

The forthcoming division of Royal Mail and Post Office Ltd (POL) is a bold move, which no other country in the world has undertaken. However, the proposal is a central part of the UK government's plans for our postal sector.

Mail revenue brings in over one third of Post Office income, a fact which made the separation of the mails service from the post office network a cause of concern for subpostmasters. This is why the commitment to a 10-year Inter-Business Agreement (IBA) between the two companies is so critical. The NFSP played a pivotal role in ensuring this agreement came to fruition as it ensures Royal Mail will carry on using the post office network as its exclusive retail outlet well into the future. The announcement that the deal has been signed was made to parliament on 24 January.

Whilst mails will continue to be a key service for the Post Office, postal services across the globe are experiencing considerable upheaval as electronic communications are displacing the material exchange of documents at a rapid pace. As well as seriously impacting on Royal Mail, these changes have profound implications for the post office network.

#### MAIL SECTOR

In the UK around 16 billion items are sent in the post every year, yielding around £6bn in revenue. Royal Mail has a market share by revenue of over 90%, the majority of which comes from businesses communicating with residential customers. A significant proportion of business mail is sent by a small number of large customers; the top 50 senders of mail send up to 40% of Royal Mail's total volumes. Residential customers send only about 13% of Royal Mail's volumes, over 2bn items a year, most of which is personal correspondence such as greetings cards.

Until 2000 mail volumes would go up during economic boom times, and increase as the population grew. However, this relationship has broken down and mail volumes have declined substantially over the past few years. In the last year alone Royal Mail's letter volumes have fallen by 6% to 59 million items a day, the lowest for 20 years.

One of the main reasons for this decline is that many customers are choosing electronic communication such as online banking or email rather than physical mail. This is particularly true



# What lies ahead?

Following the confirmation of a 10-year deal between Post Office Ltd and Royal Mail Group, **Annabel Barnett** looks at the future of the postal service

for business mail such as invoices, statements and customer communication. Delivery of items bought online has been growing, but not enough to make up for the decline in other kinds of mail.

Royal Mail has also been hit by a number of other factors including some customers switching to lower-value products such as bulk mail. In addition, many large customers have switched their business to rival postal operators.

#### FINANCIAL PROBLEMS

Last autumn Royal Mail reported that its letters business made a loss of £41m in the preceding six months. These financial results mirror those of other national postal providers, which are facing similar challenges.

Across the world Universal Service Providers, such as Royal Mail, play essential roles guaranteeing all postal customers good quality essential postal services. Historically,

some governments have considered these services part of the national infrastructure and worthy of considerable investment and support, but nowadays there is growing political pressure to rein these in.

Royal Mail's universal service obligation requires the company to provide for the delivery and collection of letters six days a week (and other postal packets five days a week), and that prices must be affordable and uniform throughout the UK. However, the postal services regulator, Ofcom, is very concerned about Royal Mail's future ability to fund this service. The regulator says in the short-term, revenues from the universal service need to be able to cover the service's costs. But in the long-term the universal service should "earn a profit consistent with commercial companies in comparable industries", at around 8%.

A universal postal service is expensive to maintain, but Ofcom clearly rules out any cross-subsidy from other more profitable parts of the business. The regulator's requirement for a commercial rate of

return, is also unsurprising since the government is planning to privatise Royal Mail in the near future.

#### COST SAVINGS

Ofcom says in order to ensure Royal Mail can afford to fund the activities required to provide the universal service, the company must continue to make significant reductions in its costs. Royal Mail is part-way through a modernisation programme and cost savings are being made through a number of different ways including closing mail centres – half are expected to shut by 2016-17.

The programme involves upgrading a significant amount of the equipment used in mail delivery. The proportion of mail that can be mechanically sorted has increased; and new machines have been introduced that sort the mail into the exact sequence of a postman or woman's walk.

Delivery workers have been asked to work differently, including making changes to their working hours and methods. Traditional methods involving postmen and women carrying the mail on foot or bicycle are being replaced by the use of high-capacity trolleys and two-person vans. Royal Mail has also been shedding staff, with around 45,000 jobs lost over the last decade.

#### PRICE RISES

Cost savings alone will not be enough for Royal Mail to finance the universal postal service and make a reasonable profit, according to the regulator. Ofcom says, "potentially significant" price rises are also likely to be necessary.

Stamp prices have been rising rapidly in recent years. The price of a First Class stamp for a standard letter went up from 26p in 2003 to 46p in April 2011, an increase of 40% once inflation is taken into account. However, the regulator is keen to point out that prices are still reasonably low compared with those in the rest of the European Union. Bulk mail prices, which are subject to fierce competition from rival mail companies, have risen less quickly.

Since 2006, the price of the majority of Royal Mail's products has been controlled by the regulator which put limits on the overall amount by which prices could rise. But Ofcom has decided that this mechanism did not work well, and believes Royal Mail should have more freedom to decide its own prices. The regulator says Second Class mail should be capped at 45p-55p for letters to ensure it is affordable, but hefty price rises are to be expected for other mail.

#### UNCERTAINTIES

The actual impact of cost savings and price rises on the finances of the universal postal service is difficult to forecast as it is hard to know what will happen to mail volumes.

Whilst it is thought that increasing amounts of physical mail will be replaced by electronic mail, the precise amounts of e-substitution will depend on a range of different factors. These include how much companies and institutions invest in new technology in order to send statements and invoices, and how keen customers are to accept alternatives. It also depends on future trends in online shopping for physical items such as clothes; and how far people shift to electronic formats for items such as music, book content and video downloads.

Mail volumes may also be affected by price rises, if some customers are unwilling to pay higher prices and stop sending mail or move to alternatives.

In addition, Royal Mail's finances are impacted by competition from rival operators. Over the past few years most large mail customers have moved to competitors who collect mail from business customers and sort it before handing it over to Royal Mail to be delivered. Around 40% of letter volumes are now being handled by these rival companies.

Royal Mail also faces risks from end-to-end competition, where competitors carry out the whole service, processing and delivering mail directly to the recipient. So far, this sort of competition has been very limited in the UK, but other countries have seen alternative suppliers delivering up to 17% of letter volumes in this way.

A further uncertainty arises from doubts about the strength of the economy. Eco-



For more information on the IBA, see the NFSP website [www.nfsp.org.uk](http://www.nfsp.org.uk)

nomical downturns reduce business activity and further depress mail volumes.

#### POST OFFICES

With mail as a bread and butter service for the network, the agreement guaranteeing that the separated Royal Mail continues to use post offices is absolutely vital. Revenues from postal services will remain a mainstay of the Post Office. Mail is essential to UK citizens and the traditional postal service is still preferred, or necessary, in many industries for functions from the postal delivery of physical legal notices to the posting of goods.

However with declining numbers of letters, like other national post offices throughout the world, POL is looking at additional services that it can offer to its customers. The UK government also acknowledges that mail services will not be a "growth area" for the Post Office and says that significant new sources of revenue for the network should come instead from the provision of government services and financial services. ■

Mail will continue to be a key service for post offices

