

Executive summary

The universal service obligation for post (the "USO") the legal requirement for Royal Mail to deliver to the United Kingdom's 32 million addresses six days a week – as currently structured is now unsustainable. Whilst it remains a vital part of life in the UK, a means of communication used and relied on by millions of people and businesses, and an important part of how society connects in every corner of the country, urgent modernisation is required.

Royal Mail is committed to deliver the one price goes anywhere USO and it is a privilege to be part of the fabric of daily life in the UK. However, the minimum requirements of the USO have remained largely unchanged for over 20 years since the UK adopted the EU Postal Services Directive. As with any service, the USO must adapt and evolve to meet the needs of those that use it. It cannot stand still in the face of changing customer behaviours and hope to survive simply because of its long and proud history. Ofcom's conclusion in its call for input on 'The future of the universal postal service' is therefore right that *"the universal service needs to change to better align with the needs of consumers and to ensure it can continue to be affordable and sustainable in the future"*.

We have talked to a wide range of customers and businesses across the UK. They recognise that change to the USO must come, and our proposals for reform protect those aspects of the USO that they told us matter most to them.

1 Falling letter volumes and unsustainable losses

The way in which people communicate has changed, causing a material decline in the use of letters that is set to continue. The USO requires Royal Mail to deliver First Class, Second Class, Retail and Access customer letters six days a week to 32 million addresses in the UK. But there is no longer a letter for every address, every day. From 20 billion letters a year posted at their peak in 2004/05, seven billion letters were sent last year, and addresses now receive just four letters a week; during the same period the number of addresses has increased by over four million.

Whilst the number of parcels that Royal Mail delivers has increased, this is in a highly competitive delivery market where Royal Mail chooses to offer industry leading terms and conditions to our employees. Demand for parcels has not increased fast enough to offset the financial impact of the structural decline in letters.

Whilst consumers are demanding more and more from parcel services and sending fewer letters, the USO in its current form means Royal Mail must maintain a high fixed cost network to deliver the USO and bulk letters six days a week to every address, without the revenue to sustain it. In practice, this means our posties are delivering fewer letters to more and more addresses, with the cost of delivering each letter ever-increasing. This fact has been recognised by Ofcom where it calculates that providing the current USO to the UK has a **net cost to Royal Mail of £325m to £675m every year** – or put another way, Royal Mail is spending around **£1m - £2m per day** to provide the USO to the UK.

We absolutely agree with Ofcom's conclusions that *"the consequences of misalignment between the obligations and users' reasonable needs are significant. We estimate that the USO imposes a considerable net cost on Royal Mail"* and that *"we consider that the net cost we have calculated may represent an unfair financial burden on Royal Mail"* such that it *"raises serious questions as to whether it is a cost Royal Mail should or even can be expected to continue to meet."* **This must be urgently addressed.**

This is the **very real and urgent financial sustainability challenge** that Royal Mail faces. Royal Mail posted losses of £419 million in financial year 2022/23 and losses in the first six months of the 2023/24 financial year of £319 million. Whilst Ofcom's own guidance outlines that Royal Mail should have the ability to earn sustainable profit margins of 5-10% per year, the average profit margin achieved over the last five years is less than 1%. A profit margin of 5% or above has been achieved only twice since privatisation more than 10 years ago (in 2014/15 and 2015/16) notwithstanding our continuing efforts to transform.

Royal Mail is doing as much as it can to transform itself to:

- **meet changing customer needs** with new products and services. In letters we have introduced Mailmark (lower prices and increased visibility of performance for customers through embedded data in barcodes) and a new economy (D+5) service for our Access and Retail customers. Barcoded stamps make each stamp unique and reduces fraud). In parcels we have improved convenience for customers by launching Parcel Collect from customers' doorsteps, expanded Sunday parcel deliveries, and are introducing more options for customers to deliver and drop-off parcels outside the home, including a new partnership with Collect+ and the roll out of 3,000 parcel lockers;
- **improve efficiency** through prioritising investment on delivering new services and adapting our estate to provide the services that customers want. We have reduced our mail centre estate from 69 to 37 and invested in 36 parcel sorting machines. We are improving quality of service by focusing on our people and driving network efficiency. We are reducing our reliance on agency staff, recruiting more permanent colleagues on new terms and conditions to drive sustainable growth and we are also shaping our future network to reflect the changing market to deliver further efficiencies;
- **invest in our future sustainability** with increased parcel automation, including two new state-of-the-art parcel super hubs in the North West of England and Midlands, which can process up to 90,000 parcels an hour. We also have the UK's largest fleet of final mile electric vans, helping to make us the UK's greenest delivery company based on competitors' reported emissions; and
- **Modernise our industrial relations** following 18 days of industrial action in 2022, we signed an agreement with the Communication Workers Union that includes:
 - seasonal hours for delivery staff to manage efficiently the peaks and troughs of mail in our business across the year;
 - a new absence policy to tackle high absence rates and frontline performance management; and
 - later start times for our delivery staff to improve our environmental footprint, deliver cost efficiency and improve quality of service by reducing our reliance on flights.

These have all been vital changes to adapt, evolve and reset into a more customer focussed and efficient business. We are doing everything we can to transform and ensure we can continue to deliver the USO for many years to come, but we cannot do this entirely on our own. **We also need Ofcom and Government to take action urgently.**

2 Our proposal – the future USO

The only way to maintain the USO is to modernise the USO. The reforms we ask for are intended to address the significant net cost of providing the USO to the UK, and to realign the USO to meet reasonable users' needs. They would allow for a more efficient and modernised USO that gives customers products and services that they want, and greater confidence in a UK-wide universal price and a parcels service for the digital age.

We have listened to customers

We have **invested significant time in understanding what our customers want** from a modern USO. This includes extensive research with over 3,000 consumers, 500 SMEs and 48 large businesses, as well as meetings with over 100 organisations over recent months, including consumers, businesses, public services (including NHS bodies) and groups representing a wide range of consumers (including in rural communities, on low incomes, older people and those with disabilities) across the UK.

Our proposal is designed to meet the needs of customers today and into the future by protecting what customers told us matters most to them in the USO and creating a platform for growth.

As part of our proposal, **we would protect what customers value with no changes** to:

- The **one price goes anywhere** service to all parts of the UK;
- The **choice of First and Second Class letters**. In our research, 81% of consumers and 83% of SMEs emphasised the importance of having a choice between a First and Second Class service;
- **First Class letters delivered daily, six days a week** (Monday to Saturday) to the same timescales. In our research, industries like publishing and greeting cards explained the importance of next day and Saturday deliveries; and
- **USO parcel services** which we are required to deliver Monday to Friday, but which we also deliver on Saturdays. On commercial parcels we will continue to deliver Monday to Saturday and increasingly on Sundays.

Vital changes to deliver our future financial sustainability

As we have set out, the USO in its current form is unsustainable. Our proposal includes the following changes which **are critical to unlocking a new delivery model and ensuring a more efficient, financially sustainable USO**:

- **all non-First Class letters would be delivered to every address every other weekday** (Monday to Friday). 92-93% of consumers in our research said non-First Class letter deliveries twice a week meet their needs: our proposal exceeds this; and
- **aligning the delivery speed of Access Standard letters with Second Class**, so it arrives within three weekdays instead of two.

As a result of these changes, we would be able to deliver a more efficient, reliable and financially sustainable service as our posties would be delivering letters to around seven out of ten addresses compared to around four out of ten today.

Expand and modernise the USO

Listening to what customers have told us is important, we also call on Ofcom to **expand and modernise** the USO for the digital age by introducing the following new features:

- **Greater reliability**
 - We recognise that we must **increase reliability** in the USO – our customers have told us that loud and clear. Our research, and Ofcom’s analysis, shows that speed and reliability are both parts of what customers value in quality of service – and more customers value reliability than value speed. Our quality of service regime has not been comprehensively reviewed for 18 years, during which time the market has changed profoundly. We propose rebalancing speed and reliability, to give customers further confidence in the service they would receive by **introducing new, additional**

reliability targets in First Class and Second Class USO products alongside revised, realistic speed targets (recognising that high speed targets drive high fixed cost in a declining market, and that no country of a comparable size has First Class or Second Class USO speed targets as high as the UK).

- **Greater choice**
 - **tracking on USO parcels** to reflect strong customer preferences, and the principle that it is only the USO that offers one price goes anywhere to everyone in the UK. Other countries have allowed tracking in the USO to protect their USOs; and
 - a new, additional “**end of day**” **Special Delivery** product that would be priced lower than the 1pm guaranteed Special Delivery product.

Working with the NHS

We value the part we play in helping the NHS to communicate with patients. In conversations with a number of NHS representatives and advocates, it was evident that letters would continue to be an important part of their communications for years to come. It also became obvious that many parts of the NHS use postal services in different ways. We are committed to working in partnership with the NHS, in all parts of the UK, to ensure that vital NHS letters are delivered in a timely manner. We would continue to offer choice to the NHS on price, and speed of services, to meet their needs. In addition to continuing to offer a First Class delivery six days a week, we would explore options with the NHS that may provide greater reliability for time sensitive medical letters.

Our people

We would continue to offer industry leading terms and conditions and our proposals create a more sustainable business for more secure jobs. Our proposals would also mean that our posties would get more Saturdays off work and create a wider range of jobs including traditional walking delivery roles with mainly letters and van-based roles with mainly parcels.

Over a period of around 18-24 months from the date of regulatory change, the total number of delivery routes is expected to reduce by c. 7,000-9,000. Whilst this may mean fewer delivery roles in Royal Mail, we expect to be able to manage the vast majority of changes through natural turnover with no compulsory redundancies. Based on current estimates, we expect voluntary redundancies to be minimal (c. 1,000 based on current modelling).

The sustainability impact of our proposal on Royal Mail

Our proposal, if implemented, would reduce the run-rate net cost of the USO to Royal Mail up to £300m per year, although this is dependent on the time taken for reform and the rate of letter decline. It would allow the business to continue to invest in modernising and transforming to provide products and services that customers want. Our proposals would also mean we can continue to operate our unique “feet on the street” delivery model, significantly contributing to keeping our emissions low, consistent with our Steps to Zero strategy.

Our prices would continue to rise across our products alongside any reform, reflecting a structurally declining market and the increasing cost burden of delivering letters, however reform of the USO would mean that prices do not rise as sharply as they would absent reform.

The scale of change

Whilst we are confident that these changes can be deployed successfully, as similar changes have been deployed internationally for other Postal Operators. Nonetheless, they represent a major change in our operation. It would likely take around 18-24 months from the point of regulatory change to fully

implement across the entire network, making **the urgency of regulatory change all the more imperative**. With complexity of this scale and constantly evolving letters and parcels markets, these changes of course come with risk through transformation costs, the value of benefits changing over time and execution.

3 Change is within Ofcom's current powers

Our proposal for USO reform can be achieved with modest regulatory change and does not require legislative changes: it requires changes to Ofcom's Postal Service Order, its Access conditions and its Designated Universal Service Provider conditions.

4 Future-proofing the USO

Whilst the USO needs urgent modernisation now, and this submission sets out those reforms that are necessary and within Ofcom's gift today, there is also a need to future-proof the USO with **three important regulatory and legislative changes** that should follow in the future and allow the USO to adapt and evolve swiftly as customer preferences continue to change in a structurally declining market. This would help to avoid the unacceptable position of the last four years where necessary reforms to adapt to quickly changing markets are not the political priorities of the day:

- Firstly, there will come a time when, even if the USO is reformed, there is still a financial burden to Royal Mail of providing the USO. **Royal Mail believes the UK needs a mechanism whereby Ofcom carries out a regular net cost calculation** (akin to those carried out in France and Belgium) at least every two years so there is transparency of the true costs of the USO to Royal Mail, allowing for a fair debate about how those costs are rightly met;
- Secondly, given the continuing structural decline in letters, the USO would need to adapt and evolve more quickly than is provided for by the current legislative framework. **Ofcom should be granted the flexibility to change the minimum requirements of the USO via regulatory change** (rather than legislative, as is currently the case); and
- Thirdly, in a declining letters market, if there is a time in the future where further reform is no longer sufficient to meet a net cost that Ofcom may identify, **it may fall on Government to contribute to those costs**, as is the case in several European countries. Ofcom has stated that *"it would be open to the Government to decide to meet some or all of the financial burden via public subsidy"*. The contribution fund in the Postal Services Act 2011, which requires contributions from postal operators or users, is recognised by Ofcom to be unworkable and must be reformed.

5 The urgent need for reform now

Changing customer needs, the structural decline in letters, and the consequential financial sustainability challenge of the USO, is not a problem unique to the UK or to Royal Mail. The need to reform the USO to tackle these issues has been recognised and acted upon by postal regulators and governments across the world for years; but the UK has stood still and done nothing. Royal Mail has been calling for reform of the USO for over four years. During that time, the business has suffered heavy losses as we have tried to modernise and transform to meet today's customer needs.

Ofcom has now recognised that reform is necessary, and that the financial cost of the USO to Royal Mail each year is significant, but **we have serious concerns that the urgency of the situation is not properly recognised**. We call on Ofcom to act faster than its Call for Input envisages (where it says it will *"provide an update in the summer"* of 2024). Instead, Ofcom must reach a swift decision on USO reform and move to consult and introduce new regulations by April 2025 at the latest – accounting for the possibility of a General Election late in 2024 which cannot be an impediment to USO reform.

Royal Mail is materially loss making and simply cannot continue to meet the significant costs of a USO that far exceeds the needs of customers.

The now recognised significant net cost of the USO to Royal Mail (£325m-£675m) has been borne since at least 2021/22 and during this time the business has incurred (and continues to incur) heavy losses. Whilst the process of regulatory reform is ongoing, and during any period of implementing change, **we call for Government to consider a temporary contribution to address the net cost of the USO.** The case for a temporary contribution is even more imperative **if Ofcom delay urgently needed regulatory reform** until after a General Election. A failure to urgently reform, as Ofcom acknowledges, could lead to *“consumers paying higher prices than necessary for USO products”*.

6 Conclusion

The USO remains an important part of life in the UK. It is valued by customers and is a key means of communication still used and relied on by millions of people and businesses. The USO generates significant UK-wide socio-economic benefits, and it is hugely important for social cohesion and economic growth by improving access to markets for SMEs, particularly in rural/remote areas. However, **in its current form, the USO carries a significant net cost to Royal Mail that is simply unsustainable: it must be reformed, and it must be reformed quickly.**

The immediate changes we propose in our submission can be implemented with relatively limited regulatory change that is within Ofcom’s gift. We also propose several other legal and regulatory changes that help future-proof the USO.

Our proposal for USO reform is built on meeting the needs of customers, protecting what they value and creating a more reliable and financially sustainable service that continues to connect all parts of the country.