

National Federation of SubPostmasters Written Evidence to the Independent Review of the Postal Services Sector

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. NFSP welcomes this decision as a valuable opportunity to take stock of the impacts of liberalisation and where necessary realign future policy on postal services.

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. The initial submission should focus on terms of reference 1 and 2:

1. To assess the impacts to date of liberalisation of the UK postal services market, including on the 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.

Submissions on the third terms of reference -

3. To consider how to maintain the USO in the light of trends and market developments identified.

are to be made by 14 May, after the panel publishes its initial thoughts.

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

2.4 As requested, NFSP will focus this written evidence submission on terms of reference 1 and 2 and will make a full submission in due course on terms of reference 3. However, due to the interrelation of so much of the subject matter in question, some aspects of this submission will touch upon themes concerning the Universal Service Obligation (USO) to be considered more closely within the later submission.

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 bigger than the UK's major bank and building society networks combined.

3.2 The Post Office also provides a widely acknowledged social and economic role in the communities it serves, and therefore makes a significant contribution to the social cohesion of the nation as a whole. The Government recognises this role and acknowledges that this requires public funding.¹

3.3 Many studies have highlighted the extremely valuable role played by the network in supporting local communities. This includes assistance for vulnerable residents, such as older and disabled people – interpreting official letters, fielding lost property, taking messages and offering practical and emotional support. In urban deprived areas and rural areas between 35% and 41% of post office customers have been found to use subpostmasters as a source of informal advice.^{2,3} Post offices also provide a focal point for communities by offering a place to come together and a venue for agencies like the police, local authorities and tourist attractions to display information. In urban deprived areas 61% of customers use their post office to access free community services, in rural areas this is reported to be as many as 69%.⁴

3.4 Post offices provide an important function in supporting local retail. Around 75% of post offices have a shop or other business attached to them. In deprived urban and rural communities post offices are frequently the only local place to take out cash. Post offices provide services for local businesses, especially through cash and deposit facilities, stamps and mailing. The Federation of Small Businesses found 20% of small businesses use the post office every day and 47% use it more than once a week.⁵

3.5 Post offices play an essential part in supporting local economies. A recent study by the New Economics Foundation (NEF) emphasises the role of post offices as an anchor for local economies.⁶ Based on detailed analysis of Manchester post offices, NEF concluded each post office contributes around £310,000 to the local economy each year, of which £120,000 is direct spending on local goods and services. In addition, NEF's analysis reveals that each post office saves small businesses in their direct vicinity in the region of £270,000 a year.

3.6 The All Party Small Shops Group has reached similar conclusions and highlights the fact that at the local level, small shops clustered together rely on each other for survival.⁷ Outlets such as post offices, newsagents, butchers and grocery stores may all depend on each other to attract people to a location rather than any one specific shop. The loss of a few of these shops may render a local shopping trip unviable for customers and lead to further closures – a domino effect. Post offices are particularly key because of their unique social value and

the sheer diversity and range of services provided which distinguishes them from other retailers. The post office is also highly valued and trusted compared with other retailers, especially in disadvantaged communities.

3.7 In recent years, reductions in government services offered through the post office network (for example, the introduction of the direct payment of state pensions and benefits into bank accounts; POL's loss of the BBC TV Licence contract; DVLA's encouragement for customers to renew vehicle tax online), as well as changes in customer behaviour, has led to a reduction in income for post offices. Post Office Ltd (POL) currently loses £4m a week.

3.8 To address this situation, the Government announced its decision in May 2007, following public consultation on its proposals, to undertake a planned and compensated programme of 2,500 post offices closures in rural and urban areas across the UK in an effort to build a sustainable network.⁸

3.9 In July 2007 POL embarked upon the Network Change Programme to implement the Government's decision, which is scheduled to run until the end of 2008. After Network Change, 90% of the population will remain within 1 mile of their nearest post office, ensuring that the network's unparalleled geographical reach remains intact.⁹

3.10 The Government also recognised the need for ongoing financial support for the parts of the post office network that are not commercially viable, and undertook to continue to pay POL a £150 million a year Social Network Payment until 2011.

3.11 NFSP has reluctantly supported Network Change to ensure that the remaining network has a sustainable and viable future. We regard the 2,500 planned, compensated closures as preferable to the alternative of mass unplanned post office closures.

3.12 However, we believe that the post office network must now stabilise and not shrink beyond the 11,500 post offices which will remain after Network Change. Any further reduction in the network will begin to undermine its unique geographical reach, as well as the network's critical mass, compromising POL's ability to effectively compete for contracts. Equally, it is essential for subpostmasters to know that their offices have futures, both individually and as part of a wider thriving network. Without this knowledge, subpostmasters will find it difficult to invest in their business and will lack the confidence necessary to do so.

3.13 NFSP is deeply concerned that even after Network Change, a great many subpostmasters' businesses will remain on the very edge of viability. To achieve sustainability for the remaining network, new products and services must be made available. NFSP believes that the Government and POL must therefore take urgent action to achieve this. This should include ensuring that POL is

awarded the contract for the successor to the Post Office card account. This should serve as a stepping stone towards the creation of a Postbank at the Post Office, to bring the UK Post Office in line with its counterparts in Italy, France and Germany.

4. Relationship Between POL and Royal Mail

4.1 Royal Mail and POL are both 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 Since 1 October 2007, subpostmasters are also paid by POL to undertake mails segregation – that is, segregating 1st and 2nd class packets on behalf of Royal Mail. Subpostmasters are also obliged to adhere to the mails integrity licence, introduced by Postcomm.

4.3 NFSP has long-standing concerns about the potential impact of postal competition on the sub post office network. Following the withdrawal from post offices of many government services, income from transactions on behalf of Royal Mail now accounts for one third of POL income (£348 million in 2007/08) and one third of subpostmasters' pay (£165 million in 2007/08).

4.4 If postal competition seriously damages Royal Mail income, this will inevitably have a negative impact on sub post offices. At a time when the post office network is facing critical challenges, threats of reduction to such a major source of income are deeply troubling.

4.5 In addition, there are approximately 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. We are concerned that a significant drop in Royal Mail profits will restrict its ability to properly remunerate SPDO-based subpostmasters for the work they do on Royal Mail's behalf and to ensure the much needed investment in those premises.

4.6 Postcomm is currently leading a debate on whether Royal Mail Group should be broken up, with POL separated from the Group.¹⁰

4.7 NFSP believes that as things stand, it would be potentially disastrous for the nation's post office network to be removed from Royal Mail Group. Even with Royal Mail income at current levels, POL is heavily loss-making, the network is currently contracting by 2,500 post offices and there remain serious concerns about the viability of the remaining network in the future.

4.8 Instead, NFSP would urge the Government to look to build additional income streams for POL within Royal Mail Group, which build upon the Post Office's

traditional position as the retail arm of Royal Mail and as the venue to meet all mails needs. In addition, we believe that the introduction of a Postbank at the Post Office would be a potentially strong means to achieve increased income and thereby sustainability for the network.

4.9 The apparent lack of any international precedent on the separation of a national mails company from its counters business is a further factor which provokes concern. There may of course be a set of circumstances which we do not currently envisage or a business model not yet developed which could see a viable future for POL if it were separated from Royal Mail. However, the combination of all of the concerns detailed above would lead us to urge the Government to approach the de-merger of Royal Mail Group with great caution and to fully consider the wider social consequences brought about by the likely impacts on POL and Royal Mail.

5 Impact of Competition on Royal Mail

5.1 Royal Mail profits dropped in year ended 25/3/07 to £194m, from £344m the previous year. Within the regulated area, Royal Mail recorded a loss of £29m within 2006/07, against profits of £168m in 2005/06. Of this, £18m was due to losses incurred by 1st and 2nd class mail – this figure £58m worse than in 2005/06.¹¹ While final figures for this financial year are not yet available, Royal Mail reported that for the first five trading months of 2007/08, revenue was down a further £78m compared to the same five months in 2006/07.¹² These ever reducing profits can be directly attributed to the development of competition.

5.2 NFSP believes that Royal Mail's reducing profitability caused by the introduction of competition is largely attributable to its universal service obligation and the loss of its historic cross-subsidy.¹³ It has been widely accepted that a relatively simple business model of cross-subsidy has traditionally underpinned the universal service.^{14,15} Historically, in order to maintain the universal service Royal Mail used revenues from low cost areas of its operations to support the higher cost operations. Thus, for example, revenues accrued from business post and many urban postal operations subsidised postal services for social mail and for remote rural customers. Royal Mail claims that stamped mail makes an average loss of around 6p per letter and packet; and that this area will continue to be loss-making as any proposed stamp price increases permitted by the regulator will not be sufficient to cover the deficit. The total loss last year on stamped mail was £178 million.¹⁶ The introduction of competition to the postal services sector has allowed competitors that are not required to support the USO to win lucrative business contracts away from Royal Mail, thereby undermining Royal Mail's ability to use revenues from lower cost areas to support higher cost customers.

5.3 NFSP will explore this issue in more detail in our second written evidence submission on the panel's terms of reference 3. However, it appears clear that one way to redress the current imbalance among players in the competitive

postal services market engendered by Royal Mail's obligation to the Universal Service would be to adjust the number of Royal Mail products subject to price controls set by Postcomm. NFSP believes that this would go some way to enabling Royal Mail to compete on a more level playing field.

5.4 NFSP believes that UK stamp prices have historically been artificially maintained at a significantly low level. If the historic cross-subsidy is lost through Royal Mail's loss of profitable business contracts to competitors, stamp prices will inevitably have to significantly increase in order to reflect this.

6. Relationship Between POL and Other Mails Operators

6.1 Postcomm is among the bodies to discuss offering other mails operators access to post offices for customers' posting and collection.¹⁷

6.2 At the moment, other mails operators are able to use the post office network through negotiation with Royal Mail, with the regulator able to intervene if negotiations fail, but so far no other operator has chosen to do so. Royal Mail reports that levels of interest among competitors have been very low. We would therefore question whether there is in fact any appetite among non-Royal Mail mails operators for this access.

6.3 UK mails volumes are now declining.¹⁸ Therefore any new work gained by POL through the introduction of new access arrangements with other operators is unlikely to be genuinely new work within the mails market, but rather the same work previously transacted on behalf of and now cannibalised from Royal Mail.

NFSP is keen to see post offices' positions as centres of mails excellence and access points for all mails maintained and developed. However, there could be a risk that such arrangements could prove to be unprofitable for subpostmasters, through the logistical and administrative complexities of transacting the same volumes of mail on behalf of several different companies. Therefore while all opportunities for the development of new work are welcome, we would nonetheless encourage the Government not to focus too closely on this issue as a potential panacea for the network for the sake of competition ideology, when in practice any such move may well have very little impact on and bring very few benefits to post offices.

6.4 In addition, NFSP would stress that if subpostmasters are to accept post from other carriers, it must be implemented nationally through Post Office Ltd, and not arranged individually with individual subpostmasters. The latter would inevitably lead to cherry-picking by the mail operators and undermine the network as a whole.

6.5 NFSP understands that as part of the Inter-Business Agreement between POL and Royal Mail, in the region of £120m of the £348m payment for services by Royal Mail to POL is for its use of bricks-and-mortar access points at post

offices. NFSP believes this to be an important and just payment – if post offices didn't exist, Royal Mail would have to create alternatives. But if other mails operators proceed to make use of the post office network as an access point for their goods and services, we assume that they will pay for this service as it does not seem reasonable to expect Royal Mail to continue to pay this fee if the access points are available for free to its competitors.

6.6 Another issue which the regulator, among others, is keen to promote is the need for subpostmasters to take greater advantage of the growth in packets and parcels post brought about by the growth in e-fulfillment.¹⁹

6.7 This is certainly an area of interest which could generate additional footfall and revenue to subpostmasters' income, but we would query the precise value of this market. While undoubtedly an area of high growth from a recently very low base, we do not hold that this area will bring in significant income to sub post offices or the network as a whole.

6.8 From a wider public policy perspective, we would urge the Government not to lose sight of the predicted ongoing high levels of digital exclusion among UK citizens²⁰ and ensure that over-emphasis is not placed on this aspect of the mails market at the expense of more traditional mails services – both in terms of social inclusion and the likely reality of market volumes.

7. Other Impacts of Postal Competition

7.1 Research suggests that so far, postal competition in the UK has only benefited large business users rather than domestic postal users and small businesses.²¹

7.2 However, where competition has taken effect, it appears to have done so to a significant extent. This is witnessed by falls in Royal Mail profits, and by statistics which suggest that 35% of all large mail users now use more than one mail provider, and 20% of top and large mail users say they intend to move away from Royal Mail within next 12 months.²²

7.3 The impact of liberalisation on potentially vulnerable or marginalised groups, including people in rural areas, people with disabilities and senior citizens, so far appears limited. However, one potential consequence of competition on these groups is that if Royal Mail profits continue to be eroded, there will be a consequential impact on POL and thereby POL's ability to support the post office network. These groups tend to be among the largest users of post offices, and we would urge the Government to be mindful of the potential social consequences of the loss of Post Office services (including access to cash) to these communities as a result of postal competition.

7.4 Current access arrangements, where competitors pay Royal Mail a fee determined by the regulator to deliver mail on the final mile, are scheduled to grow.²³

7.5 It is the stated ambition of TNT and other new mails operators to develop rival end-to-end mails services to that provided by Royal Mail.²⁴ This is despite the fact that there have been no equivalent end-to-end services developed in analogous industries already opened to competition (e.g. gas, telecoms, electricity).

7.6 NFSP believes that development of such rival end-to-end services risks significant detrimental environmental consequences, with potentially four or five other mails operators each undertaking journeys to collect and deliver mail all currently dealt with in one journey by Royal Mail.

8. International Context and Comparisons

8.1 NFSP accepts that postal competition in the UK is here to stay. But we nonetheless still query the wisdom of the UK Government in choosing to open the UK market to full competition far earlier than the requirements of EU legislation and than the overwhelming majority of other EU Member States.

8.2 The UK's choice to fully open its postal services market early has allowed competitors such as the Dutch national postal operator TNT and DHL (owned by Deutsche Post, the German national postal operators) to make significant inroads into the UK market while enjoying the financial benefits afforded by retaining a protected market in their own countries. We note that both countries in question have recently taken measures to protect their domestic postal markets – Germany in seeking to introduce a high minimum wage for postal workers; and the Netherlands in indefinitely postponing the planned introduction of full market opening in 2008.

8.3 NFSP believes that vastly preferable to this scenario would be a level playing field across all EU Member States. EU Postal Directive 2008/6/EC requires that all EU postal markets are fully liberalised by 2011, with exceptions for 13 Member States which will be permitted to delay full market opening until 2013. We will watch with interest to see if this schedule is met or if further delays will yet occur.

8.4 One provision within the Directive will allow those Member States due to fully liberalise by 2011 the opportunity to refuse access to competitors still enjoying a protected domestic market until 2013, in order to protect their own domestic markets and national postal operators.²⁵ This is a sensible approach. While we understand that the opportunity to realise this ambition is now firmly behind us, we nonetheless believe that such measures ought to have been won by the UK ahead of its early entry into full liberalisation, in order to afford some protection to Royal Mail. In the absence of this, we would question whether the UK

Government's actions have served the best interests of Royal Mail, or the wider interests of the UK economy and the national infrastructure and asset base.

8.5 NFSP also notes that the UK had limited opportunity to learn from overseas models before embarking upon full postal liberalisation in 2006. The few countries where full postal competition was already in existence prior to its introduction in the UK – Argentina, Finland, New Zealand and Sweden – are notable for how little meaningful comparison any can offer the UK in terms of their national economies, geography, population size and density.

8.6 In view of all of the above, we would urge the Government to cautiously approach any further changes to the competitive market which further threaten Royal Mail before other EU Member States, and particularly those more comparable to the UK, have had the opportunity to catch up and reach the point currently occupied by the UK, rather than allow the UK to continue to serve as a testing ground for liberalised postal services.

8.7 We would in addition urge the Government and the regulator to relax the restrictions currently placed on Royal Mail's ability to effectively compete with new mails operators through the price control. Without this, Royal Mail is doubly disadvantaged – firstly through the UK opening to competition far earlier than most other EU Member States and secondly through its ability to compete being severely limited by a restrictive regulatory regime.

8.8 There also appears to be no international precedent to provide a comparison for any de-merger of Royal Mail Group. This is presumably as both the strong synergies between the component entities and its rationale as a basic business model transcend national boundaries and the historical development of postal services markets across the world. This would leave the UK entering territory previously uncharted by any other country if it were to split POL from Royal Mail.

9. Conclusions and Recommendations

9.1 NFSP's vision is for a postal services industry which meets the needs of both business and all social mail users in an equitable and sustainable way, linked to post offices acting as the centre of all communities' mails, banking and retail needs.

9.2 POL and subpostmasters are heavily dependent on income from transactions carried out on behalf of Royal Mail. Therefore any threat to Royal Mail's profitability threatens the viability of POL and the post office network.

9.3 As things stand, a de-merger from Royal Mail Group could be disastrous for POL.

9.4 Competition is eroding the historic cross-subsidy in which Royal Mail balances costly social mail with profitable business mail.

9.5 NFSP believes that in order to compete on a level playing field with rival operators, regulatory restrictions on Royal Mail must be reduced.

9.6 The UK's decision to open to full competition early was wrong and has caused needless damage to Royal Mail.

9.7 If Royal Mail is not allowed to effectively compete, the potential social consequences for the nation through damage to Royal Mail and to the post office network, and the loss of the contribution to social cohesion which both make will be considerable.

National Federation of SubPostmasters March 2008

¹ Department of Trade and Industry, May 2007 – *“The Post Office Network - Government Response to Public Consultation”*

² Postcomm, 2001, *Serving the Community I - “Evidence of the Community Value of Post Offices in Rural Areas”*

³ Postcomm, 2001, *Serving the Community II - “Evidence of the Community Value of Post Offices in Urban Deprived Areas”*

⁴ See 2 and 3

⁵ Federation of Small Businesses, December 2006, *“Small Businesses and the UK Postal Market”*

⁶ New Economics Foundation, December 2006, *“The Last Post – the Social and Economic Impact of Changes to Postal Services in Manchester”*

⁷ All Party Parliamentary Small Shops Group, February 2006, *“High Street Britain: 2015”*

⁸ See 1

⁹ See 1

¹⁰ Postcomm, October 2007, *“Postcomm’s Annual Report of the Network of Post Offices 2006-2007 – A Sustainable Customer Focused Network”*

¹¹ Postcomm, 2007, *“Competitive Market Review of the UK Postal Market”*

¹² Royal Mail News Release: 31/10/2007

¹³ Postcomm, August 2006, *“Postcomm’s Strategy Review – The Postal Market 2010 and Beyond, Key Questions For Stakeholders”*

¹⁴ Consignia, September 2001, *“Response to Postcomm Paper on Promoting Effective Competition in UK Postal Services”*

¹⁵ National Audit Office, January 2002, *“Opening the Post”*

¹⁶ Royal Mail News Release, 20/12/2007

¹⁷ See 10

¹⁸ See 11

¹⁹ See 10

²⁰ Demos, December 2007, *“Web I’m 64: Ageing, The Internet and Digital Inclusion”*

²¹ Postcomm, 2007, *“Business Customer Survey – UK Postal Market”*

²² See 21

²³ See 11

²⁴ See 11

²⁵ EU Postal Directive 2008/6/EC