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Review of Royal Mail's pricing flexibility and the level of access headroom (the 'Interim Review' of the price control)

DMA's Response

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DMA

The Direct Marketing Association (DMA) UK Ltd is the largest trade association in the communications sector, representing both users and suppliers of Direct Marketing. We represent the majority of the major users of postal services and our client membership base represents the largest Royal Mail customer group. We represent all aspects of the supply side of postal services from mailing houses to consolidators and from agencies to data bureaux.

We have been actively involved in the consultations relating to Price Control and welcome the opportunity to contribute further to these proposals.

Introduction

This interim review has raised a number of questions that are, we believe, fundamental to the mail market as a whole, not just Royal Mail. As the dominant player and one that controls over 99% of the final mile (according to Postcomm's figures) Royal Mail's actions and pricing decisions dictate what happens and there is concern that decisions are being taken that might provide short term benefit to Royal Mail at the expense of the overall market.

We appreciate the dilemma facing Postcomm in trying to achieve a balance between a profitable Royal Mail that can safeguard the Universal Service and allowing genuine competition to develop but would emphasise that Royal Mail's competitive pressure isn't just from other licence holders. Competition has helped to drive down prices of some services in comparison to Royal Mail, but not necessarily in relation to other communications media. The analyses in this consultation demonstrate clearly that mail is not price inelastic (or at least it depends on application) and that historic price increases have almost certainly impacted volumes. We believe there is a real danger of mail pricing itself out of contention as a volume communications medium if Royal Mail is allowed to simply increase prices rather than focusing on reducing cost.

Issues for Consultation

<u>Postcomm's proposals on pricing flexibility from April 2008</u>

We support allowing Royal Mail more flexibility around pricing of individual products within an overall cap. This seems a sensible compromise that will allow RM more control over pricing of key products in relation to competition and market developments.

We also agree with the approach that allows more flexibility in Basket B bulk mail products rather than excessive price increases on products where there is no alternative provider or channel.

As mentioned previously we are concerned about how postal costs have increased overall. Yes there is some competitive pressure to reduce prices but since the main Downstream Access competitors prices are based on RM pricing, an RM price increase means an increase for the industry.

A quick analysis of prices since 2005 shows that if you have the ability to produce your mail to the most cost effective format then the cost of postage has remained the same or even reduced. Unfortunately most organisations don't have the luxury of a "clean sheet" design when producing mail. A variety of factors – existing stationery or brochures, other promotional materials, the content of the mailing itself etc – mean that many organisations can't regularly produce mail in the most cost effective format and these have seen postal prices increase by up to 40% since 2005.

Changes in Access Headroom

The DMA does not have either the expertise or resources to carry out a detailed analysis of the merits of the 3 submissions and is relying on Postcomm's own analysis.
The most worrying aspect about the analyses is that there is little confidence in the overhead allocation and the true costs of providing a Downstream Access service. We would also like to understand whether current requirements eg forecasting do provide a genuine cost benefit to RM since the requirement for a similar level of forecasting is likely to applied to "retail" products too.
Given the lack of reliable data (and degree of error on a small margin that Postcomm identified) the "status quo" seems a reasonable compromise until more accurate data becomes available.

In the medium term Downstream Access will continue to be the main form of competition for Royal Mail and it is vital that this continues to develop. We understand, for instance, that a First Class access product will be available shortly to Downstream Access operators. We believe that a more flexible access to the network (ie the competitor could use more or less of RM's resources and pay accordingly) would enable competitors to offer genuinely differentiated products and services.
RM Wholesale claim that they have not been approached by any of the other licensed operators for anything other than "standard "access terms. If this is true it is disappointing and we would encourage the other licensed operators to start negotiating with RM Wholesale (with Postcomm's blessing) for downstream access contracts designed to meet their particular requirements.

Conclusion

Given the nature of the postal market in the UK that is dominated by one key player and where even its competitors use its network, anything that RM does affects the whole market (eg industrial action).
Some of RM's proposed actions will be fundamental in shaping how the market develops (or declines !) and relative volumes. Pricing in Proportion, zonal pricing, access headroom and overall price increases all have the potential to really influence how much mail is used and for what purposes. All of these present a potential risk to the industry that can only be justified if the claimed benefits to RM – and helping to secure the USO - are achieved.
If there is any doubt about RM's ability to achieve the benefits (and their track record in delivering operational savings isn't good) then this coupled with the concerns raised over RM cost data means that they are gambling with the future of the whole postal industry in the UK.