

**National Federation of SubPostmasters  
Written Evidence to the Independent Review of the Postal Services Sector,  
Part Two**

**1. NFSP**

1.1 The National Federation of SubPostmasters (NFSP) is the only body which represents the interests of subpostmasters in the UK. Subpostmasters are private business people who run sub post offices, which currently make up 97% of the national post office network.

**2. Independent Review of the Postal Services Sector**

2.1 On 17 December 2007, the Government announced the appointment of an independent panel to conduct a review into the postal services market, following the liberalisation of the market on 1 January 2006.

2.2 On 7 March 2008 the panel issued its detailed terms of reference for the review. Within this document, the panel requested that written evidence submissions should be made in two parts. NFSP has already submitted its first written evidence on terms of reference 1 and 2:

1. To assess the impacts to date of liberalisation of the UK postal services market, including on Royal Mail, alternative carriers and consumers.
2. To explore trends in future market development and the likely impact of these on Royal Mail, alternative carriers and consumers.

This submission will focus on the review's third term of reference -

3. To consider how to maintain the Universal Service Obligation (USO) in the light of trends and market developments identified.

2.3 NFSP will only respond to those aspects of the review which fall within its remit, and as such we will predominantly focus on the impact of the postal services market on the post office network and on subpostmasters.

**3. Post Office Network**

3.1 With a current total of around 14,000 post offices, the post office network is the UK's largest retail network, serving 24 million customers a week and offering over 170 products, including mails and financial services. It is larger than the UK's major bank and building society networks combined.

3.2 As set out in detail in NFSP's first submission to the review panel, the post office network makes a widely recognised and highly significant contribution to the social and economic wellbeing of the communities it serves.

3.3 The withdrawal of many government services from post offices, combined with changing consumer behaviour and the development of new technologies, has meant that Post Office Ltd (POL) is now heavily loss making. Royal Mail Group's 2007-2008 financial results reveal that POL lost £34million last year.<sup>1</sup> Without the Government's £150 million Social Network Payment this loss would have been £184 million. The Social Network Payment is paid to POL for the social and economic service provided by the uncommercial parts of the post office network and is scheduled to be made annually until 2011.

3.4 To realise the Government's decision to undertake a planned and compensated programme of 2,500 post offices closures in rural and urban areas across the UK, POL is midway through implementing the Network Change Programme. This is an effort to address the financial losses and build a sustainable network.

3.5 As detailed in our first submission, NFSP has reluctantly supported Network Change to ensure that the remaining network has a sustainable and viable future. However the post office network must now stabilise and not shrink beyond the 11,500 post offices which will remain after Network Change.

3.6 To achieve sustainability, it is essential that the Government and POL urgently deliver new products and services to the network to increase customer numbers and footfall. NFSP believes that as a first step, the Government must award POL the contract for the successor to the Post Office card account; and that this should serve as a stepping stone towards the creation of a Postbank at the Post Office, bringing the UK Post Office in line with its more successful counterparts in Italy, France and Germany.

3.7 If this is not achieved, NFSP believes that thousands more post offices will be forced out of business in a wave of mass, unplanned closures in the months following the Network Change Programme. However, if the Government and POL can make the steps required to achieve sustainability, we believe that post offices can continue to serve social and business communities across the country as centres of excellence for mails and retail services and act as anchors for sustainable communities across the UK.

#### **4. Relationship Between POL and Royal Mail**

4.1 Royal Mail, ParcelForce and POL are all part of Royal Mail Group. Currently subpostmasters may only provide postal services on behalf of Royal Mail and ParcelForce. They cannot accept mail from other carriers for post or for collection by customers.

4.2 Subpostmasters and POL are increasingly dependent upon income from transactions on behalf of Royal Mail, which now accounts for one third of POL income (£348 million in 2007/08) and one third of subpostmasters' pay (£165

million in 2007/08). For this reason, NFSP is deeply concerned about the impact of full competition in postal services on Royal Mail.

4.3 Royal Mail Group has announced a loss of £3 million for the Royal Mail Letters business for 2007/08<sup>2</sup> due to declining mail volumes and the impact of competition in the market. In view of the post office network's growing dependence for income on transacting Royal Mail services, NFSP is gravely concerned about the impact this will inevitably have on the network, at a time when it is already facing serious challenges.

4.4 We are concerned about the impact of any weakening of Royal Mail on the 1,000 Scale Payment Delivery Offices (SPDOs, also widely known as "mailwork sub post offices"); post offices run by subpostmasters who also provide premises, facilities and supervision for Royal Mail delivery staff.

4.5 In our first submission to the review panel, we made clear our views on the subject of any de-merger of POL and Royal Mail: there are strong synergies between the two entities and no known international precedent in separating the two. We believe that guaranteed major new income streams would be required for there to be any possibility that POL could exist outwith Royal Mail Group and not swiftly find itself bankrupt. While a set of currently unforeseen circumstances may exist which could deliver a viable future for POL outside of Royal Mail Group, as things stand it would be disastrous for POL to be separated from Royal Mail.

## **5. Universal Service Obligation**

5.1 The Universal Service Obligation (USO) requires Royal Mail to provide a minimum postal service. The obligation guarantees a delivery every working day to every address in the UK, and a collection every working day from post boxes throughout the UK, at a uniform and affordable price.

5.2 Royal Mail Group has announced that for the first time the USO made a loss last year of around £100 million<sup>3</sup>. This is due to the impact of competition and the over-regulation of Royal Mail. It is widely acknowledged that the USO has traditionally been supported through a straightforward system of cross subsidy,<sup>4,5</sup> with Royal Mail using income from profitable business mail to subsidise loss-making stamped social mail.

5.3 The introduction of full competition in the UK's postal services market has, as widely predicted, lead to other operators "cherry-picking" profitable business contracts, leaving Royal Mail with less income to subsidise the loss-making social mail, which under the USO it remains required to service. This, coupled with a drop in mail volumes, has directly led to the first ever financial losses incurred by the USO.

5.4 NFSP believes that the USO is a vital national asset, enhancing and underpinning social cohesion across the UK. We therefore believe that it must be supported and not be imperilled. Together with other organisations including the National Audit Office,<sup>6</sup> we have repeatedly expressed strong concerns about the risk posed to the USO by the introduction of competition in postal services in the UK, the risk of competitors' "cherry-picking" and the consequent impact on Royal Mail's ability to continue to finance the Universal Service within the current regulatory framework.<sup>7</sup>

5.5 Postcomm's primary statutory duty is to protect the Universal Service. The financial loss experienced by the USO as a direct result of the current regulatory framework and the introduction of competition clearly demonstrates that the regulator is failing in its duties.

5.6 NFSP believes that significant, urgent changes to the regulatory framework in which Royal Mail is obliged to operate are the only option available to ensure that the USO is returned to profit and thereby safeguarded for the future. These are detailed in Section 6 of this paper.

5.7 NFSP strongly opposes suggestions that in order to return the USO to profit, the obligation for letters collections and deliveries should be reduced from six to five days per week; or that Royal Mail's quality of service targets, such as for delivery of 1<sup>st</sup> class mail, should be weakened.

5.8 A significant proportion of the population remains digitally excluded<sup>8</sup> and is therefore heavily dependent upon mail as its primary communication channel. This substantial minority of the population cannot afford to experience a further diminution of the service available to them.

5.9 As the review panel has pointed out in its initial response<sup>9</sup>, social and business mail customers have already experienced the impacts of Royal Mail's efforts to cut its costs in order to try to compete with other operators. These have included the change from two daily deliveries to one; an end to Sunday collections; and earlier collection times and later delivery times on other days. Many customers will inevitably view this as a worsening of the service provided. A change to five days a week collection and delivery, or any weakening of Royal Mail's quality of service, would without question have a negative impact on the regard in which Royal Mail is held by its customers. It will also adversely affect usage levels of Royal Mail products, with those customers who do not have access to alternatives simply using mail less, and those who do have access to them increasingly using alternative communication channels. Both outcomes will of course lead to a further decline in mails volumes as a whole.

5.10 Any reduction in the six day obligation would also directly affect the post office network. As already detailed, subpostmasters are increasingly dependent on carrying out transactions on behalf of Royal Mail for their income. Any

reduction in levels of mail usage will directly lead to a reduction in income for post offices, at a time when the network is already facing significant upheaval and incurring heavy financial losses.

## **6 The Regulatory Framework**

6.1 NFSP supports the need for good regulation of Royal Mail and the wider postal services market, with price control a key element of this. However, we believe that significant, urgent changes to the current regulatory framework in which Royal Mail operates are the only option available to ensure both that the USO is returned to profit and thereby safeguarded for the future; and that Royal Mail is able to compete on a level playing field with its rivals and be responsive to rapidly changing market requirements.

6.2 The current regulatory framework has also led to social and Small and Medium Enterprise (SME) mail users effectively subsidising large companies. Social users have experienced significant above-inflation increases in stamp prices in recent years as Royal Mail attempts to bring stamped mail prices in line with their true costs and offset losses from rival operators cherry picking its profitable business contracts. This has resulted in those who can afford it least (social mail users and small businesses) enduring the higher prices that Royal Mail is forced to set due to its loss of profitable business contracts, subsidising those who need it least – that is, large companies that are able to enjoy the benefits of rival operators. For this reason too, urgent and profound changes are required to the regulation of Royal Mail and the postal services market.

6.3 NFSP believes that Royal Mail is currently heavily over-regulated by Postcomm and this has led to the USO incurring a loss, as well as Royal Mail's total price controlled area losing £200 million.<sup>10</sup> Royal Mail states that 88% of its revenues are currently regulated and that this far exceeds both the requirements of the EU Postal Services Directive and the level of regulation experienced by any of its European counterparts.<sup>11</sup> We believe that a far more focussed, light-touch regulation is required to address the evolving competitive postal services market.

6.4 NFSP believes that the guiding principle within any realignment of the current regulatory regime ought to be that price control should cover only those products for which there is currently no competition and where competition is unlikely to emerge in the near future.

6.5 The first step required in safeguarding the USO and returning it to profit is to review the Royal Mail products which are price controlled and/or currently within the Universal Service basket. NFSP believes that only stamped mail products should remain within the Universal Service, with other products removed so as not to distort the true cost of stamped mail through cross subsidy. Royal Mail should instead be allowed to competitively price those non-stamped mail products where competition already exists.

6.6 Competition within the bulk mail sector has already reached far higher levels than the regulator had predicted.<sup>12</sup> Within this now very competitive market, we believe that there is no longer any reason for Royal Mail to be obliged to keep bulk mail products within the Universal Service, or indeed under price control.

6.7 Income from metered mail is acknowledged as cross-subsidising stamped mail.<sup>13</sup> However, we are aware that metered mail is widely used by SMEs; and as the review panel points out,<sup>14</sup> competition has so far brought no significant benefits to this group. Therefore, in order to ensure that metered mail's distorting cross subsidy is removed, while also ensuring that SMEs are not disadvantaged, NFSP proposes that metered mail be moved out of the USO basket but retained under price control, at least until competition emerges in this sector of the market.

6.8 New products should be removed from price control and the lengthy timescale involved in regulating them, to allow Royal Mail to be commercially innovative, flexible and responsive to customer needs. Royal Mail's competitors are able to adjust their prices within 24 hours to meet market or consumer needs. Royal Mail is unable to do this, instead enduring lengthy delays while the regulator investigates and comes to a decision on any new Royal Mail product proposal.

6.9 Access headroom arrangements must also be reviewed. As the current arrangements stand, Royal Mail is obliged to maintain a fixed margin between the price it charges other operators to access its pipeline and the price it charges its own retail customers. This means that it can never be competitive with other operators, however great its efficiency. NFSP believes that this has to change to allow a level playing field between Royal Mail and its competitors.

6.10 NFSP has already made clear in our first submission to the review panel our belief that final mile deliveries are a natural monopoly for Royal Mail. Furthermore they should remain so – alternatives have not been developed in any analogous utility already opened to competition; in an age of growing environmental pressures, it would be a nonsense to encourage rival operators to develop their own final mile deliveries, resulting in multiple journeys undertaken by different companies to deliver the same volumes of mail previously delivered in just one journey by Royal Mail. In addition, if competition emerges in the final mile, Royal Mail's economies of scale in this area will be inevitably reduced. Losses of economies of scale will potentially lead to job losses, which in turn will potentially lead to a yet further diminution in quality of service. To illustrate this point - Royal Mail's postmen and women are required to be able to cover all of the addresses within their "walk". Should loss of economies of scale result in job losses, meaning that fewer postmen and women have to cover a far larger "walk", there is a risk that next day deliveries will not be able to be guaranteed through the postman or woman physically not being able to achieve them, necessitating a reduction of Quality of Service targets. This can only serve to

further reduce customer confidence in and usage of mail as a communication channel.

6.11 There is also some discussion on Royal Mail's VAT exemption, with competitors arguing that it presents Royal Mail with an unfair advantage. For the most part, any such debate is academic – EU legislation exempts the public postal services operator from VAT payment, so it is not within the UK Government or Postcomm's gift to amend this. However, it is worth noting that the argument is in any case largely erroneous: the primary issue at stake has to be how to safeguard the USO; and in the first instance, this can only be achieved by returning it to profit. It is therefore clearly counter-intuitive to propose to levy VAT on Royal Mail products, as this will only serve to further accelerate the drop in Royal Mail's volumes and profits. It can also only serve to further shrink overall mail volumes, pushing those who do have a choice away from mail into using other communications channels.

6.12 As stated above, we believe that the USO is of vital social and economic importance to the nation. The only method available in the short-term to safeguard the USO is to free Royal Mail from its over-regulation to allow it to compete on a more level playing field with its rivals. If in the longer-term this move fails to secure the USO's future for reasons not yet foreseen, alternative options will need to be reviewed, such as a charge levied on all mail operators, if the USO is to stand a chance to survive.

## **7 Conclusions and Recommendations**

7.1 While a currently unforeseen business model could make POL viable outside of Royal Mail Group, under current circumstances it would be disastrous for POL to be removed from Royal Mail.

7.2 Losses incurred by Royal Mail as a result of over-regulation and competition in postal services will also impact on the post office network, through subpostmasters' growing income dependence on transacting Royal Mail services.

7.3 The USO is a vital national asset, central to the social cohesion of the country. However, it is now loss-making and its existence under threat.

7.4 To safeguard the USO, NFSP believes that substantial changes are required to the regulatory framework within which Royal Mail operates.

7.5 These changes should ensure that Royal Mail is freed from over-regulation by Postcomm and is able to compete with other operators on a level playing field, while not undermining customers' quality of service and their use of mail as a communications medium.

7.6 The “final mile” is and should remain a natural monopoly for Royal Mail, due to environmental concerns and the need to safeguard mail customers’ quality of service.

7.7 Any attempt to remove Royal Mail’s VAT exemption can only result in further reductions in mail volumes for the sector as a whole, and further risk to the USO.

## **National Federation of SubPostmasters May 2008**

### **References**

- 1 Royal Mail Group, 8 May 2008, 2007/2008 Financial Results - [http://www.news.royalmailgroup.com/article.asp?id=2222&brand=royal\\_mail\\_group](http://www.news.royalmailgroup.com/article.asp?id=2222&brand=royal_mail_group)
- 2 See 1
- 3 See 1
- 4 Consignia, September 2001, Response to Postcomm Paper on Promoting Effective Competition in UK Postal Services
- 5 National Audit Office, January 2002, “Opening the Post”
- 6 See 5
- 7 NFSP, September 2005, Response to the Trade and Industry Committee Inquiry: ‘Royal Mail After Liberalisation’
- 8 Demos, December 2007, “Web I’m 64: Ageing, The Internet and Digital Inclusion”
- 9 Independent Review of the UK Postal Services Sector, May 2008, “The Challenges and Opportunities Facing UK Postal Services: An Initial Response to Evidence”
- 10 See 1
- 11 Royal Mail, March 2008, “Response to Phase 1 of the Independent Review of the Postal Services Sector”
- 12 See 9
- 13 House of Commons Trade and Industry Committee, December 2005, “Royal Mail After Liberalisation”
- 14 See 9