonisation of technical standards
- the creation of independent national regulatory authorities.

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In the UK this gave rise to the Postal Services Act 2000, which set out the requirements for the UK mail market to:

- provide a universal service
- further the interests of postal users, wherever possible by promoting competition
- have regard to the interests of the chronically sick, disabled, pensioners, those on low incomes and those living in rural areas
- promote efficiency and economy on the part of postal operators
- ensure that postal operators can finance their activities.

The Postal Services Commission (Postcomm) was created by the Act as the independent regulator for the UK postal market in order to achieve this. Postcomm has a number of objectives.

Postcomm's objectives

- Protection of the universal service — the means by which anyone can post letters and packets to any other part of the country at the same affordable rate. It guarantees the delivery of mail to all households and businesses every working day and at least one collection a day from all access points in the UK.
- The licensing of all mail operators working within the licensed area.
- Introducing competition into mail services.
- Regulating Royal Mail – acting as the proxy for competition while Royal Mail retains a dominant position.
- Advising government on the post office network.

Postcomm's approach

In meeting its obligations Postcomm is seeking to create a vibrant, dynamic competitive market environment which will change expectations and stimulate both innovation and investment. To achieve this Postcomm has decided that the interests of the UK mail industry and its customers are best served if it takes the lead within Europe in opening the UK market ahead of the timetable set by the EU Directive.

Licensed and reserved areas

The mail market has actually been opening up to competition for a number of years, and has up to now been separated into several tiers.

- Mail over 350 grams and with a cost of over £1 to carry has been open to competition for many years, as evidenced by the number of parcel and courier companies that operate in the UK.
- Mail under this limit was Royal Mail's preserve (with a few specific exceptions) until 2001, when the band between 350 grams and 100 grams became open to competition.
- Royal Mail maintained a reserved area for any mail under 100 grams and a cost of under 80p until 2003.
- In 2003 Postcomm created a licensed path into this reserved area by allowing any mail to be carried by a licensed operator as long as the mailing consisted of more than 4,000 items.
- In 2006 the EU Directive required the reserved area to be reduced to 50 grams and 60p, but in the UK Postcomm decided to remove all weight and price limits completely.

Most of the mail carried in the UK is still under the new ceiling for the reserved area of 50 grams, so moving to this new limit would barely increase the level of competition. But by removing all weight and price limits, the UK provides an environment in which a wide range of innovative and ambitious new entrants can provide choice and cost and service benefits to mail users.

Regulatory and licensing regime

But removing weight and price limits does not mean abandoning the market to a free-for-all. Postcomm, while always striving to provide a 'light touch' approach, in the absence of full competition must act as its proxy, so it maintains careful control of the market levers.

Postcomm maintains control of market levers

- Price and Quality of Service Control allows Postcomm to set the financial parameters within which Royal Mail must work, ensuring that in the absence of effective competition it acts as an efficient operator and charges customers fairly, while earning adequate funds to develop its business and maintain its obligations under its licence, most importantly the provision of the universal service.
- Quality of service monitoring allows Postcomm to ensure that Royal Mail's delivery and collection performance meets certain standards in line with the expectations of the market.
- Non-discrimination and anti-competitive behaviour controls ensure that Royal Mail cannot unduly discriminate between customers nor use its dominant position to compete unfairly.
- Licence requirements are placed upon all operators to ensure that they understand their obligations to the market. These include assurances as to the backgrounds of the controlling persons; financial guarantees to underpin the operation in case of business failure; and commitments over mail security with the application of a mail integrity code of practice and common operational procedures.

Developments in the market

At the time of writing Postcomm has issued 14 long-term licences for operators to provide mail services in competition with Royal Mail. Two others have interim short-term licences. All of them are listed, with their contact details, on the Postcomm website (www.psc.gov.uk).

To date, the vast majority of competition has entered the market by one of two means.

Market developments

- Downstream access. This is where an alternative mail operator is contracted to collect, sort, consolidate and transport mail to Royal Mail's inbound mail centres for insertion into the Royal Mail delivery network. These operators aim to provide lower costs for this 'upstream' element of the operation and introduce some value-added features, such as later collection times and track-and-trace of mail bags, that allow the customer to re-engineer its own operation to reduce mail supply-chain costs and give an enhanced service to its customers.

- Customer downstream access. This is similar to downstream access except that the sending customer retains a contract with Royal Mail and separately contracts with a transport company (often a licensed operator) for the delivery to Royal Mail's inbound mail centres.

This access approach has been very important in allowing new entrants to gain a foothold in the market without having to replicate completely the national delivery network that Royal Mail has built up over the past 350 years.

In addition there are some organisations that bypass Royal Mail's network completely and provide an end-to-end solution. At the moment these are limited to business-to-business and specialist mail operations, but they can provide some real enhancements, such as early morning delivery and high-security distribution for the same or lower price than traditional offerings.

The future

With the previous reserved area restrictions now lifted it is expected that there will be considerable interest from many organisations, large and small, national and niche, and that the existing operators will develop their capability and capacity and seek to expand their range of offerings.

New and existing services

- End to end/business to consumer. This is likely to develop in and between main centres of population, but is unlikely to be an everyday service. Deliveries are likely to be targeted at two specific days in the week but with a high percentage delivered on those days. Such services are already offered in mainland Europe, and are being adopted by direct marketing mailers seeking a high level of confidence as regards the fall to earth of their campaigns so as to align their response and fulfilment capacity better.
- Consumer/SME collections. This will require an access network to be established where consumers and smaller businesses can drop mail off at a time and place convenient to them. It will also require an operator which is able to consolidate and sort a large number of small mailings. There are already operators deploying such networks, and it does not take too much imagination to identify organisations from other commercial sectors which could easily provide this capability and might be interested in entering the market.

In addition to new services Postcomm is working to make sure that existing services, provided by Royal Mail but required across the whole industry, remain available and fit for purpose in an open market.

- The Postcode Address File (PAF). A proposal document on the future management of PAF was published in February 2006 to allow the wider market to comment and contribute to the development of this important asset.
- The redirections service. Arrangements will be put in place to allow all mail operators to have appropriate access to redirections

information held by Royal Mail in order to ensure that mail is not misdelivered regardless of the operator.

Threats

Threats in an open market

In developing the open market environment Postcomm is alive to the dangers that currently exist and will continue to exist until effective competition is established and mail users have a viable choice. In the meantime it is important that Royal Mail is able to continue to compete even as it loses market share (as inevitably it must).

The viability of Royal Mail

Postcomm ensures that Royal Mail will be able to continue to finance its licensed activities through its Price and Quality of Service Control, the most recent of which covers the period April 2006–2010. The Price Control not only protects the mail user from unduly high prices and erosion of quality of service, but also protects Royal Mail by:

- ensuring it has sufficient investment funds to develop its operational capability, leading to reduced costs and improved service (allowing it to compete in an open market)
- providing safety measures should market volumes fall in the face of alternative media competition or exceptional increases in its liabilities (eg pensions).

It is worth noting that under the current Price Control and three years after the introduction of competition into the bulk-mail arena, Royal Mail still retains a 97 per cent market share and, spurred on by competition, has improved both its quality of service and its financial performance.

The universal service (USO)

Ensuring the health of Royal Mail also serves to protect the universal service, which Royal Mail is required to provide under its licence. But even with a healthy Royal Mail, some are concerned that the focus of the market will be on high-density urban delivery areas, leaving lower-density, higher-cost rural delivery areas unserved. This will not happen, as the preservation of the universal service is both a clear obligation for Royal Mail under its licence and Postcomm's primary statutory duty. As we move into an open market Postcomm is developing its leading indicators and contingency plans to ensure that prompt corrective action can be taken in the event of any signs of fragility in Royal Mail's capacity to maintain the universal service.

But even though Postcomm is taking these precautions, the requirement to provide the universal service is now widely seen as a significant marketing advantage to Royal Mail. As the only company that goes everywhere every day, this fact alone will ensure that it retains sufficient market share to allow it to meet the USO obligation effectively. This is supported by international experience in countries such as Sweden, where there has been a fully open market with full end-to-end competition for

more than ten years. The universal service is still safe there even though the former monopoly provider now has only 75 per cent market share.

Quality of service

Many people will be concerned over the potential decline in the quality of mail services. This paper has already examined how Postcomm ensures Royal Mail's quality of service, and this provides the benchmark standard for all other operators. If they cannot maintain at least the same level as Royal Mail, customers will simply not use them and therefore, in this respect, the market is already starting to self-regulate. The experience to date, as reported in Postcomm's recent survey of business customers, is that those who have changed suppliers have found no deterioration in the quality of service they receive and all have found that the level of customer service and account management from all providers, including Royal Mail, has improved, spurred on by competition.

Mail security

The final significant concern for mail users is the security of mail services. As mentioned earlier, this is addressed by the licence conditions, to which all operators must adhere.

- Companies must provide bank guarantees or commercial agreements to allow the recovery and delivery of mail in transit should they, for any reason, cease operations.
- The mail integrity code of practice ensures that all operators must put in place appropriate safeguards on the employment of staff and the monitoring and reporting of any notable incidents, upon which Postcomm will act.
- Common operational procedures introduce a default minimum standard to which all operators must adhere so that mail found in the wrong network can be repatriated safely to the original sender

Opportunities from an open market

The introduction of competition into the UK mail market will provide a number of opportunities for all industry stakeholders.

Opportunities

Innovation and investment

New mail operators will provide new inward investment and innovative ideas as they seek to differentiate their services from others and carve out their place in the market. This will drive the introduction of new technology and operational capability which will allow mail to develop as a value-added communication and marketing medium — something it must do if it is to compete with alternative media in the wider context.

Additional revenue streams

For the mail supply industry (mailing houses, print operations, technology and equipment suppliers and consultants) there will be additional revenue streams as they create solutions to manage the increased number of mail

operators, new services and greater complexity that are a necessary by-product of a competitive, multiple-supplier market.

Choice for mail users

But most importantly, for the mail user there will be for the first time in 350 years:

- genuine choice in terms of quality, service specification and price
- flexibility, eg around collection times and interface arrangements
- significant value added: track-and-trace of mail, enhanced management information
- increased after-sales service driven by genuine competition.

The challenge

The challenge for the whole mail market — from mail operators through the mail supply industry to the mail customer — is to engage in this open marketplace and investigate the opportunities it provides.

Postcomm is creating the environment, but it takes the market to make it work.

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Further reading

Postcomm (2005) *Competitive Market Review*, November, Postcomm, London.

Postcomm (2005) *Business Customer Survey*, Postcomm, London.

More information on the opening of the UK mail market is available at www.psc.gov.uk.